



# The Bank of East Asia, Limited

(incorporated with limited liability in Hong Kong)

**500,000 Units, each comprising  
U.S.\$1,000 principal amount of the U.S.\$500,000,000 Step-Up Subordinated Notes due 2059  
issued by  
The Bank of East Asia, Limited  
and  
U.S.\$1,000 in liquidation preference of the U.S.\$500,000,000 Non-Cumulative Step-Up  
Preference Shares issued by Innovate Holdings Limited  
Issue Price: 100%**

Each unit comprises one of a series of the U.S.\$500,000,000 Step-Up Subordinated Notes due 2059 (the “Notes”) issued by The Bank of East Asia, Limited (“BEA” or the “Bank”) and one of a series of the U.S.\$500,000,000 Non-Cumulative Step-Up Preference Shares (the “Preference Shares”) issued by Innovate Holdings Limited (“Innovate” or the “Company”), a wholly-owned direct subsidiary of the Bank, incorporated with limited liability in the British Virgin Islands. Each unit comprising one Note and one Preference Share is referred to in this Offering Circular as a “Unit” and together as the “Units”. Prior to the Assignment Date (as defined in “Terms and Conditions of the Notes — Definitions”), Notes and Preference Shares may not be traded separately from one another and may only be traded together as Units (see “Description of the Units”, “Terms and Conditions of the Notes — Transfer of Notes; Issue of Certificates; Stapling” and “Preference Share Terms — Restrictions on Transfer”).

The Notes will constitute direct and unsecured obligations of the Bank and will be subordinated in right of payment to the claims of the Senior Creditors (as defined in “Terms and Conditions of the Notes — Definitions”). Payments in respect of, or arising from, the Notes are conditional on the Bank being solvent at the time of payment by the Bank. The Notes will bear interest (i) from, and including the Issue Date (as defined in “Terms and Conditions of the Notes — Definitions”) to, but excluding, 5 November 2019 at the rate of 8.50% per annum, and (ii) thereafter at the rate of three-month LIBOR plus 7.3605% per annum. Interest will be payable semi-annually in arrear on 5 May and 5 November of each year commencing on 5 May 2010 up to, and including, 5 November 2019 and thereafter quarterly in arrear on 5 February, 5 May, 5 August and 5 November of each year. See “Terms and Conditions of the Notes — Interest”. In addition, interest on the Notes (i) need not be paid, at the option of the Bank, on any Interest Payment Date (as defined in “Terms and Conditions of the Notes — Definitions”) if, during the 12 calendar months preceding a date on which interest is due to be paid in respect of the Notes, no dividend has been declared or paid on any class of share capital of the Bank and (ii) shall not be paid on any Interest Payment Date to the extent that the Bank does not have sufficient Distributable Profits (as defined in “Terms and Conditions of the Notes — Definitions”). See “Terms and Conditions of the Notes — Interest — Deferral of Interest”.

The Notes are subject to the Assignment (as defined in “Terms and Conditions of the Notes — Definitions”). With effect from the Assignment Date (as defined in “Terms and Conditions of the Notes — Definitions”), each holder of a Preference Share shall be entitled only to payments of non-cumulative preferential dividends on the Preference Shares, subject to the limitations, discretions and qualifications as set out in the “Preference Share Terms — Dividends — Limitation on payment of dividends”. With effect from the Assignment Transfer Date, the Notes shall cease to be traded with the Preference Shares as a Unit and the Notes will be automatically transferred to Innovate. The Assignment Date will occur prior to redemption of the Notes. Consequently, investors in the Units will not be entitled to any redemption payment on the Notes.

Payments in respect of, or arising from, the Preference Shares are conditional on the Bank being solvent at the time of payment. No dividends are payable with respect to the Preference Shares up to, but excluding the Assignment Date. With effect from (and including) the Assignment Date, non-cumulative preferential dividends on the Preference Shares will accrue, (i) from, and including, the Interest Payment Date immediately prior to the Assignment Date to, but excluding, 5 November 2019 at the rate of 8.50% per annum, and (ii) thereafter at the rate of three-month LIBOR plus 7.3605% per annum. With effect from (and including) the Assignment Date, dividends will be payable semi-annually in arrear on 5 May and 5 November of each year up to, and including, 5 November 2019, and thereafter quarterly in arrear on 5 February, 5 May, 5 August and 5 November of each year. Innovate is not obliged to pay dividends with respect to the Preference Shares if (i) it is not permitted to do so under applicable law and regulation, (ii) during the 12 calendar months preceding the date on which a dividend is due to be paid in respect of the Preference Shares, no dividend had been declared or paid on any class of share capital of the Bank or (iii) the Bank does not have sufficient Distributable Profits. See “Preference Share Terms — Dividends — Limitation on payment of dividends”. All payment obligations of Innovate in respect of the Preference Shares are guaranteed (the “Guarantee”) on a subordinated basis pursuant to a Deed of Guarantee dated 5 November 2009 by the Bank for the benefit of the holders of the Preference Shares.

The Preference Shares are perpetual securities and have no fixed or final redemption date. The Preference Shares may be redeemed, subject to certain conditions (as further described herein), at the option of the Company, on any Optional Redemption Date, in whole but not in part, in an amount equal to 100% of the liquidation preference with respect to such Preference Shares, together with an amount equal to any accrued but unpaid dividends up to the date fixed for the relevant redemption (terms as defined in “Preference Share Terms — Definitions”). The Preference Shares may also be redeemed at the option of the Company if (i) either the Company is obliged to pay Additional Amounts (as defined in “Preference Share Terms — Definitions”) or the Bank is obliged to pay Bank Additional Amounts (as defined in “Preference Share Terms — Definitions”) or (ii) the Bank is not able to claim a tax deduction in Hong Kong on payments under the Notes. See “Preference Share Terms — Redemption”.

On the Substitution Date, the Substitute Preference Shares (as defined in the “Preference Share Terms — Definitions”) shall be issued by the Bank in exchange for the Preference Shares, which shall be cancelled. The Substitute Preference Shares shall be issued on substantially identical terms to the Preference Shares. See “Preference Share Terms — Substitution”. The Bank does not currently have the authority to create and issue the Substitute Preference Shares. The Bank has, however, undertaken to convene an extraordinary general meeting and to use its best endeavours to obtain the approval of the shareholders of the Bank to create and issue the Substitute Preference Shares on the Substitution Date.

The Units have been rated Baa1 by Moody’s Investors Service, Inc. (“Moody’s”) and BBB- by Standard & Poor’s Rating Service (“S&P”), a division of The McGraw-Hill Companies Inc. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. In particular, Moody’s has announced its intention to revise its existing rating methodology for subordinated capital, including hybrid securities, issued by banks. There is a significant risk that this would result in the downgrading of the Units to non-investment grade. See “Investment Considerations — Considerations Relating to the Securities — Credit Ratings”.

Investors are advised to read and understand the contents of this document before investing. If in doubt, investors should consult an adviser.

See “Investment Considerations” beginning on page 21 for a discussion of certain considerations to be taken into account in connection with an investment in the Units.

Approval in-principle has been received for the listing of the Notes and the Preference Shares on the Singapore Exchange Securities Trading Limited (the “SGX-ST”). The SGX-ST assumes no responsibility for the correctness of any statements made, opinions expressed or reports contained in this Offering Circular. Admission of the Notes and the Preference Shares to the Official List of the SGX-ST is not to be taken as an indication of the merits of the Bank, Innovate, the Notes or the Preference Shares. No application has been or will be made for the listing of the Units. The Bank has undertaken to use all reasonable endeavours to obtain a listing for the Substitute Preference Shares, if issued, on either the SGX-ST or The Stock Exchange of Hong Kong Limited (the “HKSE”).

The Units, the Notes, the Preference Shares, the Substitute Preference Shares and the Guarantee (together, the “Securities”) have not been and will not be registered under the United States Securities Act of 1933, as amended (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 (as defined in Regulation S under the Securities Act (“Regulation S”)) except in certain transactions exempt from the registration requirements of the Securities Act. The Securities are being offered and sold only outside the United States in accordance with Regulation S.

The Notes will be represented by beneficial interests in a permanent global certificate (the “Global Note Certificate”) in registered form, without interest coupons attached, which will be registered in the name of a nominee of, and shall be deposited on or about the Issue Date, with a common depository for, Euroclear Bank S.A./N.V. (“Euroclear”) and Clearstream Banking, société anonyme (“Clearstream”). The Preference Shares will be represented by beneficial interests in a permanent global certificate (the “Global Preference Share Certificate”) and together with the Global Note Certificate, the “Global Certificates”) in registered form which will be registered in the name of a nominee of, and deposited on or about the Issue Date, with a common depository for, Euroclear and Clearstream. Beneficial interests in the Global Certificates will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear and Clearstream. Except as described herein, certificates for Notes and Preference Shares will not be issued in exchange for interests in the Global Certificates.

No global security and no definitive certificates will be issued in respect of the Units. Interests in the Units will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear and Clearstream. With effect from the Assignment Date the Units will cease to exist and no interest in them will be shown on such records.

Any offer or sale of the Units in any member state of the European Economic Area which has implemented Directive 2003/71/EC (the “Prospectus Directive”) must be for a minimum purchase price or minimum consideration of at least U.S.\$100,000 or addressed to Qualified Investors (as defined in the Prospectus Directive).

Joint Bookrunners and Joint Lead Managers

UBS Investment Bank

Deutsche Bank

Co-Managers

BNP Paribas

CALYON

HSBC

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Each of the Bank and Innovate confirms that (i) this Offering Circular contains all information with respect to the Bank, Innovate, and the Bank's subsidiaries (collectively, the "Group") and the Securities that is material in the context of the issue and offering of the Securities; (ii) the information contained herein is true and accurate in all material respects and is not misleading; (iii) the opinions and intentions expressed in this Offering Circular are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions; (iv) there are no other facts, the omission of which would, in the context of the issue and offering of the Securities, make this Offering Circular as a whole or any such information or the expression of any such opinions or intentions misleading in any material respect; and (v) all reasonable enquiries have been made by each of the Bank and Innovate to ascertain such facts and to verify the accuracy of all such information and statements. In addition, each of the Bank and Innovate accepts full responsibility for the accuracy of the information contained in this Offering Circular.

In making an investment decision, investors must rely on their own examination of the Bank, Innovate and the terms of the offering of the Securities, including the merits and risks involved. By receiving this Offering Circular, investors acknowledge that (i) they have not relied on UBS AG or Deutsche Bank AG, Singapore Branch (the "Joint Lead Managers"), BNP Paribas, CALYON or The Hongkong and Shanghai Banking Corporation Limited (the "Co-Managers", together with the Joint Lead Managers, the "Managers") or any person affiliated with the Managers in connection with their investigation of the accuracy of any information in this Offering Circular or their investment decision; and (ii) no person has been authorised to give any information or to make any representation concerning the Bank, Innovate, the Group or the Securities other than as contained in this Offering Circular and, if given or made, any such other information or representation should not be relied upon as having been authorised by the Bank, Innovate or the Managers.

No representation or warranty, express or implied, is made by the Managers, the Initial Purchaser, the Trustee or any of the Agents as to the accuracy or completeness of the information contained in this Offering Circular. Neither the delivery of this Offering Circular nor the offer of the Securities shall, under any circumstances, constitute a representation or create any implication that there has been no change in the affairs of the Bank, Innovate or the Group since the date of this Offering Circular or that any information contained herein is correct as at any date subsequent to the date hereof.

None of the Bank, Innovate, the Managers, the Initial Purchaser (as defined in "*Subscription and Sale*"), the Trustee, the Agents or any of their respective affiliates or representatives is making any representation to any prospective purchaser of the Securities regarding the legality of an investment by such purchaser under applicable laws. In addition, you should not construe the contents of this Offering Circular as legal, business or tax advice. Prospective investors should be aware that they may be required to bear the financial risks of an investment in the Securities for an indefinite period. Prospective investors should consult with their own advisers as to the legal, tax, business, financial and related aspects of a purchase of the Securities.

This Offering Circular does not constitute an offer to sell, or an invitation by or on behalf of the Bank, Innovate, the Managers, the Initial Purchaser, the Trustee, the Agents or any of their respective affiliates or representatives to purchase any of the Securities, and may not be used for the purpose of an offer to, or a solicitation by, anyone, in each case, in any jurisdiction or in any circumstances in which such offer or solicitation is not authorised or is unlawful. There are restrictions on the distribution of this Offering Circular and the making of solicitations pursuant thereto in certain jurisdictions, including, among others, the United States, the European Economic Area, the United Kingdom, Hong Kong and Singapore, further details of which are set out under "*Subscription and Sale*". Recipients of this Offering Circular are required to inform themselves about and observe any applicable restrictions.

Each purchaser of Securities must comply with all applicable laws and regulations in force in each jurisdiction in which it purchases, offers or sells such Securities or possesses or distributes this Offering Circular and must obtain any consent, approval or permission required by it for the purchase, offer or sale by it of such Securities under the laws and regulations in force in any jurisdictions to which it is subject or in which it makes such purchases, offers or sales and neither the Bank, Innovate, nor the Managers shall have any responsibility therefor.

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In this Offering Circular, unless otherwise specified or the context requires, all references to “**Hong Kong dollars**” and “**HK\$**” are to the lawful currency of the Hong Kong Special Administrative Region of the People’s Republic of China (“**Hong Kong**”); all references to “**U.S. dollars**” or “**U.S.\$**” are to the lawful currency of the United States of America (the “**United States**”); all references to “**C\$**” are to the lawful currency of Canada; all references to “**\$S**” are to the lawful currency of Singapore; all references to “**CNY**” or “**Renminbi**” are to the lawful currency of the People’s Republic of China (the “**PRC**”); all references to “**mainland China**” are to the PRC excluding Hong Kong, Macau and Taiwan; all references to “**£**” and “**sterling**” are to the lawful currency of the United Kingdom of Great Britain and Northern Ireland (the “**United Kingdom**”); and all references to “**HKFRSs**” are to Hong Kong Financial Reporting Standards.

For convenience only, all Hong Kong dollar amounts in this Offering Circular (excluding the Financial Statements) have been translated into U.S. dollar amounts at the rate of U.S.\$1.00 = HK\$7.80. Such translations should not be construed as representations that the Hong Kong dollar amounts referred to could have been, or could be, converted into U.S. dollars at that or any other rate or at all.

In this Offering Circular, where information has been presented in thousands or millions of units, amounts may have been rounded up or down. Accordingly, totals of columns or rows of numbers in tables may not be equal to the apparent total of the individual items and actual numbers may differ from those contained herein due to rounding.

With effect from the financial statements for the Bank for the year ended 31 December 2007, interest income and expense from trading financial assets and liabilities and financial instruments designated at fair value are reported under “Interest income” and “Interest expense” instead of “Net trading profits” and “Net result from financial instruments designated at fair value through profit or loss”, respectively, as in previous years. The change has been made principally to match the interest expense arising from non-trading liabilities that fund the trading book with the interest income from trading assets. This also facilitates the comparison of the Group’s net interest income and net interest margin with many peer banks in Hong Kong. Unless otherwise indicated, the comparative figures for the year ended 31 December 2006 in the description of the financial results of the Group in this Offering Circular have been reclassified to conform with current presentation.

The financial information for the six months ended 30 June 2008 has been restated due to the unauthorised manipulation of the valuation of certain equity derivatives held by the Bank, which was announced to the public on 18 September 2008. As a result of the application of HKAS 1 (revised 2007), Presentation of Financial Statements, and HKFRS 8, Operating Segments, certain comparative figures have also been adjusted and restated to conform to the presentation of financial statements as at and for the six months ended 30 June 2009 and to present comparative amounts in respect of items disclosed for the first time as at 30 June 2009.

This Offering Circular contains forward-looking statements regarding the intent, belief or current expectations of the Bank with respect to its financial condition and future results of operations. In many cases, but not all, words such as “anticipate”, “believe”, “estimate”, “expect”, “intend”, “may”, “plan”, “probability”, “project”, “risk”, “seek”, “should”, “target” and similar expressions are used in relation to the Bank to identify forward-looking statements. You can also identify forward-looking statements in discussions of strategy, plans or intentions. These statements reflect the current views of the Bank with respect to future events and are subject to risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialise, or should underlying assumptions prove incorrect, the Bank’s actual results may vary materially from those it currently anticipates. Given these risks and uncertainties, prospective investors are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this Offering Circular. Any obligation to update, or to announce publicly any revision to, any of the forward-looking statements contained in this Offering Circular to reflect future actual events or developments is disclaimed. The information contained in this Offering Circular, including without limitation the information under “*Investment Considerations*”, and “*Business of the Bank*”, identifies important factors that might cause the forward-looking statements not to be realised.

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## Summary

*The following summary is qualified in its entirety by, and is subject to, the detailed information contained or referred to elsewhere in this Offering Circular. For a discussion of certain considerations that should be made in connection with an investment in the Notes, see “Investment Considerations”.*

### OVERVIEW

Incorporated in 1918, BEA is the largest independent local bank in Hong Kong in terms of assets. As at 30 June 2009, BEA's consolidated assets, advances to customers and customer deposits were HK\$411,857 million (U.S.\$52,802 million), HK\$231,392 million (U.S.\$29,666 million) and HK\$320,801 million (U.S.\$41,128 million), respectively. The comparative figures (i) as at 31 December 2008 were HK\$415,254 million (U.S.\$53,238 million), HK\$230,339 million (U.S.\$29,531 million) and HK\$323,802 million (U.S.\$41,513 million), respectively, (ii) as at 31 December 2007 were HK\$393,979 million (U.S.\$50,510 million), HK\$218,184 million (U.S.\$27,972 million) and HK\$284,186 million (U.S.\$36,434 million), respectively and (iii) as at 31 December 2006 were HK\$294,202 million (U.S.\$37,718 million), HK\$166,178 million (U.S.\$21,305 million) and HK\$209,524 million (U.S.\$26,862 million), respectively.

The shares of BEA have been listed on HKSE since the 1930s. As at 30 September 2009, the authorised share capital of BEA was 2,600 million ordinary shares of HK\$2.50 each, of which approximately 1,842.06 million ordinary shares have been issued, are outstanding and have been fully paid. Based on the closing price of its shares on the HKSE on 30 September 2009, BEA's market capitalisation was approximately HK\$51,577.68 million (U.S.\$6,612.52 million). BEA's shares have been a constituent stock of the Hang Seng Index since 1984.

BEA provides retail and wholesale banking services through its Personal Banking, Corporate Banking, Wealth Management, Treasury Markets, China and International divisions. BEA's core businesses are deposit taking and home mortgage lending in Hong Kong. Its other activities include retail investment and wealth management services, commercial and industrial lending, consumer finance, credit cards, insurance, services related to Hong Kong's Mandatory Provident Fund (“MPF”) Scheme, internet banking services, trust services, foreign exchange, trade finance, project finance, loan syndication, remittances, foreign exchange margin trading, stock broking, asset management services and other fee-based services.

In addition, through the Group's principal subsidiaries, BEA is able to extend other services to its customers. Blue Cross (Asia-Pacific) Insurance Limited (“Blue Cross”) and BEA Life Limited (“BEA Life”) offer a range of life and non-life insurance products and services. Tricor Holdings Limited (“Tricor”), together with its subsidiaries, provides its customers with a range of integrated business, corporate and investor services.

As at 30 September 2009, the Group offered a broad range of banking and related financial services through a network of 89 branches, 7 major subsidiaries and 50 wealth management centres called “SupremeGold Centres”, in Hong Kong.

In order to access the mainland China market and overseas Chinese markets, BEA expanded its operations to mainland China, Taiwan, Macau, the United States, Canada, the United Kingdom, the British Virgin Islands and South East Asia. As at 30 September 2009, BEA's overseas operations had in total 48 branches, 52 sub-branches and 4 representative offices, as well as several affiliates and joint ventures.

In 2007, The Bank of East Asia (China) Limited (“BEA (China)”), was licensed and was approved to conduct Renminbi business with local residents in mainland China. As at 30 September 2009, BEA (China) operated 18 branches and 49 sub-branches in mainland China and plans to expand its network in strategic locations in mainland China. In addition to the BEA (China) network, BEA also operates a branch in Shanghai, through which it provides its foreign exchange wholesale services to corporate customers in mainland China, and also operates three representative offices. For a discussion of the products and services provided by BEA (China), see “Business of the Bank — Mainland China, Taiwan and Macau”.

BEA maintains two branches in Taiwan, which are located in Taipei and Kaohsiung. In June 2009, BEA acquired AIG Group's Taiwan wealth management business, which has been re-launched under the new name of BEA Wealth Management Services (Taiwan) Limited ("BEA Wealth Management Services (Taiwan)"). BEA also maintains one branch, three sub-branches and 10 ATMs in Macau.

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, approximately 18.6%, 24.9%, 29.8% and 28.7%, respectively, of the assets of the Group were accounted for in mainland China, Taiwan and Macau. For the years ended 31 December 2006, 2007 and 2008 and for the six months ended 30 June 2009 approximately 16.9%, 23.7%, 18,550%<sup>(1)</sup> and 44.7%, respectively, of BEA's consolidated profit before taxation were accounted for in mainland China, Taiwan and Macau.

The majority of BEA's lending is on a secured, floating-rate basis and adheres to pre-established loan-to-value limitations depending on the underlying collateral and the credit risk of customers. Security typically consists of a first legal charge over real property, listed securities and cash deposits. Some of BEA's lending is on a guaranteed basis.

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, the Group's capital adequacy ratio was approximately 14.2%, 12.6%, 13.8% and 13.0%, respectively, compared to the statutory minimum requirement of 8.0%, and its loan to deposit ratio was approximately 76.7%, 73.6%, 69.9% and 71.5%, respectively. For the years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, BEA's average liquidity ratio was approximately 44.0%, 43.5%, 38.4% and 43.8%, respectively. See "Selected Statistical and Other Information" for further details.

The Group relies on its deposit base for the majority of its funding requirements. As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, customer deposits accounted for approximately 81.6%, 81.4%, 88.1% and 89.6%, respectively, of borrowed funds. The remainder of the Group's funding requirements as at 31 December 2006, 2007 and 2008 and as at 30 June 2009 were satisfied through the issuance of certificates of deposit and, particularly for its Renminbi funding requirements, through interbank borrowings. In July 2009, BEA (China) issued RMB4 billion in aggregate principal amount of Renminbi-denominated bonds in order to diversify the Group's Renminbi funding sources.

For the six months ended 30 June 2009, the Group's profit after taxation was HK\$1,205 million (U.S.\$154 million), an increase of approximately 46.8% from the six months ended 30 June 2008. For the year ended 31 December 2008, the Group's profit after taxation was HK\$104 million (U.S.\$13 million), a decrease of approximately 97.5% from the year ended 31 December 2007. For the year ended 31 December 2007, the Group's profit after taxation was HK\$4,221 million (U.S.\$541 million), an increase of approximately 21.1% from the year ended 31 December 2006.

For the six months ended 30 June 2009, the Group achieved a return on average assets of approximately 0.6% and a return on average equity of approximately 7.2%, as compared to approximately 0.01% and 0.12%, respectively, for the year ended 31 December 2008, approximately 1.2% and 14.6%, respectively, for the year ended 31 December 2007 and, approximately 1.3% and 13.7%, respectively, for the year ended 31 December 2006.

## STRATEGY

BEA's core objectives are to strengthen its position as the largest independent bank in Hong Kong, to further develop its domestic franchise as one of Hong Kong's leading banks and to expand its operations in mainland China and other overseas countries.

As part of the strategy for growth in the future, BEA will focus significantly on its operations in mainland China.

*Note:*

(1) For the year ended 31 December 2008, the Group's financial performance was adversely affected by the one-off write down of HK\$3,549 million for its investments in CDOs and SIVs conducted in Hong Kong (see "Selected Statistical and Other Information — Asset Quality — Held-to-maturity Debt Securities"). The loss before taxation for Hong Kong operations for the period was HK\$1,876 million, and the Group's consolidated profit before taxation for the period was HK\$8 million. As a result, when the profit before taxation for the period for China operations (including Taiwan and Macau) (HK\$1,484 million) is compared against the Group's consolidated result, it accounts for 18,550% of the consolidated profit before taxation.

The key components of BEA's strategy are as follows:

- Expansion in mainland China and other overseas countries
- Diversification of non-interest income
- Enhancement of profitability via active asset and liability management
- Transformation of its branch network
- Acquisitions and organic growth
- Focus on enhancing operational efficiency

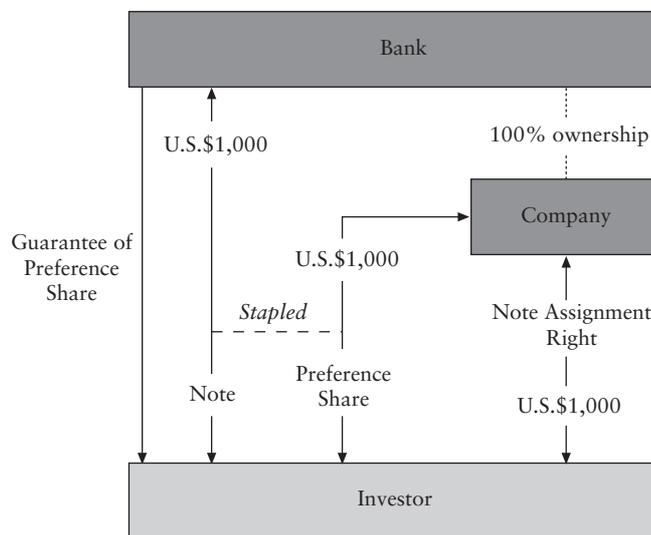
# The Offering

The following is an overview and a brief summary of certain terms of this offering. For a more detailed description of the Units and of the terms of the Notes, the Preference Shares, the Guarantee and the Substitute Preference Shares, see “Description of the Units”, “Terms and Conditions of the Notes”, “Preference Share Terms”, “Description of the Guarantee” and “Substitute Preference Share Terms”, respectively. Capitalised terms used herein and not defined have the meanings given to them in “Terms and Conditions of the Notes”, “Preference Share Terms”, “Description of the Guarantee” and “Substitute Preference Share Terms”, as applicable.

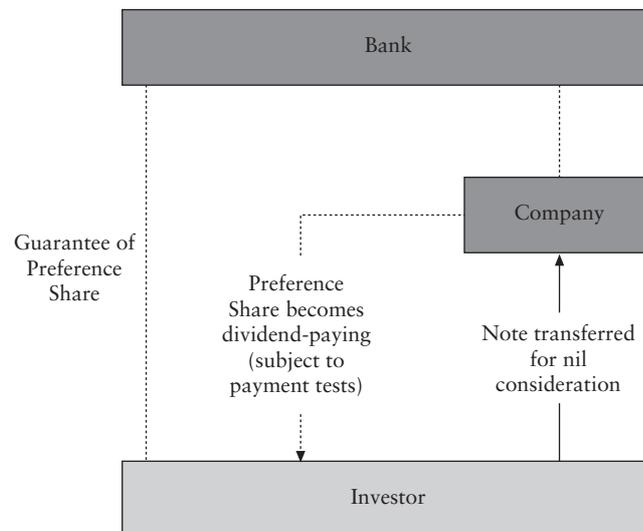
## OVERVIEW

The following diagrams represent the structure of the offering of the Securities on issue, following the occurrence of an Assignment Event and following the occurrence of a Substitution Event.

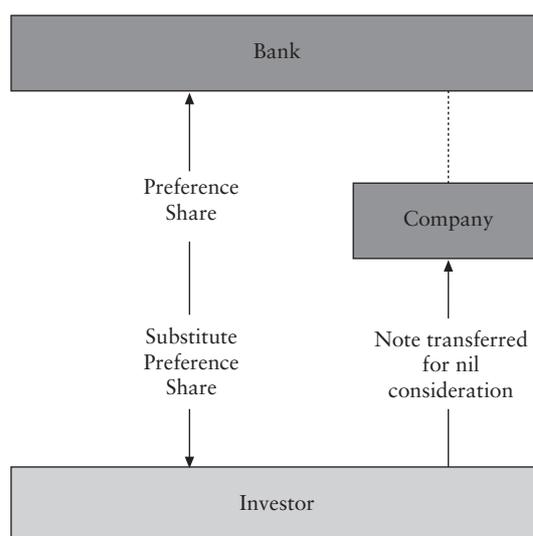
*On Issue:*



*Following the occurrence of an Assignment Event:*



Following the occurrence of a Substitution Event:



On the Issue Date, the Bank will issue U.S.\$500,000,000 in aggregate principal amount of the Notes and the Company will issue U.S.\$500,000,000 in aggregate liquidation preference of the Preference Shares. Pursuant to the Subscription Agreement, the Notes and the Preference Shares will be subscribed by UBS Limited as the Initial Purchaser at the Notes Subscription Price and the Preference Shares Subscription Price (each as defined in “*Subscription and Sale*”), respectively.

On the Issue Date, the Bank, the Company, the Trustee, the Registrar and the Initial Purchaser will enter into the Assignment Deed, pursuant to which the Initial Purchaser will agree to assign the Notes to the Company on the occurrence of an Assignment Event in consideration for the payment of an assignment payment in an aggregate amount of U.S.\$500,000,000. See “*Subscription and Sale*”.

Also on the Issue Date, the Bank, the Company, the Trustee and the Registrar (in its capacities as registrar for each of the Notes, the Preference Shares and the Units) will enter into the Stapling Deed, pursuant to which each of them will agree that, prior to the Assignment Date, the Notes and the Preference Shares will only be capable of being transferred as a Unit comprising one Note and one Preference Share. To that end, the Registrar will agree in the Note Agency Agreement, the Preference Share Agency Agreement and the Stapling Deed, as applicable, that prior to the Assignment Date no transfer of a Note or a Preference Share will be effected other than on a transfer of the relevant Unit reflected in the Unit Register procured to be kept jointly by the Bank and the Company. With effect from the Assignment Date, such restrictions will no longer apply, the Unit Register will be cancelled and the Registrar will as soon as practicable on or after the Assignment Transfer Date register the transfer of the Notes to the Company as Assignee under the Assignment Deed.

The Bank, the Company, the Principal Agent and the Preference Share Registrar will enter into the Substitution Deed on the Issue Date. The Bank has undertaken in the Subscription Agreement to convene an Extraordinary General Meeting of the Bank for the purposes of considering and if thought fit, passing a resolution providing for the creation and issue on the Substitution Date of the Substitute Preference Shares and to use its best endeavours to obtain the approval of the Bank’s Shareholders to such issue of Substitute Preference Shares. Subject to the passing of such resolution, the Bank will undertake in the Substitution Deed for the benefit of the Company and the Preference Shareholders to create and issue the Substitute Preference Shares on the Substitution Date in exchange for the Preference Shares and in consideration for the Company releasing the Bank from its liabilities in respect of the Notes.

The Bank will enter into the Deed of Guarantee on the Issue Date, pursuant to which the Bank will unconditionally and irrevocably guarantee that if the Company does not pay, as and when due and payable, any Guaranteed Payment by the time and on the date specified for such payment, the Bank will pay that sum to or to the order of the Preference Shareholders, in the manner provided in the Memorandum and Articles. Guaranteed Payments include (i) all dividends due on the Preference Shares to which the Preference Shareholders are entitled and which have become due and payable (or that would have become due and payable but for mandatory provisions of British Virgin Islands law applicable to the Company), including any related Additional

Amounts; and/or (ii) any liquidation preference, and any cash amounts due in respect of redemption of the Preference Shares, to which the Preference Shareholders are entitled and which have become due and payable. The rights and claims of the Preference Shareholders under the Guarantee are subordinated to the claims of Senior Creditors.

**Units**

- Issuer ..... The Bank of East Asia Group.
- The Units ..... 500,000 units (the “Units”), each comprising one Step-Up Subordinated Note due 2059 issued by the Bank in a principal amount of U.S.\$1,000 and one Perpetual Non-Cumulative Step-Up Preference Share of no par value having an aggregate liquidation preference of U.S.\$1,000 issued by the Company.
- Stapling ..... In accordance with the Conditions, the Memorandum and Articles and the Stapling Deed, prior to the Assignment Date, each Note together with a corresponding Preference Share may only be traded together as a Unit and any purported transfer otherwise will be void.

The Bank and the Company will undertake with the Trustee and the Preference Shareholders in the Stapling Deed that, until the Assignment Date, the Bank and the Company will maintain, outside Hong Kong and the United Kingdom, a joint register for the Units.

The purchase, sale and transfer of the Units may only be effected through accounts at Euroclear and Clearstream. No global or definitive certificates will be issued in respect of the Units in any circumstances. The Bank and the Company have entered into arrangements with Euroclear and Clearstream whereby, prior to the Assignment Date, Notes and Preference Shares may not be transferred through their respective accounts other than by transfer of the relevant Units of which they form part through such accounts.

On the occurrence of an Assignment Event, the Bank shall instruct Euroclear and Clearstream not to accept the Notes for clearance in their respective systems with effect from the Assignment Date. On and with effect from the Assignment Date, the Note Registrar shall transfer the Notes represented by the Global Note Certificate to the Company by entry in the Note Register without the need for any further formality.

- Rating ..... The Units have been rated Baa1 by Moody’s and BBB- by S&P. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning organisation. In particular, Moody’s has announced its intention to revise its existing rating methodology for subordinated capital, including hybrid securities, issued by banks. There is a significant risk that this would result in the downgrading of the Units to non-investment grade. See “*Investment Considerations — Considerations Relating to the Securities — Credit Ratings*”.

- Selling Restrictions ..... There are restrictions on the offer, sale and transfer of the Securities in certain jurisdictions, including, among others, the United States, the European Economic Area, the United Kingdom, Hong Kong, and Singapore. For a description of the restrictions on offers and sales of the Securities, see “*Subscription and Sale*”.

<b>Listing</b> .....	No application has been or will be made for the listing of the Units.
<b>Common Code</b> .....	046288360
<b>ISIN</b> .....	XS0462883603
<b>Minimum Purchase Price</b> .....	Any offer or sale of Units in any member state of the European Economic Area which has implemented the Prospectus Directive must be for a minimum purchase price or minimum consideration of at least U.S.\$100,000 or addressed to Qualified Investors (as defined in the Prospectus Directive).

**Notes**

<b>Issuer</b> .....	The Bank.
<b>The Notes</b> .....	U.S.\$500,000,000 Step-Up Subordinated Notes due 2059.
<b>Issue Price</b> .....	U.S.\$1,000 per Note.
<b>Issue Date</b> .....	5 November 2009.
<b>Status</b> .....	The Notes constitute direct and unsecured obligations of the Bank, conditional in accordance with the Conditions and ranking <i>pari passu</i> without any preference among themselves.
<b>Subordination</b> .....	Payments in respect of, or arising from, the Notes are conditional upon the Bank being solvent at the time of payment by the Bank. The rights and claims of the Noteholders are subordinated to the claims of Senior Creditors.
<b>Stapling</b> .....	Prior to the Assignment Transfer Date, no Noteholder may require the transfer of a principal amount of Notes to be registered by the Bank and the Registrar unless it is simultaneously requesting the transfer to the same transferee of an equal aggregate amount in liquidation preference of the Preference Shares.
<b>Assignment</b> .....	Each Noteholder by virtue of becoming or being the holder of any Note irrevocably agrees and acknowledges that it holds each Note subject to the Assignment.
<b>Assignment Event</b> .....	<p>“<b>Assignment Event</b>” means the occurrence of any of the following:</p> <ul style="list-style-type: none"> <li>(i) the deferral of payment of any interest on any Note in accordance with Condition 7(g);</li> <li>(ii) a Substitution Event;</li> <li>(iii) an Enforcement Event;</li> <li>(iv) following the giving of a valid redemption notice in respect of the Preference Shares, the date scheduled for redemption in such notice;</li> <li>(v) the Business Day (as defined for the purposes of Condition 3) prior to the Maturity Date;</li> </ul>

(vi) an Optional Assignment Date; or

(vii) an HKMA Assignment Date.

**Redemption on Substitution** ..... Subject to the Conditions, the Bank shall redeem the Notes, in whole but not in part, on the occurrence of a Substitution Event in exchange for the Bank being released by the Company from its obligations under the Notes on issuing and allotting to the Preference Shareholders the Substitute Preference Shares.

**Substitution Event** ..... “Substitution Event” means:

- (i) the HKMA determines in writing that the Bank has a Capital Adequacy Ratio of less than 8% or such other percentage as the HKMA shall stipulate from time to time, as being the minimum required Capital Adequacy Ratio for licensed banks, provided that a Substitution Event will not be deemed to have occurred until the end of any grace period allowed by the HKMA for the Bank to bring its Capital Adequacy Ratio above 8% or such other stipulated percentage;
- (ii) a Winding-Up Proceeding is instituted in Hong Kong against the Bank and is not dismissed within 30 Business Days from the initial date of institution; or
- (iii) the HKMA exercises its power to appoint a manager of the Bank under Section 52 of the Banking Ordinance (Cap.155) of Hong Kong.

**Interest** ..... The Notes bear interest from and including the Issue Date to, but excluding, 5 November 2019 at the Rate of Interest payable semi-annually in arrear on 5 May and 5 November in each year and thereafter at the Rate of Interest payable quarterly in arrear on 5 February, 5 May, 5 August and 5 November in each year, subject as provided in Condition 5, Condition 7(g) and Condition 9.

**Rate of Interest** ..... The rate of interest applicable to the Notes shall be:

- (i) at a fixed interest rate for the period from, and including, the Issue Date to, but excluding, 5 November 2019 of 8.50% per annum; and
- (ii) at a floating interest rate for the period from, and including, 5 November 2019 of three-month LIBOR plus 7.3605% per annum.

**Mandatory Deferral of Interest** ..... Where, as at any Interest Record Date, the Bank does not have Distributable Profits equal to or greater than the interest payment scheduled for such Interest Payment Date and all other payments to be made on the same date in respect of any obligation ranking or expressed to rank *pari passu* with the Notes (in each case translated into U.S. dollars at the then current exchange rate) (the “*Pari Passu Payments*”), such Interest Payment Date shall be referred to as a “**Mandatory Deferral Date**”. The Bank must, unless otherwise allowed by the HKMA, reduce the amount of interest payable on a Mandatory Deferral Date to an amount that may be paid on a *pro rata* basis with all other *Pari Passu Payments* without exceeding the relevant amount of Distributable Profits, subject to the minimum amount of interest payable on any Interest Payment Date being zero. Any failure by the Bank to pay an amount exceeding the *pro rata* amount of the Bank’s Distributable Profits attributable to the Notes on a Mandatory Deferral Date shall not constitute a default by the Bank for any purpose.

<b>Optional Deferral of Interest .....</b>	Where during the 12 calendar months preceding any Interest Payment Date no dividend has been declared or paid on any class of share capital of the Bank, such due date shall be referred to as an “ <b>Optional Interest Payment Date</b> ”. The Bank may if it so elects, but shall not be obliged to, pay on any Optional Interest Payment Date the interest that is due to be paid on such date in respect of the Notes and any failure to pay shall not constitute a default by the Bank for any purpose.
<b>Arrears of Interest.....</b>	<p>Any interest not paid on an Optional Interest Payment Date or a Mandatory Deferral Date shall (except to the extent such interest shall subsequently have been paid) constitute “<b>Arrears of Interest</b>”. Arrears of Interest shall themselves bear interest at the then prevailing Rate of Interest.</p> <p>Arrears of Interest shall, prior to the commencement of the Winding-Up of the Bank and subject to the provisions of Condition 7(g), be paid in whole or in part upon the next following Interest Payment Date on which a payment is made. Arrears of Interest shall otherwise only become payable on (i) the due date for repayment of the Notes to which such Arrears of Interest relate, (ii) the date on which any declaration or payment of any dividend on any class of share capital of the Bank is made or (iii) the commencement of the Winding-Up of the Bank.</p>
<b>Withholding taxes.....</b>	All payments of principal and interest (including Arrears of Interest) in respect of the Notes by or on behalf of the Bank shall be made free and clear of Hong Kong withholding taxes, unless such withholding or deduction is required by law. In that event, the Bank shall, subject to certain customary exceptions, pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required.
<b>Maturity.....</b>	5 November 2059.
<b>Listing .....</b>	Approval in-principle has been received for the listing of the Notes on the SGX-ST.
<b>Governing Law .....</b>	The Notes (save for the provisions relating to subordination which will be governed by, and construed in accordance with, Hong Kong law) will be governed by, and shall be construed in accordance with, English law.
<b>Form of the Notes .....</b>	<p>The Notes will be issued in registered form and will initially be represented by a Global Note Certificate, which will be registered on or about the Issue Date in the name of a nominee of a common depository on behalf of Euroclear and Clearstream. Prior to the Assignment Transfer Date, the purchase, sale and transfer of the Notes may only be effected through accounts at Euroclear and Clearstream. The Global Note Certificate will be exchangeable for definitive registered certificates in the denomination of U.S.\$1,000 and integral multiples in excess thereof, only in the limited circumstances set out therein.</p> <p>As interests in the Notes may only be transferred prior to the Assignment Date as a constituent part of the Units and, therefore, will not be accepted for clearance separately through Euroclear and Clearstream, the Notes will not be allocated a Common Code or ISIN.</p>

Trustee .....	DB Trustees (Hong Kong) Limited.
Transfer and Principal Agent, and Calculation Agent .....	Deutsche Bank AG, Hong Kong Branch.
Registrar .....	Deutsche Bank Luxembourg S.A.

**Preference Shares**

Issuer.....	The Company.
The Preference Shares.....	Perpetual Non-Cumulative Step-Up Preference Shares in an aggregate liquidation preference of U.S.\$500,000,000.
Issue Price .....	U.S.\$1,000 per Preference Share.
Issue Date .....	5 November 2009.
Status .....	The Preference Shares rank <i>pari passu</i> without any preference among themselves and in priority to the ordinary shares of the Company.
Guarantee .....	The Bank has unconditionally and irrevocably guaranteed the Guaranteed Payments. Payments in respect of, or arising from, the Guarantee are conditional upon the Bank being solvent at the time of payment by the Bank.  The rights and claims of the Preference Shareholders under the Guarantee are subordinated to the claims of Senior Creditors.
Stapling .....	Prior to the Assignment Transfer Date, no holder may require the transfer of an amount in liquidation preference of the Preference Shares to be registered by the Company and the Registrar unless it is simultaneously requesting the transfer to the same transferee of an equal aggregate principal amount of Notes.
Redemption at the Option of the Company.....	Subject to the Act, prior written approval of the HKMA, all other applicable law and regulation and the provisions of the Memorandum and Articles, the Preference Shares may be redeemed at the option of the Company in whole, but not in part, on the Dividend Payment Date falling on 5 November 2019 or thereafter on every Dividend Payment Date at a redemption price equal to 100% of their liquidation preference together with accrued and unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period.
Redemption for Tax Reasons .....	Subject to the Act, prior written approval of the HKMA, all other applicable law and regulation and the provisions of the Memorandum and Articles, the Preference Shares may be redeemed at the option of the Company in whole, but not in part, at any time at a redemption price equal to 100% of their liquidation preference together with accrued and unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period, if: <ul style="list-style-type: none"> <li>(i) the Company has or will become obliged to pay Additional Amounts as a result of any change in, or amendment to, the laws or regulations of the British Virgin Islands;</li> </ul>

- (ii) the Bank has or will become obliged to pay Bank Additional Amounts as a result of any change in, or amendment to, the laws or regulations of Hong Kong; or
- (iii) as a result of any change in, or amendment to, the laws or regulations of Hong Kong, (1) the Bank would not be entitled to claim a deduction in respect of computing its taxation liabilities in Hong Kong, or such entitlement is materially reduced; or (2) the Bank would not, to any material extent, be entitled to have such deduction set against the profits of companies with which it is grouped for applicable Hong Kong tax purposes.

**Regulatory Redemption**..... Subject to the Act, prior written approval of the HKMA, all other applicable law and regulations and the provisions of the Memorandum and Articles, the Preference Shares may be redeemed at the option of the Company in whole, but not in part, at any time at a redemption price equal to the Regulatory Event Redemption Price together with accrued but unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period, following the occurrence of a Regulatory Redemption Event.

In relation to the Preference Shares, a “**Regulatory Redemption Event**” occurs if:

- (i) the Preference Shares no longer qualify as solo Category I Core Capital of the Bank; or
- (ii) any or all consents or approvals required for the creation and issue of the Substitute Preference Shares are not obtained by the Bank within 180 days of the Issue Date.

**Substitution**..... Subject to the Act, all applicable laws and regulations and the provisions of the Memorandum and Articles, on the occurrence of a Substitution Event, the Company and the Bank, pursuant to the Substitution Deed, shall substitute the Preference Shares in whole, but not in part, for Substitute Preference Shares without any requirement for consent or approval of the holders of the Preference Shares.

**Dividends**..... Prior to an Assignment Date, the Preference Shares shall not entitle the holders thereof to receive any dividend. With effect from the Assignment Date and subject to the limitations, discretions and qualifications set out in the Memorandum and Articles, each Preference Share shall entitle the holder thereof to receive out of the profits of the Company available for distribution and permitted by law to be distributed, in priority to the payment of any dividend to holders of the ordinary shares of the Company (other than the Ordinary Share Dividend) but *pari passu* among themselves, a non-cumulative preferential dividend from, and including, the Interest Payment Date immediately prior to the Assignment Date to, but excluding, 5 November 2019 at the Dividend Rate payable semi-annually in arrear on 5 May and 5 November in each year and thereafter at the Dividend Rate payable quarterly in arrear on 5 February, 5 May, 5 August and 5 November in each year.

Subject to the limitations, discretions and qualifications set out in the Memorandum and Articles, each Preference Share shall entitle the holder thereof to receive out of the profits of the Company available for

distribution and permitted by law to be distributed, in priority to the payment of any dividend to holders of Company Ordinary Shares but *pari passu* among themselves, an Initial Dividend. The Initial Dividend will be payable on the first Dividend Payment Date occurring on or immediately after the Assignment Date. If, as a result of the limitations, discretions and qualifications set out in the Memorandum and Articles, the Initial Dividend is not paid on the first Dividend Payment Date occurring immediately after an Assignment Date such Initial Dividend will be cancelled and no holder shall have any claim in respect thereof, whether on a Winding-Up or otherwise.

- Dividend Rate**..... The Dividend Rate applicable to the Preference Shares shall be:
- (i) at a fixed rate for the period from, and including, the Issue Date to, but excluding, 5 November 2019, of 8.50% per annum; and
  - (ii) at a floating rate for the period from, and including, 5 November 2019 of three-month LIBOR plus 7.3605% per annum.
- Mandatory Deferral of Dividends** ..... Where, as at any Dividend Record Date, the Bank does not have Distributable Profits equal to or greater than the dividend scheduled for such Dividend Payment Date and all other payments to be made in respect of any obligation ranking or expressed to rank *pari passu* with the Guarantee (in each case translated into U.S. dollars at the then current exchange rate) (the “*Pari Passu Payments*”), such Dividend Payment Date shall be referred to as a Mandatory Limitation Date. The Company must, unless otherwise allowed by the HKMA, reduce the amount of dividend payable on a Mandatory Limitation Date to an amount that may be paid on a *pro rata* basis with all other *Pari Passu Payments* without exceeding the relevant amount of Distributable Profits, subject to the minimum amount of dividend payable on any Dividend Payment Date being zero. Any failure by the Company to pay an amount exceeding the *pro rata* amount of the Bank’s Distributable Profits attributable to the Preference Shares on a Mandatory Limitation Date shall not constitute a default by the Company for any purpose.
- Optional Deferral of Dividends**..... Where during the 12 calendar months preceding a date on which a dividend is due to be paid in respect of the Preference Shares no dividend has been declared or paid on any class of share capital of the Bank, such due date shall be referred to as an “**Optional Dividend Payment Date**”. The Company may if it so elects, but shall not be obliged to, pay on any Optional Dividend Payment Date the dividend that is due to be paid on such date in respect of the Preference Shares and any failure to pay shall not constitute a default by the Company for any purpose.
- Solvency Condition on Payments** ..... All payments in respect of the Preference Shares are conditional upon the Bank being solvent at the time of payment by the Company.

<b>Winding-Up .....</b>	<p>On a Winding-Up of the Company, Preference Shareholders shall have a claim for a sum equal to the aggregate of:</p> <ul style="list-style-type: none"> <li>(i) the liquidation preference of the Preference Shares;</li> <li>(ii) an amount equal to dividends accrued thereon for the then current Dividend Period (which may include the Initial Dividend); and</li> <li>(iii) an amount equal to any dividend thereon which has been resolved to be paid on or after the date of commencement of the Winding-Up of the Company but which is payable in respect of a Dividend Period ending on or before such date.</li> </ul>
<b>Voting Rights .....</b>	The holders of the Preference Shares shall not be entitled to convene, attend or vote at any general meeting of the Company except in certain limited circumstances.
<b>Restrictions on Activities .....</b>	The Memorandum and Articles restrict the Company's business to the transactions contemplated by the documents governing the offering of the Securities or any act incidental to or necessary in connection therewith.
<b>Withholding Taxes.....</b>	All payments in respect of the Preference Shares by or on behalf of the Company shall be made free and clear of British Virgin Islands withholding taxes, unless such withholding or deduction is required by law. In that event, the Company shall pay, subject to certain customary exceptions, such additional amounts as will result in the receipt by the holders of such amounts as would have been received by them if no such withholding or deduction had been required.
<b>Listing .....</b>	Approval in-principle has been received for the listing of the Preference Shares on the SGX-ST.
<b>Governing Law .....</b>	The Preference Shares will be governed by, and shall be construed in accordance with, British Virgin Islands law.
<b>Form of the Preference Shares .....</b>	<p>The Preference Shares will be issued in registered form and will initially be represented by a Global Preference Share Certificate, which will be registered on or about the Issue Date in the name of a nominee of a common depository on behalf of Euroclear and Clearstream. The purchase, sale and transfer of the Preference Shares may only be effected through accounts at Euroclear and Clearstream. The Global Preference Share Certificate will be exchangeable for definitive registered certificates in the denomination of U.S.\$1,000 and integral multiples in excess thereof, only in the limited circumstances set out therein.</p> <p>Interests in the Preference Shares may only be transferred prior to the Assignment Date as a constituent part of the Units and by reference to the Common Code and ISIN allocated to the Units. With effect from the Assignment Date, interests in Preference Shares may be transferred separately by reference to the ISIN and Common Code set out below.</p>
<b>Common Code .....</b>	046288505
<b>ISIN.....</b>	XS0462885053

### **Substitute Preference Shares**

<b>Issuer</b> .....	The Bank.
<b>The Substitute Preference Shares</b> .....	Perpetual Non-Cumulative Step-Up Preference Shares in an aggregate liquidation preference of U.S.\$500,000,000.
<b>Issue Price</b> .....	U.S.\$1,000 per Substitute Preference Share. Substitute Preference Shares will be issued (if required) in exchange for Preference Shares with a liquidation preference in an equal amount.
<b>Issue Date</b> .....	Upon the occurrence of a Substitution Event.
<b>Status</b> .....	The Substitute Preference Shares rank <i>pari passu</i> without any preference among themselves and in priority to the Bank Ordinary Shares.
<b>Solvency Condition on Payments</b> .....	All payments in respect of the Substitute Preference Shares are conditional upon the Bank being solvent at the time of payment.
<b>Subordination</b> .....	The rights and claims of the Substitute Preference Shareholders are subordinated to the claims of Senior Creditors.
<b>Winding-Up</b> .....	On a Winding-Up of the Bank, Substitute Preference Shareholders shall have a claim for a sum equal to the aggregate of:  (i) the liquidation preference of the Substitute Preference Shares;  (ii) an amount equal to dividends accrued thereon for the then current Dividend Period (which may include the Initial Dividend); and  (iii) any other amounts attributable to the Substitute Preference Shares.
<b>Redemption at the Option of the Bank</b> .....	Subject to the Companies Ordinance, prior written approval of the HKMA, all other applicable law and regulations and the provisions of the Bank Articles, the Substitute Preference Shares may be redeemed at the option of the Bank in whole, but not in part, on the Dividend Payment Date falling on 5 November 2019 or thereafter on every Dividend Payment Date at a redemption price equal to 100% of their liquidation preference together with accrued and unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period.
<b>Redemption for Tax Reasons</b> .....	Subject to the Companies Ordinance, prior written approval of the HKMA, all other applicable law and regulation and the provisions of the Bank Articles, the Substitute Preference Shares may be redeemed at the option of the Bank in whole, but not in part, at any time at a redemption price equal to 100% of their liquidation preference together with accrued and unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period, if the Bank has or will become obliged to pay Additional Amounts as a result of any change in, or amendment to, the laws or regulations of Hong Kong.

**Regulatory Redemption**..... Subject to the Companies Ordinance, prior written approval of the HKMA, all other applicable law and regulations and the provisions of the Bank Articles, the Substitute Preference Shares may be redeemed at the option of the Bank in whole, but not in part, at any time at a redemption price equal to the Regulatory Event Redemption Price together with accrued but unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period, following the occurrence of a Regulatory Redemption Event.

In relation to the Substitute Preference Shares, a “**Regulatory Redemption Event**” occurs if the Substitute Preference Shares no longer qualify as solo Category I Core Capital of the Bank.

**Dividends** ..... Subject to the limitations, discretions and qualifications set out in the Bank Articles, each Substitute Preference Share shall entitle the holder thereof to receive out of the profits of the Bank available for distribution and permitted by law to be distributed, in priority to the payment of any dividend to holders of Bank Ordinary Shares but *pari passu* among themselves, a non-cumulative preferential dividend from, and including, the Interest Payment Date immediately prior to the Assignment Date to, but excluding, 5 November 2019 at the Dividend Rate payable semi-annually in arrear on 5 May and 5 November in each year and thereafter at the Dividend Rate payable quarterly in arrear on 5 February, 5 May, 5 August and 5 November in each year.

Subject to the limitations, discretions and qualifications set out in the Bank Articles, each Substitute Preference Share shall entitle the holder thereof to receive out of the profits of the Bank available for distribution and permitted by law to be distributed, in priority to the payment of any dividend to holders of Bank Ordinary Shares but *pari passu* among themselves, an Initial Dividend. The Initial Dividend will be payable on the first Dividend Payment Date occurring on or immediately after the Issue Date. If, as a result of the limitations, discretions and qualifications set out in the Bank Articles, the Initial Dividend is not paid on the first Dividend Payment Date occurring immediately after the Issue Date such Initial Dividend will be cancelled and no holder shall have any claim in respect thereof, whether on a Winding-Up or otherwise.

**Dividend Rate**..... The Dividend Rate applicable to the Substitute Preference Shares shall be:

- (i) at a fixed rate for the period from, and including, the Issue Date to, but excluding, 5 November 2019 of 8.50% per annum; and
- (ii) at a floating rate for the period from, and including, 5 November 2019 of three-month LIBOR plus 7.3605% per annum.

Mandatory Deferral of Dividends .....	Where, as at any Dividend Record Date, the Bank does not have Distributable Profits equal to or greater than the dividend scheduled for such Dividend Payment Date and all other payments to be made in respect of any obligation ranking or expressed to rank <i>pari passu</i> with the Substitute Preference Shares (in each case translated into U.S. dollars at the then current exchange rate) (the “ <i>Pari Passu Payments</i> ”), such Dividend Payment Date shall be referred to as a Mandatory Limitation Date. The Bank must, unless otherwise allowed by the HKMA, reduce the amount of dividend payable on a Mandatory Limitation Date to an amount that may be paid on a <i>pro rata</i> basis with all other <i>Pari Passu</i> Payments without exceeding the relevant amount of Distributable Profits, subject to the minimum amount of dividend payable on any Dividend Payment Date being zero. Any failure by the Bank to pay an amount exceeding the <i>pro rata</i> amount of the Bank’s Distributable Profits attributable to the Substitute Preference Shares on a Mandatory Limitation Date shall not constitute a default by the Bank for any purpose.
Optional Deferral of Dividends .....	Where during the 12 calendar months preceding a date on which a dividend is due to be paid in respect of the Substitute Preference Shares no dividend has been declared or paid on any class of share capital of the Bank, such due date shall be referred to as an “ <b>Optional Dividend Payment Date</b> ”. The Bank may if it so elects, but shall not be obliged to, pay on any Optional Dividend Payment Date the dividend that is due to be paid on such date in respect of the Substitute Preference Shares and any failure to pay shall not constitute a default by the Bank for any purpose.
Voting .....	The holders of the Substitute Preference Shares shall not be entitled to convene, attend or vote at any general meeting of the Bank except in limited circumstances.
Withholding Taxes.....	All payments in respect of the Substitute Preference Shares by or on behalf of the Bank shall be made free and clear of Hong Kong withholding taxes, unless such withholding or deduction is required by law. In that event, the Bank shall, subject to customary exceptions, pay such additional amounts as will result in the receipt by the holders of such amounts as would have been received by them if no such withholding or deduction had been required.
Listing .....	In the case that Substitute Preference Shares are issued, the Bank will undertake to use all reasonable endeavours to obtain and maintain a listing of the Substitute Preference Shares on either the SGX-ST or The Stock Exchange of Hong Kong Limited and to obtain acceptance for clearance of the Substitute Preference Shares in Euroclear and Clearstream.
Governing Law .....	The Substitute Preference Shares will be governed by, and shall be construed in accordance with, Hong Kong law.

**Form of the Substitute Preference Shares .....**

The Substitute Preference Shares will be issued in registered form and will initially be represented by a Global Substitute Preference Share Certificate, which will be registered on or about the Issue Date in the name of a nominee of a common depository on behalf of Euroclear and Clearstream. The purchase, sale and transfer of the Substitute Preference Shares may only be effected through accounts at Euroclear and Clearstream. The Global Substitute Preference Share Certificate will be exchangeable for definitive registered certificates in the denomination of U.S.\$1,000 and integral multiples in excess thereof, only in the limited circumstances set out therein.

As the creation and issue of the Substitute Preference Shares have yet to be approved, they have not been accepted for clearance through Euroclear and Clearstream and, consequently, have not been allocated a Common Code or ISIN.

*The Bank does not currently have the authority to create and issue the Substitute Preference Shares. The Bank has, however, undertaken in the Subscription Agreement to convene an extraordinary general meeting to be held within 180 days of the Issue Date and to use its best endeavours to obtain the approval of the shareholders of the Bank to the creation and issue of the Substitute Preference Shares as required under the Substitution Deed. See “Investment Considerations - Considerations relating to the Securities - Issuance of the Substitute Preference Shares is subject to shareholders’ approval at the extraordinary general meeting of BEA”.*

## Summary Financial and Other Information

### Summary Consolidated Financial and Other Information Relating to the Group

The audited consolidated profit and loss accounts of the Group for the years ended 31 December 2006, 2007 and 2008, the audited consolidated balance sheets of the Group as at 31 December 2006, 2007 and 2008, the unaudited consolidated profit and loss accounts of the Group for the six months ended 30 June 2008 and 2009 and the unaudited consolidated balance sheets of the Group as at 30 June 2008 and 2009 are included in this Offering Circular. The Group's consolidated financial statements are prepared and presented in accordance with HKFRS.

With effect from the financial statements for the Bank for the year ended 31 December 2007, interest income and expense from trading financial assets and liabilities and financial instruments designated at fair value are reported under "Interest income" and "Interest expense" instead of "Net trading profits" and "Net result from financial instruments designated at fair value through profit or loss", respectively, as in previous years. The change has been made principally to match the interest expense arising from non-trading liabilities that fund the trading book with the interest income from trading assets. This also facilitates the comparison of the Group's net interest income and net interest margin with many peer banks in Hong Kong. Unless otherwise indicated, the comparative figures for the year ended 31 December 2006 in the description of the financial results of the Group in this Offering Circular have been reclassified to conform with current presentation.

The financial information for the six months ended 30 June 2008 has been restated due to the unauthorised manipulation of the valuation of certain equity derivatives held by the Bank, which was announced to the public on 18 September 2008. As a result of the application of HKAS 1 (revised 2007), Presentation of Financial Statements, and HKFRS 8, Operating Segments, certain comparative figures have also been adjusted and restated to conform to the presentation of financial statements as at and for the six months ended 30 June 2009 and to present comparative amounts in respect of items disclosed for the first time as at 30 June 2009.

The following table sets forth the summary consolidated financial and other information of the Group as at and for the periods indicated. The summary consolidated historical financial data as at and for the years ended 31 December 2006, 2007 and 2008 set forth below are derived from the Group's audited consolidated financial statements which have been audited by KPMG. The summary consolidated historical financial data as at and for the six months ended 30 June 2008 and 2009 set forth below are based on the Group's unaudited consolidated financial statements which have been reviewed by KPMG.

### CONSOLIDATED PROFIT AND LOSS ACCOUNTS

	Years ended 31 December			Six months ended	
				30 June	
	2006	2007	2008	2008	2009
	<i>(in HK\$ millions)</i>				
Interest income .....	14,049	18,309	17,465	8,832	6,326
Interest expense .....	(9,050)	(12,332)	(10,672)	(5,349)	(3,092)
Net interest income .....	4,999	5,977	6,793	3,483	3,234
Fee and commission income .....	1,899	2,608	2,618	1,425	1,258
Fee and commission expense .....	(288)	(471)	(473)	(238)	(245)
Net fee and commission .....	1,611	2,137	2,145	1,187	1,013
Net trading profits/(losses) .....	591	1,417	(1,292)	(213)	874
Net result from financial instruments designated at fair value through profit or loss .....	110	(1,154)	(1,612)	(1,043)	(407)
Other operating income .....	253	437	423	271	237
Non-interest income/(expense) .....	2,565	2,837	(336)	202	1,717

## Summary Financial and Other Information

	Years ended 31 December			Six months ended 30 June	
	2006	2007	2008	2008	2009
	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)
Operating income .....	7,564	8,814	6,457	3,685	4,951
Operating expenses .....	(3,465)	(4,691)	(5,779)	(2,764)	(3,041)
Operating profit before impairment losses .....	4,099	4,123	678	921	1,910
Impairment losses on loans and advances .....	(244)	(216)	(558)	(89)	(474)
(Charge for)/Write back of impairment losses on held-to-maturity investments .....	13	(42)	(44)	(33)	(9)
Impairment losses on available-for-sale financial assets .....	—	(228)	(352)	(198)	(10)
(Charge for)/Write back of impairment losses on associates .....	25	(41)	—	—	—
Impairment losses on goodwill .....	(24)	—	—	—	—
Write back of impairment losses on bank premises .....	28	132	6	5	—
Impairment losses .....	(202)	(395)	(948)	(315)	(493)
Operating profit/(loss) after impairment losses .....	3,897	3,728	(270)	606	1,417
Net profit/(loss) on sale of held-to-maturity investments .....	—	—	25	—	(8)
Net profit on sale of available-for-sale financial assets .....	50	667	197	185	70
Net profit on disposal of loans and receivables .....	—	—	1	—	1
Net profit/(loss) on sale of subsidiaries/associates .....	1	406	(8)	(9)	—
Net profit/(loss) on sale of fixed assets .....	(8)	(1)	178	(2)	19
Valuation gains/(losses) on investment properties .....	138	293	(168)	198	89
Share of profits less losses on associates .....	182	92	53	95	79
Profit for the year before taxation .....	4,260	5,185	8	1,073	1,667
Income tax					
Current tax					
— Hong Kong .....	(487)	(258)	(64)	18	(33)
— Overseas .....	(229)	(331)	(566)	(235)	(224)
Deferred tax .....	(58)	(375)	726	(35)	(205)
Profit for the year after taxation .....	3,486	4,221	104	821	1,205
Attributable to:					
Owners of the parent .....	3,435	4,144	39	785	1,169
Minority interest .....	51	77	65	36	36
Profit after taxation .....	3,486	4,221	104	821	1,205
Proposed final dividend per share .....	HK\$1.03	HK\$1.18	HK\$0.02	—	—
Per share					
— Basic earnings .....	HK\$2.04*	HK\$2.41*	HK\$0.02*	HK\$0.43	HK\$0.64
— Diluted earnings .....	HK\$2.02*	HK\$2.39*	HK\$0.02*	HK\$0.43	HK\$0.64
— Dividends .....	HK\$1.33*	HK\$1.51*	HK\$0.23*	HK\$0.21	HK\$0.28

\* These figures have been adjusted for the bonus issue of shares to BEA's shareholders in April 2009. See "Dividend Policy".

## Summary Financial and Other Information

### CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	As at 31 December		As at 30 June	
	2006	2007	2008	2009
	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)
<b>ASSETS</b>				
Cash and balances with banks and other financial institutions .....	8,318	17,853	28,105	19,283
Placements with banks and other financial institutions .....	66,864	94,704	96,574	85,667
Trade bills .....	620	812	1,164	973
Trading assets .....	2,938	4,847	3,437	4,401
Financial assets designated at fair value through profit or loss .....	8,643	8,658	4,130	6,299
Advances to customers and other accounts .....	175,097	231,740	243,725	246,150
Available-for-sale financial assets .....	12,002	12,217	18,560	23,872
Held-to-maturity investments .....	10,249	10,761	5,006	7,374
Investments in associates .....	1,077	2,793	2,486	2,553
Fixed assets .....	5,750	6,856	9,146	11,017
— Investment properties .....	1,289	1,726	1,839	2,218
— Other property and equipment .....	4,461	5,130	7,307	8,799
Goodwill and intangible assets .....	2,605	2,668	2,734	4,110
Deferred tax assets .....	39	70	187	158
<b>Total Assets</b> .....	<b>294,202</b>	<b>393,979</b>	<b>415,254</b>	<b>411,857</b>
<b>EQUITY AND LIABILITIES</b>				
Deposits and balances of banks and other financial institutions .....	31,959	39,060	27,045	22,158
Deposits from customers .....	209,524	284,186	323,802	320,801
Trading liabilities .....	943	2,372	2,846	2,010
Certificates of deposit issued .....	6,998	12,165	5,491	2,867
— At fair value through profit or loss .....	1,944	7,660	3,777	2,497
— At amortised cost .....	5,054	4,505	1,714	370
Current taxation .....	334	229	333	287
Deferred tax liabilities .....	598	872	77	294
Other accounts and provisions .....	8,047	10,997	12,139	17,487
Loan capital .....	8,154	13,652	11,036	12,035
— At fair value through profit or loss .....	4,289	8,983	6,395	7,392
— At amortised cost .....	3,865	4,669	4,641	4,643
<b>Total Liabilities</b> .....	<b>266,557</b>	<b>363,533</b>	<b>382,769</b>	<b>377,939</b>
Share capital .....	3,875	3,936	4,183	4,604
Reserves .....	23,388	26,163	27,963	28,957
<b>Total equity attributable to equity holders of the Group</b> .....	<b>27,263</b>	<b>30,099</b>	<b>32,146</b>	<b>33,561</b>
Minority interests .....	382	347	339	357
<b>Total Equity</b> .....	<b>27,645</b>	<b>30,446</b>	<b>32,485</b>	<b>33,918</b>
<b>Total Equity and Liabilities</b> .....	<b>294,202</b>	<b>393,979</b>	<b>415,254</b>	<b>411,857</b>
<b>OTHER SELECTED FINANCIAL DATA</b>				
	(%)	(%)	(%)	(%)
Loan to Deposit Ratio .....	76.7	73.6	69.9	71.5
Capital Adequacy Ratio .....	14.2	12.6	13.8	13.0
Average Liquidity Ratio .....	44.0	43.5	38.4	43.8
Return on Average Assets .....	1.3	1.2	0.01	0.6
Return on Average Shareholders' Funds .....	13.7	14.6	0.1	7.2

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## Investment Considerations

*Prospective investors should carefully take into account the considerations described below, in addition to the other information contained herein, before investing in the Securities. The occurrence of one or more events described below could have an adverse effect on the Bank's business, financial condition, or results of operations, and could affect the ability of the Bank or Innovate to make payments under the Notes, the Preference Shares, the Guarantee or the Substitute Preference Shares, as the case may be. Additional considerations and uncertainties not presently known to the Bank or Innovate, or which the Bank or Innovate currently deems immaterial, may also have an adverse effect on an investment in the Securities.*

### **CONSIDERATIONS RELATING TO BEA**

#### **Hong Kong Economy**

BEA conducts most of its operations and generates most of its revenue in Hong Kong. BEA's performance and the quality and growth of its assets are necessarily dependent on the overall economy in Hong Kong. As a result, any downturn in the Hong Kong economy may adversely affect BEA's business, financial condition or results of operations.

In 2003, the Hong Kong economy was severely affected by the Severe Acute Respiratory Syndrome ("SARS"), which resulted in, among other things, increased provisions which negatively affected BEA's 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 United States subprime mortgage crisis and the global credit crunch in 2007, and the collapse of Lehman Brothers Inc. ("Lehman Brothers") in September 2008, which adversely affected global financial markets and the liquidity in global credit markets. These developments resulted in a general slowing of economic growth 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. 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 BEA 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 the Hong Kong economy or BEA's business and financial condition will not continue to be adversely affected.

In response to the adverse conditions in the financial markets and the global economy, many countries, including the PRC, have implemented fiscal measures and other stimulus packages targeted at reducing the adverse impact of the global economic crisis and to revive their economies. Since the second half of 2009, there has been evidence mounting that the global economy is recovering, and some of the fiscal measures and other stimulus packages are currently proposed to be withdrawn or scaled back by various countries. However, the global economic outlook remains uncertain and there can be no assurance that the withdrawal of such fiscal measures will not have any adverse impact on the Hong Kong economy and BEA's business, financial condition and result of operations.

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 (year-to-year), BEA expects 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. There can be no assurance that BEA's operations will not be adversely affected by any future deterioration in the United States, the PRC and the Hong Kong economy.

#### **Competition**

The banking industry in Hong Kong is a mature market and BEA is 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. In particular, competition in the credit card, corporate lending, and residential mortgage lending businesses is intense. There can be no assurance that BEA will be able to compete effectively in the face of such increased competition. Increased competition may make it difficult for BEA to increase the size of its loan portfolio and deposit base and may cause increased pricing competition, which could have an adverse effect on its growth plans, margins, ability to pass on increased costs of funding, results of operations and financial condition.

## Investment Considerations

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In particular, since 2000, certain banks in Hong Kong, including BEA, have lowered interest rates charged on non-Hong Kong government guaranteed new home mortgage advances (“**Mortgage Interest Rates**”). As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, BEA charged an average of approximately 2.67%, 2.82%, 2.86% and 2.86%, respectively, below the Best Lending Rate (“**BLR**”) on its home mortgage advances portfolio, excluding the Government Home Ownership Scheme (“**GHOS**”), Private Sector Participation Scheme (“**PSPS**”) and Tenants Purchase Scheme (“**TPS**”) mortgages and staff advances, before accounting for the effect of cash incentive payments. There can be no assurance that competition among banks in Hong Kong for home mortgage advances will not result in further reductions in Mortgage Interest Rates. Further reductions in Mortgage Interest Rates could have an adverse effect on BEA’s business, financial condition or results of operations.

The banking industry in mainland China is becoming increasingly competitive. BEA expects competition from foreign commercial banks to increase significantly as previous restrictions on their geographical presence, customer base and operating licences in mainland China were removed in April 2007 pursuant to the PRC’s World Trade Organisation (“**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, which has also increased competition in the banking industry in mainland China. Many of these banks compete with BEA for the same customer base and some of them may have greater financial, management and technical resources than BEA. Further, under Supplement VI to the CEPA, with effect from 1 October 2009, banks in Hong Kong that have established branch outlets 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. BEA expects increasing competition from foreign banks for the banking business in Guangdong. The increased competition from other banks may result in an increase in the amount of BEA’s loans made at a discount to the People’s Bank of China benchmark rate, which may reduce the average yield on BEA’s loans.

The increased competition in the markets where BEA operates may adversely affect BEA’s business and prospects, the effectiveness of its strategies, its results of operations and financial condition by potentially:

- reducing BEA’s market share in its principal products and services;
- reducing the growth of BEA’s loan and deposit portfolios and other products and services;
- reducing BEA’s interest income and net interest margin;
- reducing BEA’s fee and commission income;
- increasing BEA’s non-interest expenses; and
- increasing competition for qualified managers and employees.

### **Maturity of the Hong Kong Banking Sector**

BEA focuses principally on the Hong Kong market for retail and corporate customers. The banking sector in Hong Kong is extremely competitive. According to statistics published by the Hong Kong Monetary Authority (“**HKMA**”) as at 30 September 2009, there were 146 licensed banks, both international and local, competing for a population of approximately seven million people. There is a limited market, especially for retail banking products such as home mortgage advances, credit cards and personal advances. BEA’s main markets for retail and corporate advances are Hong Kong and mainland China. Due to the maturity of the Hong Kong banking sector, BEA intends to continue to expand its retail and corporate lending portfolio by growing its mainland China-related business. However, BEA is likely to face increased competition in the mainland China market from existing local mainland Chinese banks and other foreign banks entering the market. See “— *Considerations Relating to BEA — Competition*”. There can be no assurance that BEA can further expand or maintain its market share in Hong Kong or that it can successfully increase its mainland China retail or corporate lending portfolios, and its failure to do so could have an adverse effect on the business, financial condition and results of operations of BEA.

### **Maintaining the Growth Rate in Customer Deposits**

Although BEA has issued debt securities to diversify its funding sources, customer deposits remain its primary funding source in Hong Kong. In mainland China, BEA's strategy is to increase the growth of customer Renminbi deposits in order to maintain stability in its source of funds and to minimise costs associated with interbank lending. From 31 December 2004 to 30 June 2009, total deposits increased from HK\$167,916 million to HK\$323,668 million, and retail deposits grew from HK\$163,738 million to HK\$320,801 million. However, there are many factors affecting the growth of deposits, some of which are beyond BEA's control, such as economic and political conditions, the availability of alternative investment choices and retail customers' changing perceptions toward savings. There can be no assurance that BEA will be able to grow its customer deposits at a pace sufficient to support its expanding business.

In September 2008, rumours that BEA believes to be unfounded were disseminated in Hong Kong questioning the liquidity and stability of BEA. These rumours triggered a bank run on BEA on 23 September 2008, prompting BEA to report the matter to the HKMA and the Hong Kong police. Although the bank run was subsequently contained without significantly affecting BEA's liquidity, there can be no assurance that similar incidents will not occur in the future, or that, if a bank run does occur, BEA's operations and liquidity will not be adversely affected by it.

On 14 October 2008, as part of its measures to maintain the liquidity of, and confidence in, the Hong Kong financial markets, the Hong Kong government announced the use of the Exchange Fund to guarantee repayment of all customer deposits held with authorised institutions in Hong Kong subject to the rules laid down in the Deposit Protection Scheme. The guarantee took immediate effect and is scheduled to remain in force until the end of 2010. There can be no assurance that the level of customer deposits of BEA will not be adversely affected by the withdrawal of or any changes to the Deposit Protection Scheme.

If BEA fails to maintain the growth rate in deposits or if a substantial portion of BEA's depositors withdraw their demand deposits or do not roll over their time deposits upon maturity, the liquidity position, financial condition and results of operations of BEA may be materially and adversely affected and BEA may need to seek more expensive sources of funding to meet its funding requirements.

### **Expansion in Hong Kong and Mainland China Markets**

BEA's strategy involves expansion of its business in the Hong Kong and mainland China markets through organic growth and through mergers, acquisitions and alliances, if suitable opportunities arise. BEA (China) obtained a business licence from the State Administration for Industry and Commerce as a locally incorporated bank on 29 March 2007 and officially commenced business on 2 April 2007. On 20 April 2007, it received approval from the China Banking Regulatory Commission ("CBRC") to carry out Renminbi business with local residents in mainland China. The establishment of a locally incorporated bank is one of the prerequisites for Renminbi retail banking service in mainland China.

Further expansion into mainland China may present BEA with new risks and challenges, such as new regulatory environments, different market practices and competition in such markets. For a discussion of recent or proposed acquisitions and disposals of BEA's businesses, see "*Recent Developments*" and "*Business of the Bank — Mainland China, Taiwan and Macau*". Expansion and integration of new mergers, acquisitions and alliances may also require significant operational, administrative and management resources. The success of any mergers, acquisitions and alliances will depend in part on the ability of BEA's management to integrate the operations of newly acquired businesses with its existing operations and, where applicable, to integrate various departments, systems and processes. Consequently, BEA's ability to implement its business strategy may be constrained and the timing of such implementation may be affected due to demands placed on existing resources by the process. There can be no assurance that the acquired entities will achieve the level of performance that BEA anticipates or the projected demand for and margins of BEA's products and services will be realised. The failure to manage expansion effectively could have an adverse effect on BEA's business, financial condition and results of operations.

### **Dependence on Key Personnel and Recruitment**

BEA's ability to sustain its growth and meet future business demands depends on its ability to attract and recruit suitably skilled and qualified staff. Given BEA's rapid expansion in the mainland China market, there can be no

## Investment Considerations

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assurance that BEA will be able to recruit staff in sufficient numbers or with sufficient experience, or that pressure on recruitment will not lead to significant increases in BEA's employment costs. Competition for suitably skilled and qualified staff is particularly acute in mainland China. Any of these factors could adversely affect BEA's business, financial condition and results of operations.

In addition, BEA also faces strong competition to retain skilled and qualified staff, and the loss of key personnel or any inability to manage attrition levels in different employee categories may have an adverse effect on BEA's business, its ability to grow and its control over various business functions.

In 2009, there were departures from BEA's senior management, including Mr. Joseph Pang Yuk-wing (the former Executive Director and Deputy Chief Executive), who retired from his directorship and managerial role with BEA, and Mr. Daniel Wan Yim-keung (the former Group Chief Financial Officer, General Manager and Head of the Strategic Planning and Control Division), who resigned from his office. There can be no assurance that there will be no further departures of personnel from the senior management of BEA and that, if future departures do occur, BEA's business and operations will not be adversely affected.

### Expanding Range of Products and Services Offered in Mainland China

In order to meet the needs of its customers and to expand its business, BEA has been expanding its range of products and services in mainland China offered by BEA (China). Expansion of the business of BEA in mainland China is subject to certain risks and challenges, including:

- new products and services may not be accepted by customers or meet BEA's expectations for profitability;
- 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 BEA is not able to achieve the intended results with respect to its new products and services to be offered in mainland China, this could have an adverse effect on the business, financial condition and results of operations of BEA.

### Exposure to Mainland China Market

As at 30 September 2009, BEA's wholly-owned subsidiary, BEA (China), headquartered in Shanghai, operated 18 branches in Shanghai, Shenzhen, Xiamen, Guangzhou, Zhuhai, Dalian, Xi'an, Beijing, Chengdu, Hangzhou, Chongqing, Qingdao, Shenyang, Wuhan, Nanjing, Tianjin, Hefei and Urumqi as well as 49 sub-branches (9 in Shanghai, 8 in Shenzhen, 7 in Guangzhou, 4 in both Xiamen and Xi'an, 3 in each of Beijing, Chongqing, Dalian and Zhuhai, 2 in Chengdu, 1 in each of Hangzhou, Qingdao and Shenyang). BEA (China) also operated six 24-hour self-service banking centres and more than 310 automatic teller machines ("ATMs") in major urban areas in mainland China. In addition to the BEA (China) network, BEA also operates a branch in Shanghai to provide foreign exchange wholesale services to corporate customers in mainland China and has 3 representative offices in Fuzhou, Suzhou and Dongguan. BEA (China) has also obtained preliminary approval to set up a new branch in Shijiazhuang, upgrade BEA's Suzhou Representative Office into a full-service branch and establish 4 new sub-branches in mainland China. In addition, BEA maintains 2 branches in Taiwan, which are located in Taipei and Kaohsiung, and 1 branch and 3 sub-branches in Macau.

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, advances to customers made by BEA's mainland China, Taiwan and Macau branches amounted to HK\$46,198 million, HK\$78,566 million, HK\$96,885 million and HK\$91,711 million, respectively, representing approximately 27.8%, 36.0%, 42.1% and 39.6%, respectively, of its total advances to customers. The value of BEA's advances in mainland China, as well as its advances to companies that have business interests in 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 political leadership, the rate of inflation, exchange controls and the exchange rate, the regulations governing banking businesses and the impact on the economy of the PRC's

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accession to the WTO). There can be no assurance that BEA's continued exposure to mainland China or its strategy to grow its business in mainland China will not have a negative impact on BEA's earnings or an adverse effect on BEA's business, financial condition or results of operations or that the economic and political environment in mainland China will remain favourable to BEA's business in mainland China in the future.

### United States Operations

As at 30 September 2009, BEA's wholly owned subsidiary, The Bank of East Asia (U.S.A.) N.A. ("BEAUSA") operated 13 branches in the United States. In August 2009, BEA injected U.S.\$25 million into BEAUSA for the purposes of (i) maintaining the minimum capital adequacy ratio of 12.5% as required by the Office of Comptroller of Currency (the regulator for the banking sector in the United States), and (ii) increasing the capital resources of BEAUSA in order to increase its loan portfolio and improve its interest earnings.

Given the uncertainty in the outlook for the economy of the United States, there can be no assurance that BEA will not be required to contribute further funds to maintain BEAUSA's business operations in the United States for the purposes of complying with the capital reserve requirements set by the Office of Comptroller of Currency, discharging any obligation imposed on it by law or regulations, maintaining its solvency or debt servicing ability, or preventing it from breaching any covenant or agreement entered into by BEAUSA.

For the six months ended 30 June 2009, BEAUSA made provisions of U.S.\$8.8 million for potential losses in its loan portfolio. There can also be no assurance that BEAUSA will not make further provisions in respect of its loan advances made in the United States, which may adversely impact BEA's financial performance.

### Concentration Risk

#### *Mainland China*

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, the total amount of loans made to foreign investment enterprises for use onshore were HK\$22,510 million, HK\$29,528 million, HK\$26,797 million and HK\$32,474 million, respectively, which accounted for 51%, 39%, 29% and 37%, respectively, of the total customer advances made by BEA in mainland China. The non-performance of advances held by these foreign investment enterprises could have a material adverse effect on BEA's business, financial condition and results of operations.

#### *Exposure to the Property Market*

BEA has significant exposure to the property market due to its portfolio of property-related advances.

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, home mortgage advances (including advances under GHOS, PSPS and TPS) in Hong Kong accounted for approximately 22.9%, 17.1%, 11.1% and 11.7%, respectively, and advances for property development and investment in Hong Kong accounted for approximately 16.2%, 16.1%, 15.8% and 16.3%, respectively, of BEA's total advances to customers.

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, property related loans accounted for approximately 35.8%, 47.9%, 44.6% and 45.9%, respectively, of BEA's total outstanding customer advances in mainland China, Taiwan and Macau.

Property prices can be affected by a number of factors, including, among other things, the supply of, and demand for, comparable properties, the rate of economic growth, the interest rate environment and prevailing political and economic circumstances. Historically, the Hong Kong and mainland China property markets have been cyclical and property prices have been volatile. For example, Hong Kong residential property prices, after reaching record highs in 1997, fell significantly as a result of the Asian economic downturn. In addition, while the Hong Kong property market showed improvement during the period from 2004 to the first half of 2008, property prices in Hong Kong declined in the second half of 2008 and early 2009, before showing improvement in the second quarter of 2009. There can be no assurance that property values will not experience decreases in the future. If the property market slows down, BEA's business, financial condition and results of operations may be adversely affected.

### Interest Rate Risk

As with most banks, BEA's net interest income is a significant factor in determining its overall financial performance. For the years ended 31 December 2006, 2007 and 2008 and for the six months ended 30 June

2009, BEA's net interest income represented approximately 66.1%, 67.8%, 105.2% and 65.3%, respectively, of its operating income. Interest rates in Hong Kong have remained relatively low and have been falling steadily in recent years, however there can be no assurance that interest rates will not be raised or that increases in interest rates will not be frequent. BEA realises income from the margin between income earned on its assets and interest paid on its liabilities. BEA's net interest rate margins, as the weighted average of the difference between interest rates on the loan advances made by, and the cost of, debt funding for BEA, for the years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009 were 2.03%, 1.91%, 1.85% and 1.77% respectively. As some of its assets and liabilities are repriced at different times, BEA is vulnerable to fluctuations in market interest rates. As a result, volatility in interest rates could have an adverse effect on BEA's business, financial condition, liquidity and results of operations.

An increase in interest rates could lead to a decline in the value of securities in BEA's portfolio. A sustained increase in interest rates could also raise BEA's funding costs without a proportionate increase in loan demand (or any increase at all). Rising interest rates would therefore require BEA to re-balance its assets and liabilities in order to minimise the risk of potential mismatches and maintain its profitability. In addition, rising interest rate levels may adversely affect the economy in Hong Kong and the financial condition and repayment ability of its corporate and retail borrowers, including holders of credit cards, which in turn may lead to a deterioration in BEA's credit portfolio.

### **Classification of Advances and Adequacy of Allowance for Advance Losses**

In 2007, Hong Kong implemented the Basel II regulatory framework. In accordance with guidelines set by the HKMA, BEA obtained approval to adopt the Foundation Internal Ratings-based Approach, and classifies its advances into twenty grades under which impaired loans are classified into one of the following three categories corresponding to levels of risk: "Sub-standard", "Doubtful" and "Loss". See "*Selected Statistical and Other Information*". The classification of impaired advances into one of these categories depends on various quantitative and qualitative factors, including the number of months payment in arrears, the type of advance, the tenor of the advance and the expected recovery status of the advance.

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 loan advances at a different time or being classified in a category reflecting a different degree of risk than would be required in certain other countries. While BEA believes that its lending policies are more prudent than those that are required under Hong Kong laws and regulations, BEA is not required to maintain such policies at levels above those generally applicable to banks in Hong Kong. For a description of the banking regulations that apply to banks in Hong Kong, see "*Regulation and Supervision — Regulation and Supervision in Hong Kong*".

### **Liquidity and Short-Term Funding**

Most of BEA's funding requirements are met through short-term funding sources, primarily in the form of customer and interbank deposits. As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, approximately 92.7%, 91.3%, 85.9% and 85.7% respectively, of BEA's customer deposits had a remaining maturity of three months or less. Historically, a substantial portion of such customer deposits has been rolled over upon maturity and these deposits have been, in essence, a stable source of long-term funding. However, no assurance can be given that this pattern will continue. If a substantial number of depositors fail to roll over deposited funds upon maturity, BEA's liquidity position would be adversely affected and BEA may need to seek alternative sources of short-term or long-term funding to finance its operations, which may be more expensive than existing deposits.

As mentioned in "*Maintaining the Growth Rate in Customer Deposits*" above, the dissemination of rumours in Hong Kong questioning the liquidity and stability of BEA triggered a bank run in September 2008. Although the bank run was subsequently contained without significantly affecting BEA's liquidity, there can be no assurance that similar incidents will not occur in the future, or that, if a bank run does occur, BEA's liquidity and funding will not be adversely affected by it.

On 14 October 2008, the Hong Kong government announced the use of the Exchange Fund to guarantee repayment of all customer deposits held with all authorised institutions in Hong Kong subject to the rules laid down in the Deposit Protection Scheme. The guarantee took immediate effect and is scheduled to remain in force until the end of 2010. There can be no assurance that the level of BEA's customer deposits, and therefore BEA's liquidity, will not be adversely affected by the withdrawal of, or any changes to, the Deposit Protection Scheme.

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The HKMA acts as the lender of last resort to all authorised institutions in Hong Kong to provide support for liquidity needs in the banking system generally as well as to specific institutions. In this regard, 30% of BEA's interest-earning assets are acceptable to the HKMA for such an emergency funding support, and such asset figures are subject to review by HKMA bi-monthly. 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 or that it would elect to provide such assistance in the future to BEA in the event of a liquidity crisis.

### Currency Risks

The majority of BEA's revenue is generated spot in Hong Kong dollars. Nonetheless, as at 31 December 2006, 2007 and 2008 and as at 30 June 2009, BEA held a substantial part of its spot assets in U.S. dollars amounting to HK\$76,801 million, HK\$94,859 million, HK\$83,532 million and HK\$73,785 million, respectively. Although the Hong Kong dollar has been linked to the U.S. dollar since 1983, there can be no assurance that such linkage will be maintained in the future. In order 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. In addition, the Hong Kong government has in the past expressed its commitment to maintaining exchange rate stability under the Linked Exchange Rate System, an automatic interest rate adjustment mechanism. However, there can be no assurance that the Hong Kong dollar will continue to be linked to the U.S. dollar or that, in the event of a liquidity problem affecting the Hong Kong dollar, such bilateral repurchase agreements or automatic interest rate adjustment mechanism will help to maintain adequate liquidity for the Hong Kong dollar. BEA's 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.

### BEA's Unsecured Loan Portfolio

A part of BEA's corporate loan portfolio comprises unsecured loans, the repayment of which is largely dependent on the cashflow of the borrower and adherence to the financial covenants contained in the loans. The majority of BEA's personal banking loan portfolio comprises loans secured by properties while the remaining portion comprises mainly unsecured personal loans and credit card receivables, which generally carry higher rates of interest. Although BEA carefully assesses the repayment ability of such borrowers, these loan products are not secured by any collateral and entail a higher degree of credit risk than secured loan products. If there is a downturn in the economy, the credit quality and charge-off rates experienced by BEA may deteriorate.

### Investments in Debt Securities

BEA holds a portfolio of debt securities with different investment grades. BEA has analysed its investments in debt securities according to the designation of external credit institutions such as Moody's Investor Services. As at 31 December 2008, BEA had a total investment in debt securities of HK\$13,763 million, of which approximately 13% were rated Aaa, 41% were rated between Aa1 to Aa3, 20% were rated between A1 to A3, 8% were rated lower than A3 and 18% were unrated. As at 30 June 2009, BEA had a total investment in debt securities of HK\$22,168 million, of which approximately 18% were rated Aaa, 28% were rated between Aa1 to Aa3, 29% were rated between A1 to A3, 10% were rated lower than A3, 5% were rated P-1 and 10% were unrated.

In 2008 and 2009, BEA suffered substantial losses from its investments in collateralised debt obligations ("CDOs") and structured investment vehicles ("SIVs") (see "*Selected Statistical and Other Information — Asset Quality — Held-to-maturity Debt Securities*"). As at 31 December 2008, the fair value of all of the CDOs held by BEA had been written down to zero and the fair value of all except one of the SIVs held by BEA had been written down to zero.

Given the uncertainties in the current credit and capital markets, there can be no assurance that BEA will not suffer any future marked-to-market losses on its original investment amount in its portfolio of debt securities.

### Repurchase of Lehman Brothers Mini-bonds subscribed or purchased through BEA

On 22 July 2009, BEA entered into an agreement with the HKMA, the SFC and 15 other distributing banks pursuant to which BEA has made an offer to eligible persons to repurchase their holdings in structured investment products issued by Pacific International Finance Limited and arranged by Lehman Brothers group companies, commonly known as Lehman Brothers Mini-bonds, subscribed or purchased through BEA. As at 21

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October 2009, approximately 96.8% of the eligible persons have accepted the offer (see “*Business of the Bank — Litigation*”). It is still uncertain at this stage whether the remaining 3.2% of the eligible persons will make monetary or compensatory claims against BEA. There can be no assurance that BEA may not be involved in any significant litigation, arbitration or similar proceedings or incur any significant liability or penalties in relation to the Lehman Brothers Mini-bonds or other similar structured investment products in the future.

### Unauthorised Acts of Employees

In September 2008, during the course of a regular independent control review performed by BEA, BEA discovered that one of the employees on its equity derivatives desk had manipulated the valuation of certain equity derivatives held by BEA without authorisation and in violation of the prescribed operational procedures of BEA. BEA immediately reported its findings to the HKMA and the Hong Kong police, and issued an announcement on 19 September 2008 to the HKSE together with restated consolidated financial statements for the six months ended 30 June 2008.

The impact of the unauthorised manipulation was to reduce the profit before tax previously disclosed for the six months ended 30 June 2008 by a total amount of HK\$131 million. BEA regards this event to be an isolated incident and anticipates there will be no further adverse financial impact in connection with it.

BEA has since implemented tighter internal control measures in relation to its equity derivatives operations, however, there can be no assurance that similar incidents or any unauthorised act of its employees will not occur in the future, or that, if such incidents do occur, BEA's business, reputation, results of operations and financial conditions will not be adversely affected.

### Information Technology Systems

BEA is highly dependent on the ability of its information technology systems to process accurately a large number of transactions across numerous and diverse markets and its broad range of products in a timely manner. The proper functioning of its financial control, risk management, accounting, customer service and other data processing systems, together with the communication networks between its various branches and sub-branches and its main data processing centres, are critical to its business and its ability to compete effectively. Although there is backup data for key data processing systems and BEA has established a backup system to carry on principal functions in the event of a catastrophe or a failure of its primary systems, there can be no assurance that BEA's operations will not be materially disrupted if there is a partial or complete failure of any of these primary information technology systems or communications networks. Such failures could be caused by, among other things, software bugs, computer virus attacks or conversion errors due to system upgrading. In addition, any security breach caused by unauthorised access to information or systems, loss or corruption of data and malfunction of software, hardware or other computer equipment could have a material adverse effect on BEA's business, reputation, results of operations and financial condition.

In addition, BEA's ability to remain competitive will depend in part on its ability to upgrade its information technology systems on a timely and cost-effective basis. Additionally, the information available to and received by BEA through its existing information technology systems may not be timely or sufficient for BEA to manage risks and plan for, and respond to, market changes and other developments in its current operating environment. BEA is making, and intends to continue to make, investments to improve or upgrade its information technology systems. In 2009, BEA has implemented a new information technology system which caters to and records all corporate and personal loan transactions carried out in the Bank. BEA expects the total amount of capital expenditure for this system to be approximately HK\$54 million. There can be no assurance that the implementation of this new system will improve BEA's operations, its profitability or its chance of recovery for any loans impaired. Any substantial failure to improve or upgrade its information technology systems effectively or on a timely basis could have a material adverse effect on BEA's competitiveness, financial condition and results of operations.

### Different Corporate Disclosure and Regulatory Requirements

BEA's issued shares are listed on HKSE and, as such, BEA is 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. See “*Regulation and Supervision — Regulation and Supervision in Hong Kong*”. Since BEA operates 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 Accord 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. These changes may result in the incurrence of substantial compliance and monitoring costs and there can be no assurance that any breach of applicable laws and regulations will not adversely affect BEA’s reputation or its business, financial condition and results of operations.

Certain products and services provided by BEA are regulated by other regulators including the SFC in Hong Kong. BEA carefully manages legal and compliance risks, including in relation to the sale of financial products and anti-money laundering regulations.

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. During the six months ended 30 June 2009, BEA reviewed its internal procedures and controls on risk exposures and implemented new measures governing the sale process for financial products. These measures include, for example, strict guidelines in categorising financial products based on objective criteria and standard.

BEA has taken steps to implement the recommendations by relevant regulators and to comply with any new or modified regulations, including the introduction of secured voice recording solutions at all local Hong Kong branches. The increasing amount of regulation and investor protection measures have increased the Bank’s operational and compliance expenses. There can be no assurance that the relevant regulatory authorities will not implement further regulations and that such change will not materially increase the operational and compliance cost of BEA or adversely affect BEA’s business or operations. There can also be no assurance that breaches of legislation or regulations by BEA will not occur and, to the extent that such a breach does occur, that significant liability or penalties will not be incurred.

### **Recurrence of SARS, Human Swine Influenza A (H1N1), Avian Influenza or Other Highly Contagious Diseases in Asia and Elsewhere**

During the first half of 2003, Hong Kong, along with many other countries in Asia, encountered an outbreak of SARS, a highly contagious and potentially deadly disease. 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 11 June 2009, the World Health Organization raised its pandemic alert level to Phase 6, its highest level, after considering data confirming the Human Swine Influenza A (H1N1) outbreak. To date, there has been a significant number of confirmed cases of Human Swine Influenza A (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 Human Swine Influenza A (H1N1) will not increase. The SARS outbreak caused an adverse effect on the economies of the affected regions, including Hong Kong and mainland China. Like other financial institutions, BEA’s 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 BEA’s branches and an adverse impact on asset quality due to a weakened economy and higher unemployment rate. There can be no assurance that BEA’s business, financial condition and result of operations would not be adversely affected if another outbreak of SARS or another highly contagious disease occurs.

### **Internet Banking Services**

To the extent that BEA’s internet banking activities involve the storage and transmission of confidential information, security breaches could expose BEA to possible liability and damage BEA’s reputation. BEA’s networks may be vulnerable to unauthorised access, computer viruses and other disruptive problems. Costs incurred in rectifying any of such disruptive problems may be high and may adversely affect BEA’s business,

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financial condition and results of operations. Concerns regarding security risks may deter BEA's existing and potential customers from using its internet banking products and services. Eliminating computer viruses and alleviating other security problems may result in interruptions, delays or termination of service to users accessing BEA's Cyberbanking services. Undetected defects in software products that BEA uses when providing its Cyberbanking services, and BEA's inability to sustain a high volume of traffic, may have a material adverse effect on BEA's internet banking business.

### Further Issuance of Securities

BEA's financial condition, results of operations and capital position are affected by a range of factors such as economic conditions, interest rates, the credit environment, asset quality, operating income and level of provisioning. A slowdown in the economy could lead to a deterioration in BEA's asset quality and an increase in provisions for bad and doubtful debts, which may result in a deterioration of BEA's capital adequacy position or breach capital requirements under Hong Kong law, rules and regulations (including guidelines issued by the HKMA).

In order to strengthen its capital adequacy position or to ensure that it remains in compliance with applicable capital requirements under Hong Kong law, rules and regulations (including guidelines issued by the HKMA), BEA may from time to time raise additional capital through such means and in such manner as it may consider appropriate including, without limitation, the issue of further subordinated notes (whether on terms similar to the Notes or otherwise) or other hybrid capital instruments, subject to any regulatory approval that may be required. There can be no assurance that such future capital raising activities will not adversely affect the market price of the Units in the secondary market.

## CONSIDERATIONS RELATING TO HONG KONG

On 1 July 1997, Hong Kong ceased to be a Crown Colony of the United Kingdom and became a Special Administrative Region of the PRC. Although Hong Kong has thus far enjoyed a high degree of legislative, judicial and economic autonomy since the handover, there can be no assurance that there will not be a change in regulatory oversight as a consequence of the exercise of PRC sovereignty over Hong Kong or a change in government policy as a consequence of the election of a new Chief Executive or that, should any such change occur, BEA's business, financial condition and results of operations will not be adversely affected.

Despite an increasing contribution to BEA's revenues from its mainland China operations, most of BEA's revenues are derived from its operations conducted in Hong Kong. As a result, BEA's financial condition and results of operations are influenced by the general state of the Hong Kong economy (including the level of unemployment) and the political environment in Hong Kong. The economic and political environment in Hong Kong is, in turn, significantly affected by a variety of external factors, including the economic and political environment in the PRC and throughout Asia. There can be no assurance that the economy in Hong Kong will grow. If economic growth slows down in Hong Kong (whether as a result of a global economic slow down or otherwise), BEA's business, financial condition or results of operations may be adversely affected.

## CONSIDERATIONS RELATING TO THE SECURITIES

### The Notes and the Preference Shares cannot be traded separately prior to the Assignment Date

The Notes and the Preference Shares constitute the Units. Together, the Conditions, the Terms of the Preference Shares, the Note Agency Agreement, the Preference Share Agency Agreement and the Stapling Deed contain provisions preventing a transfer of Notes separately from Preference Shares prior to the Assignment Date (see "*Terms and Conditions of the Notes*" and "*Terms of the Preference Shares*"). In addition, the Bank and the Company have entered into arrangements with Euroclear and Clearstream whereby Euroclear and Clearstream will only effect book-entry transfers of interests in Notes and Preference Shares as transfers together of Units until the Assignment Date. Investors should be aware that prior to the Assignment Date any purported transfer of a Note or a Preference Share other than as a Unit will be void. Following the Assignment Date, the Units will be cancelled and the Note will be transferred to the Company pursuant to the Assignment (see "*— The Notes will be transferred to the Company on the Assignment Date*" below). Consequently, with effect from the Assignment Date, former holder of Units will hold an interest only in the Preference Shares.

### **The obligations of the Bank under the Notes, the Guarantee and the Substitute Preference Shares are deeply subordinated**

The obligations of the Bank under the Notes, the Guarantee and the Substitute Preference Shares are subordinated to the claims of Senior Creditors (see “*Terms and Conditions of the Notes — Subordination*”, “*Description of the Guarantee*” and “*Terms of the Substitute Preference Shares — Capital*”). Therefore, upon a Winding-Up of the Bank, the Bank’s obligations under the Notes, the Guarantee and/or the Substitute Preference Shares will only be satisfied if the Bank can satisfy in full all of its obligations to Senior Creditors. As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, the Bank had total consolidated liabilities of HK\$267 billion, HK\$364 billion, HK\$383 billion and HK\$378 billion, respectively. There are no provisions of the Notes, the Trust Deed, the Guarantee, the Substitute Preference Shares or the Articles of the Bank that limit the ability of the Bank to incur additional indebtedness, including indebtedness that ranks senior to, or *pari passu* with, the Notes, the Guarantee and the Substitute Preference Shares on a Winding-Up of the Bank, or that limit the ability of the Bank to issue other preference shares or other instruments or incur other obligations so ranking.

In addition, all payments under the Notes, the Preference Shares, the Substitute Preference Shares and the Guarantee are conditional on the Bank being solvent at the time of payment and no payment under any of them shall become due and payable except to the extent that such payment can be made and the Bank still be solvent immediately thereafter.

As a significant and growing proportion of the Bank’s business is operated through subsidiaries, the Bank’s right to participate in any distribution of the assets of such subsidiaries upon the winding-up or dissolution of such subsidiaries, and therefore, the ability of investors to benefit indirectly from such distribution, is subject to the prior claims of creditors of such subsidiaries. Accordingly, the Notes, the Guarantee and the Substitute Preference Shares are effectively subordinated to all existing and future liabilities of the Bank’s subsidiaries and holders of the Notes or the Substitute Preference Shares or the Preference Shares (to the extent of the Guarantee) should look only to the assets of the Bank for payment.

### **The Company is a wholly-owned subsidiary of the Bank the business of which is limited to activities connected to the issue of the Preference Shares**

The Company is a wholly-owned subsidiary of the Bank, the business of which is limited to activities connected to the issue of the Preference Shares. As such, prior to the Assignment Date it has no significant assets other than the Assignment Right. After the Assignment Date, the principal asset of the Company will be its holding of the Notes, payments under which are intended to fund any dividend payments on the Preference Shares. Preference Shareholders also benefit from the Guarantee under which the Bank guarantees the Guaranteed Payments under the Preference Shares. To the extent that payments of dividends that are due and payable are not paid, Preference Shareholders will have recourse principally to BEA as the Guarantor of the Guaranteed Payments.

### **Interest on the Notes may be deferred and dividends on the Preference Shares and the Substitute Preference Shares may not be payable in certain circumstances**

Payments in respect of, or arising from, the Notes are conditional on the Bank being solvent at the time of payment by the Bank. If the Bank does not declare or pay any dividends on any class of shares in the 12-month period preceding an Interest Payment Date or Dividend Payment Date on either the Preference Shares or the Substitute Preference Shares, as the case may be, the Bank or the Company, as applicable, may elect not to pay the relevant interest or dividend on the relevant Interest Payment Date or Dividend Payment Date, as the case may be. In addition, to the extent that the Bank does not have sufficient Distributable Profits as at any Interest Record Date or Dividend Record Date, payments of interest or dividends on the related Interest Payment Date or Dividend Payment Date, as the case may be, must be reduced on a *pro rata* basis with all other payments due on the same date and ranking at the same level in priority of payment. Non-payment of the relevant amount of interest or dividends in such circumstances shall not constitute a default under the Notes, the Preference Shares or the Substitute Preference Shares.

### **Payments of dividends on the Preference Shares and Substitute Preference Shares is non-cumulative**

Payments in respect of, or arising from, the Preference Shares are conditional on the Bank being solvent at the time of payment. Dividend payments on the Preference Shares and the Substitute Preference Shares are non-cumulative. If, and to the extent that, dividends are not paid on the Preference Shares or the Substitute Preference Shares either because the Company or the Bank, as the case may be, is not permitted to pay them in

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accordance with applicable law or because of the contractual restrictions in the Preference Share Terms or the Articles of the Bank, holders of the Preference Shares or the Substitute Preference Shares, as the case may be, will not receive such payments and will have no claim in respect thereof, whether or not the Company or the Bank subsequently makes payments of any dividends on the Preference Shares or the Substitute Preference Shares.

### **The Notes will be transferred to the Company on the Assignment Date**

Pursuant to the Assignment Deed and the Notes, investors in the Notes, by virtue of becoming or being holders of the Notes, irrevocably agree and acknowledge that they hold their Notes subject to the Assignment. Consequently, with effect from the Assignment Date, persons holding Notes prior to the Assignment Date shall cease to be entitled to any payment of interest in respect of the Notes with effect from, and including, the Assignment Date and will cease to have any claim in a Winding-Up of the Bank in respect of the Notes. In addition, with effect from the Assignment Date, all purported transfers of Notes, other than the transfer of all Notes to the Company, will be void and former holder of Units will hold an interest only in the corresponding Preference Shares.

### **The Preference Shares will be exchanged for the Substitute Preference Shares on the occurrence of a Substitution Event**

On the occurrence of a Substitution Event, the Preference Shares will be automatically exchanged by the Company and the Bank for the Substitute Preference Shares on the basis of one Substitute Preference Share for each Preference Share. On substitution, the Guarantee will be cancelled. Persons that were holders of Preference Shares prior to the Substitution Date shall, with effect from the Substitution Date, be holders of directly issued Substitute Preference Shares of the Bank.

### **Issuance of the Substitute Preference Shares is subject to shareholders' approval at the extraordinary general meeting of BEA**

BEA does not currently have the authority to create and issue the Substitute Preference Shares. BEA has, however, undertaken to convene an extraordinary general meeting and to use its best endeavours to obtain the approval of shareholders of BEA to create and issue the Substitute Preference Shares on the Substitution Date. However, there can be no assurance that the resolution will be passed at the extraordinary general meeting and the failure to pass the resolution will constitute a Regulatory Redemption Event (as defined in the Preference Shares Terms) which gives BEA the option to redeem the Preference Shares. Upon the redemption of the Preference Shares, the Notes will be transferred to the Company on the Assignment Date. See “— *The Notes will be transferred to the Company on the Assignment Date*”.

In addition, purchasers of the Units who also hold equity securities in the Bank may be excluded from voting at the extraordinary general meeting if they are determined to have a material interest in the transaction as determined by the Listing Rules.

### **Holders of the Notes and Preference Shares have limited enforcement rights**

Neither the Trustee nor any Noteholder may take action to enforce the obligations of the Bank under the Notes. In particular, neither the Trustee nor any Noteholder may issue any demand under Section 178(1)(a) of the Companies Ordinance in respect of the Notes, institute any Winding-Up Proceeding against the Bank or levy or enforce any distress or other execution to, on, or against any assets of the Bank. In addition, no Preference Shareholder may take any action to enforce the obligations of the Company under the Preference Shares or the Bank under the Guarantee. In particular, no Preference Shareholder may issue any demand for the payment of debts to the Company, institute a Winding-Up Proceeding against the Company or levy or enforce any distress or other execution to, on, or against any assets of the Company and no Preference Shareholder may issue any demand under Section 178(1)(a) of the Companies Ordinance in respect of the Guarantee, institute any Winding-Up Proceeding against the Bank or levy or enforce any distress or other execution to, on, or against any assets of the Bank.

### **The terms of subordinated instruments that the Bank may issue could limit the Bank's ability to make payments on the Notes or the Substitute Preference Shares or the Company's ability to make payments on the Preference Shares**

No provision of the Notes, the Trust Deed, the Preference Shares, the Substitute Preference Shares, the Articles of the Bank or the Memorandum and Articles of the Company prohibit the Bank or any subsidiary of the Bank (other than the Company) from issuing obligations that rank *pari passu* with the Securities. Therefore, upon a Winding-Up of the Bank, holders of the Securities would share equally with the holders of such other obligations in a distribution of the assets of the Bank.

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### **Investors may have to bear the economic risk of an investment in the Units indefinitely**

Neither the Preference Shares nor the Substitute Preference Shares have a stated maturity. While the Bank is obliged to redeem the Notes at their principal amount together with accrued interest and Arrears of Interest on the Maturity Date, under the terms of the Notes, all outstanding Notes must be transferred to the Company pursuant to the Assignment on the Business Day prior to the Maturity Date. The Company may, but is not obliged to, redeem the Preference Shares at its option on any Optional Redemption Date, on the happening of certain tax events or on the happening of a Regulatory Event. The Bank may, but is not obliged to, redeem the Substitute Preference Shares at its option on any Optional Redemption Date, on the happening of certain tax events or on the happening of a Regulatory Event. Early redemption of the Preference Shares or the Substitute Preference Shares is subject to the prior written consent of the HKMA. Unless the Preference Shares are redeemed at the option of the Company or the Substitute Preference Shares are redeemed at the option of the Bank, investors would have to sell their Units (before the Assignment Date) or Preference Shares or Substitute Preference Shares (after the Assignment Date) in order to realise the cash value of their investment. Neither the Rate of Interest on the Notes nor the Dividend Rate on the Preference Shares or the Substitute Preference Shares will be adjusted to reflect subsequent changes in interest rates or other market conditions, the Bank's results of operations or financial conditions or any decline in the market price of the Bank's ordinary shares. As a result, investors may not be able to sell the Units, the Preference Shares or the Substitute Preference Shares, as the case may be, for the amount of their original investment.

### **Voting rights of the holders of Preference Shares and Substitute Preference Shares are limited**

The rights of the holders of Preference Shares and Substitute Preference Shares to convene, attend and vote at any general meeting of the Company or the Bank, respectively, are limited.

### **Exchange rate risks and exchange controls**

Payments under the Securities will be made in U.S. dollars. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "Investor's Currency") other than U.S. dollars. These include the risk that exchange rates may significantly change (including changes due to devaluation of the U.S. dollar or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the U.S. dollar would decrease (1) the Investor's Currency equivalent yield on the Securities, (2) the Investor's Currency equivalent market value of the Units and (3) the Investor's Currency equivalent market value of any amount invested that is returned to the investor.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less payment than expected, or no payment at all.

### **Secondary Market**

Approval in-principle has been received for the listing of the Notes and the Preference Shares on the SGX-ST. No application has been or will be made for the listing of the Units. Upon the occurrence of a Substitution Event, application will be made for the listing of the Substitute Preference Shares on the SGX-ST or the HKSE. Neither the Bank nor the Company is able to predict the market price and the liquidity of the market for the Units or the Preference Shares, or following a Substitution Event, Substitute Preference Shares that may be issued in exchange for the Preference Shares. It is possible that the Units, the Preference Shares and the Substitute Preference Shares may trade at a market price below the issue price. The price of the Units, the Preference Shares and the Substitute Preference Shares may fluctuate due to various factors, including financial market conditions. Investors who wish to sell their Units, Preference Shares or the Substitute Preference Shares may be unable to do so at an acceptable price, or at all, if insufficient liquidity exists in the market for the Units, the Preference Shares or the Substitute Preference Shares. Illiquidity may have a material adverse effect on the market value of the Units, the Preference Shares and the Substitute Preference Shares.

### **Modification, Waivers and Substitution of the Notes**

The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

## **Investment Considerations**

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The Conditions also provide that the Trustee may, without the consent of the Noteholders, (i) agree to any modification of the Conditions or the Trust Deed (other than in respect of a Reserved Matter as defined in the Conditions) if such modification will not be materially prejudicial to the interests of Noteholders and to any modification of the Notes or the Trust Deed which is of a formal, minor or technical nature or is to correct a manifest error or (ii) authorise or waive any proposed breach or breach of the Notes or the Trust Deed (other than a proposed breach or breach relating to the subject of a Reserved Matter) if the interests of the Noteholders will not be materially prejudiced or (iii) agree to the substitution of another entity as principal debtor under the Notes in place of BEA, in the circumstances described in Condition 17.

### **Meetings of Preference Shareholders**

The Memorandum and Articles of the Company contain provisions for calling meetings of Preference Shareholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Preference Shareholders including Preference Shareholders that did not attend and vote at the relevant meeting and Preference Shareholders that voted in a manner contrary to the majority.

### **Change of Law**

The Conditions are governed by English law (except for the provisions relating to subordination which are governed by the laws of the Special Administrative Region of Hong Kong). The Terms of the Preference Shares are governed by the laws of the British Virgin Islands and the Terms of the Substitute Preference Shares are governed by Hong Kong law. No assurance can be given as to the impact of any possible judicial decision or change to English law or the laws of the British Virgin Islands or the Special Administrative Region of Hong Kong or administrative practice in any such jurisdiction after the date of issue of the Notes.

### **Interest rate risk**

Investment in the Units involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes and the Preference Shares.

### **Credit Ratings**

The Units have been rated Baa1 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 Units. 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.

The rating by Moody's for the Units was assigned in line with Moody's existing methodology. On 16 June 2009, Moody's released a Request for Comment, requesting market feedback on potential changes to its rating methodology for bank subordinated capital and on 19 October 2009, announced that it will release by the end of November 2009 its new rating methodology for subordinated capital, including hybrid securities, issued by banks. Ratings potentially affected by changes to the methodology will be placed on review shortly thereafter. After the methodology is finalised, Moody's will review the way it classifies hybrid securities in terms of the relative amount of debt and equity that they contribute to calculations of a bank's capital ratios. If the revised methodology is implemented as proposed, there is a significant risk that the rating on the Units would be downgraded to non-investment grade. No assurance can be given that Moody's will not withdraw or lower its rating of the Units (including lowering the rating of the Units to below investment grade) as a result of the application of its new rating methodology in reviewing the rating of the Units.

There is a risk that the credit rating of the Bank and of the Units may change as a result of changes in the Bank'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 judgement, 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 Units and the Preference Shares.

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## Use of Proceeds

The net proceeds of the issue of the Notes and Preference Shares after deducting the selling, management and underwriting commissions to the Managers and other distributors and other expenses in connection with the issue of the Notes and Preference Shares will be approximately U.S.\$494,300,000. The net proceeds from the issue of Notes will be used for the general working capital requirements of the Group. The net proceeds from the issue of the Preference Shares will be applied in consideration for the Assignment (as defined in the “*Terms and Conditions of the Notes*”).

## Capitalisation and Indebtedness

### CAPITALISATION AND INDEBTEDNESS OF THE GROUP

As at 30 September 2009, BEA had an authorised share capital of HK\$6,500 million consisting of 2,600 million ordinary shares of HK\$2.50 each, and issued and fully paid up share capital of approximately HK\$4,605.2 million consisting of approximately 1,842.06 million ordinary shares of HK\$2.50 each.

The following table sets out the Group's consolidated capitalisation and indebtedness as at 30 June 2009 and as adjusted for the issue of the Notes and the Preference Shares.

	As at 30 June 2009	
	Actual	As adjusted
	HK\$ (in millions)	HK\$ (in millions)
Short-term borrowings <sup>(1)</sup>		
Customer deposit accounts .....	310,035	310,035
Certificates of deposits in issue .....	1,494	1,494
Deposits from banks .....	22,111	22,111
Total short-term borrowings .....	<u>333,640</u>	<u>333,640</u>
Medium-term borrowings <sup>(2)</sup>		
Customer deposit accounts .....	10,142	10,142
Certificates of deposits in issue .....	769	769
Deposits from banks .....	36	36
Loan capital .....	12,035	12,035
Total medium-term borrowings .....	<u>22,982</u>	<u>22,982</u>
Long-term borrowings <sup>(3)</sup>		
Customer deposit accounts .....	624	624
Certificates of deposits in issue .....	604	604
Total long-term borrowings .....	<u>1,228</u>	<u>1,228</u>
Capital resources		
Share capital .....	4,604	4,604
Reserves .....	28,957	28,957
Proposed dividends .....	—	—
Shareholders' funds .....	<u>33,561</u>	<u>33,561</u>
Minority interests .....	357	357
Total Units to be issued <sup>(4)</sup> .....	—	3,900
Total minority interests .....	<u>357</u>	<u>4,257</u>
Total capital resources .....	<u>33,918</u>	<u>37,818</u>
Total capitalisation <sup>(5)</sup> .....	<u>58,128</u>	<u>62,028</u>
Short-term borrowings and total capitalisation .....	<u>391,768</u>	<u>395,668</u>

*Notes:*

- (1) Short-term borrowings refer to borrowings of remaining maturity of not more than one year.
- (2) Medium-term borrowings refer to borrowings of remaining maturity of over one year to five years.
- (3) Long-term borrowings refer to borrowings of remaining maturity of more than five years.
- (4) The aggregate principal amount of the Units was converted from U.S. dollars to Hong Kong dollars at the rate of U.S.\$1.00 = HK\$7.80.
- (5) Total capitalisation comprises total medium-term borrowings, total long-term borrowings and total capital resources.

Save as disclosed, there has been no material change in the Group's total capitalisation since 30 June 2009.

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# Business of the Bank

## INTRODUCTION

### Overview

Incorporated in 1918, BEA is the largest independent local bank in Hong Kong in terms of assets. As at 30 June 2009, BEA's consolidated assets, advances to customers and customer deposits were HK\$411,857 million (U.S.\$52,802 million), HK\$231,392 million (U.S.\$29,666 million) and HK\$320,801 million (U.S.\$41,128 million), respectively. The comparative figures as at 31 December 2008 were HK\$415,254 million (U.S.\$53,238 million), HK\$230,339 million (U.S.\$29,531 million) and HK\$323,802 million (U.S.\$41,513 million), respectively, (ii) as at 31 December 2007 were HK\$393,979 million (U.S.\$50,510 million), HK\$218,184 million (U.S.\$27,972 million) and HK\$284,186 million (U.S.\$36,434 million) and (iii) as at 31 December 2006 were HK\$294,202 million (U.S.\$37,718 million), HK\$166,178 million (U.S.\$21,305 million) and HK\$209,524 million (U.S.\$26,862 million), respectively.

The shares of BEA have been listed on the HKSE since the 1930s. As at 30 September 2009, the authorised share capital of BEA was 2,600 million ordinary shares of HK\$2.50 each, of which approximately 1,842.06 million ordinary shares have been issued and are outstanding and have been fully paid. Based on the closing price of its shares on the HKSE on 30 September 2009, BEA's market capitalisation was approximately HK\$51,577.68 million (U.S.\$6,612.52 million). BEA's shares have been a constituent stock of the Hang Seng Index since 1984.

BEA provides retail and wholesale banking services through its Personal Banking, Corporate Banking, Wealth Management, Treasury Markets, China and International divisions. BEA's core businesses are deposit taking and home mortgage lending in Hong Kong. Its other activities include retail investment and wealth management services, commercial and industrial lending, consumer finance, credit cards, insurance, services related to the MPF Scheme, internet banking services, trust services, foreign exchange, trade finance, project finance, loan syndication, remittances, foreign exchange margin trading, stock broking, asset management services and other fee-based services.

In addition, through the Group's principal subsidiaries, BEA is able to extend other services to its customers. Blue Cross and BEA Life offer a range of life and non-life insurance products and services. Tricor, together with its subsidiaries, provides its customers with a range of integrated business, corporate and investor services.

As at 30 September 2009, the Group offered a broad range of banking and related financial services through a network of 89 branches, 7 major subsidiaries and 50 wealth management centres called "SupremeGold Centres", in Hong Kong.

As at 30 September 2009, BEA's overseas operations had in total 48 branches, 52 sub-branches and 4 representative offices, as well as several affiliates and joint ventures, in mainland China, Taiwan, Macau, the United States, Canada, the United Kingdom, the British Virgin Islands and South East Asia.

BEA was one of the first foreign banks to receive approval to establish a locally incorporated bank in mainland China. The locally incorporated bank, BEA (China), obtained a business licence from the State Administration for Industry and Commerce on 29 March 2007 and officially commenced business on 2 April 2007. On 20 April 2007, BEA (China) received approval from the CBRC to carry out Renminbi business with local residents in mainland China. The products and services provided by BEA (China) for personal and corporate customers in mainland China include, but are not limited to, Cyberbanking, Renminbi and foreign currency deposit-taking, remittance services, purchase and sale of foreign currencies, Renminbi forward services, SupremeGold accounts, Renminbi debit and credit cards, credit card settlement services, private banking services, Qualified Domestic Institutional Investors ("QDII") services, derivative and investment products, agency services for general and life insurance products, wealth management services, cash management services, consumer loans, property mortgage loans, construction loans, property investment loans, working capital financing, project financing, trade finance facilities, accounts receivable financing, banker's acceptance, credit investigations, guarantees, standby letters of credit, entrusted loans, and cross border Renminbi trade settlement services.

## Business of the Bank

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As at 30 September 2009, BEA (China) operated 18 branches and 49 sub-branches in mainland China and plans to expand its network in strategic locations in mainland China. In addition to the BEA (China) network, BEA also operates a branch in Shanghai, through which it provides its foreign exchange wholesale services to corporate customers in mainland China, and also operates three representative offices.

In Taiwan, BEA maintains one branch each in Taipei and Kaohsiung. In June 2009, it acquired AIG group's Taiwanese wealth management business, which was re-launched under the new name of BEA Wealth Management Services (Taiwan). BEA also maintains one branch, three sub-branches and 10 ATMs in Macau.

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, approximately 18.6%, 24.9%, 29.8% and 28.7%, respectively, of the assets of the Group were accounted for in mainland China, Taiwan and Macau. For the years ended 31 December 2006, 2007 and 2008 and for the six months ended 30 June 2009 approximately 16.9%, 23.7%, 18,550%<sup>(1)</sup> and 44.7%, respectively, of BEA's consolidated profit before taxation were accounted for in mainland China, Taiwan and Macau.

The majority of BEA's lending is on a secured, floating-rate basis and adheres to pre-established loan-to-value limitations depending on the underlying collateral and the credit risk of customers. Security typically consists of a first legal charge over real property, listed securities and cash deposits. Some of BEA's lending is on a guaranteed basis.

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, the Group's capital adequacy ratio was approximately 14.2%, 12.6%, 13.8% and 13.0%, respectively, compared to the statutory minimum requirement of 8.0%, and its loan to deposit ratio was approximately 76.7%, 73.6%, 69.9% and 71.5%, respectively. For the years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, BEA's average liquidity ratio was approximately 44.0%, 43.5%, 38.4% and 43.8%, respectively. See "Selected Statistical and Other Information" for further details.

The Group relies on its deposit base for the majority of its funding requirements. As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, customer deposits accounted for approximately 81.6%, 81.4%, 88.1% and 89.6%, respectively, of borrowed funds. The remainder of the Group's funding requirements as at 31 December 2006, 2007 and 2008 and as at 30 June 2009 were satisfied through the issuance of certificates of deposit and, particularly for its Renminbi funding requirements, through interbank borrowings. In July 2009, BEA (China) issued RMB4 billion in aggregate principal amount of Renminbi-denominated bonds in order to diversify the Group's Renminbi funding sources.

For the six months ended 30 June 2009, the Group's profit after taxation was HK\$1,205 million (U.S.\$154 million), an increase of approximately 46.8% from the six months ended 30 June 2008. For the year ended 31 December 2008, the Group's profit after taxation was HK\$104 million (U.S.\$13 million), a decrease of approximately 97.5% from the year ended 31 December 2007. For the year ended 31 December 2007, the Group's profit after taxation was HK\$4,221 million (U.S.\$541 million), an increase of approximately 21.1% from the year ended 31 December 2006 (HK\$3,486 million (U.S.\$447 million)).

For the six months ended 30 June 2009, the Group achieved a return on average assets of approximately 0.6% and a return on average equity of approximately 7.2%, as compared to approximately 0.01% and 0.12%, respectively, for the year ended 31 December 2008, approximately 1.2% and 14.6%, respectively, for the year ended 31 December 2007 and, approximately 1.3% and 13.7%, respectively, for the year ended 31 December 2006.

The Group's operations and financial performance for the year ended 31 December 2008 were severely affected by the adverse conditions in the financial markets and deterioration in the global economy. A severe decrease in

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**Note:**

- (1) For the year ended 31 December 2008, the Group's financial performance was adversely affected by the one-off write down of HK\$3,549 million for its investments in CDOs and SIVs conducted in Hong Kong (see "Selected Statistical and Other Information — Asset Quality — Held-to-maturity Debt Securities"). The loss before taxation for Hong Kong operations for the period was HK\$1,876 million, and the Group's consolidated profit before taxation for the period was HK\$8 million. As a result, when the profit before taxation for the period for China operations (including Taiwan and Macau) (HK\$1,484 million) is compared against the Group's consolidated result, it accounts for 18,550% of the consolidated profit before taxation.

the Group's profit for the period resulted from the HK\$3.5 billion one-off write down of the fair value of the Group's portfolio of all of its CDOs and almost all of its SIVs (see "*Selected Statistical and Other Information — Asset Quality — Held-to-maturity Debt Securities*"), and the decrease in profit from the Personal Financial Services business.

The uncertain economic environment has continued to put pressure on the Group's performance for the six months ended 30 June 2009 but, although there has been some recovery in particular for the second quarter of 2009, there was no further substantial write down or impairment recorded by the Bank during the six months ended 30 June 2009.

### History

Incorporated in 1918, BEA was one of Hong Kong's first independent local banks. BEA set up its first branch in Shanghai in 1920 and has operated in mainland China ever since. BEA believes that it is well positioned to provide banking services to customers in mainland China and Chinese customers abroad.

In 1975, BEA launched the first Hong Kong dollar credit card in conjunction with Bank of America, called the East Asia BankAmericard/VISA. In 1979, the East Asia BankAmericard/VISA credit card became the first credit card that was accepted in mainland China as a result of an agreement between BEA and the Bank of China on foreign currency credit card settlement services.

BEA is one of the founders of Joint Electronic Teller Services Ltd. ("JETCO"), which was formed to set up a network of ATMs in Hong Kong and Macau. BEA is also one of the founders of EPS Company (Hong Kong) Limited ("EPSCO") in Hong Kong, which was formed to facilitate the electronic transfer of funds at the point of sale. In 1999, BEA was the first bank in Hong Kong to launch online stock trading through its wholly-owned subsidiary, East Asia Securities Company Limited ("East Asia Securities"). BEA was also the first bank in Hong Kong to provide comprehensive internet banking services to its customers, through its Cyberbanking service.

In 2004, following the relaxation in the restrictions on Hong Kong banks conducting personal Renminbi business, BEA introduced Renminbi deposit, exchange, remittance, card (both debit and credit) and retail Renminbi non-deliverable forward contract services. In the same year, BEA enhanced its Cyberbanking service, and became the first bank in Hong Kong to provide an independent mobile phone and personal digital assistant ("PDA") banking service.

BEA (China) became the first foreign bank to launch Renminbi debit cards and Renminbi credit cards in mainland China in May and December 2008, respectively.

In July 2009, BEA (China) issued RMB4 billion in aggregate principal amount of Renminbi-denominated bonds in Hong Kong, becoming the first locally-incorporated foreign bank in mainland China to issue Renminbi bonds to retail investors in Hong Kong. In September 2009, BEA (China) was granted the status of Domestic Settlement Bank and Domestic Agent Bank for cross border Renminbi trade settlement services, and completed its first cross-border Renminbi trade settlement transaction and intends to continue to offer Renminbi trade settlement services in the pilot cities, such as Shanghai, Guangzhou, Shenzhen and Zhuhai.

Over the years, BEA has continuously expanded its operations in mainland China and at present has a total of 72 outlets in mainland China including the headquarters of BEA (China), 18 branches, 49 sub-branches, 3 representative offices and 1 booking branch. BEA was one of the first foreign banks to be granted QDII status by the CBRC, and the first to obtain a foreign exchange quota to conduct QDII business. It was also one of the first foreign banks accredited to provide Renminbi fixed deposit services to local residents in mainland China. BEA was one of the first foreign banks to establish a locally incorporated bank in mainland China (BEA (China)) and to conduct Renminbi business with local residents.

In 2007, BEA was awarded the "Best Foreign Retail Bank in China" by the Asian Bankers, one of the "Top 5 Foreign Banks" of the "China Business News Financial Brand Ranking 2007" as well as "Best Foreign Subsidiary Bank in China" in the 2007 Asian Banks Competitive Rankings held during The 21st Century Annual Finance Summit of Asia.

In 2008, BEA (China) was awarded the “2008 Best Internet Banking among Foreign Banks in China” by China Internet Weekly, the “Retail Financial Service Brand” in the 2008 China Business News Financial Brand Ranking and the “Best Foreign Retail Bank” in the 2008 Asian Banks Competitive Rankings held during the 21st Century Annual Finance Summit of Asia.

BEA (China)’s achievements were further recognised through a number of awards received in the first half of 2009, including “Best Development Team for Information Technology”, “Best Information Technology Strategy Award” and “Best Technical Strategy Award” in 2008 from the National Information Evaluation Centre, “Best Financial Services in 2008” at the Golden-Shell Award of Finance hosted by the 21st Century Business Herald, and “30 Years of Reform and Opening-up - Leadership Award for Best Industry Contribution” from China Internet Week.

### **STRATEGY**

BEA’s core objectives are to strengthen its position as the largest independent bank in Hong Kong, to develop further its domestic franchise as one of Hong Kong’s leading banks and to expand its operations in mainland China and other overseas countries. As part of the strategy for growth in the future, BEA will focus significantly on its operations in mainland China. The key components of BEA’s strategy are as follows.

#### **Expansion in mainland China and other overseas countries**

BEA intends to continue to develop its business in overseas markets including mainland China, North America, Europe and South East Asia. The mainland China market will remain an important focus for BEA. BEA intends to strengthen its position in mainland China to capitalise on opportunities arising from the full liberalisation of the banking sector and of Renminbi business. Through the establishment of a locally incorporated bank, BEA (China), BEA is able to provide Renminbi retail banking service to local residents in mainland China. Leveraging from BEA’s international banking experience and long history of presence in mainland China, BEA (China) aims to position itself as a “Chinese foreign bank” — a foreign bank run by ethnic Chinese which understands the local culture and needs of its customers.

Given the size of mainland China and the already extensive physical presence of the domestic banks, BEA does not intend to compete with the domestic banks by opening an extensive branch network. BEA currently focuses on corporate lending and considers other foreign banks to be its main competitors for the segments of the mainland China market that it targets.

At the same time, BEA (China) intends to diversify its client base by extending its service coverage in mainland China via its Cyberbanking system and network of ATMs and 24-hour self service centres. Such automated systems will afford maximum convenience to its customers. BEA believes this strategy is the most effective and efficient way to compete for business in mainland China. Nevertheless, BEA will continue to extend its branch network prudently based on business demand.

In addition to expanding its businesses in strategic locations in mainland China, BEA plans to continue to evaluate opportunities to acquire or enter into cooperative agreements with other banks in order to expand its overseas presence, in particular with banks that focus on retail and small-to-medium-sized enterprise (“SME”) customer segments in overseas Chinese communities.

#### **Diversification of non-interest income**

BEA intends to implement its strategy in Hong Kong by continuing to broaden its product range, upgrading product features and exploring new market opportunities. BEA’s wealth management and private banking business will remain the focus of BEA’s core business development in the near future. BEA plans to develop its corporate services and share registration businesses further through its subsidiary Tricor. BEA will also continue to develop the insurance business of Blue Cross and intensify cross-selling opportunities to its existing customer base. With the setting up of BEA Life, a wholly-owned subsidiary, in January 2008, BEA has positioned itself to capture new market opportunities through offering a broad range of life insurance solutions. In addition, BEA believes that the development of its Cyberbanking services will enable it to attract new customers for its banking services that are less readily accessible through traditional delivery channels.

### Enhancement of profitability via active asset and liability management

BEA intends to continue to optimise its asset mix through active asset and liability management and allocation in order to enhance its profitability and net worth.

### Transformation of its branch network

Through repositioning and rationalising its branch network and re-distributing resources, BEA seeks to transform its Hong Kong branches into sales centres to provide banking products and services to its customers and in particular, to target high net worth customers. As of 30 September 2009, BEA operated 50 SupremeGold Centres, offering a platform for BEA to provide priority services to high net worth customers.

BEA has complied with the HKMA's circular dated 9 January 2009, which requires all authorised institutions (including BEA) to implement various recommendations from the HKMA including, but not limited to, (i) physical segregation of their ordinary banking business from the retail securities business, (ii) information separation between ordinary banking accounts and investment accounts, and (iii) the separation of staff involved in the ordinary banking business and the sale of investment products.

### Acquisitions and organic growth

BEA aims to grow organically, by providing one-stop financial services to customers, and through acquisitions, by seeking expansion opportunities in Hong Kong and internationally that have the potential to enhance BEA's return on equity. For a discussion on recent or proposed acquisitions and disposals of businesses, see "*Recent Developments*" and "*Business of the Bank — Mainland China, Taiwan and Macau*".

### Focus on enhancing operational efficiency

BEA anticipates improvements in its operational efficiency following the centralisation of its back office functions at BEA Tower in Millennium City 5 in Hong Kong and the back office operating centre in Guangzhou. BEA aims to enhance efficiency and market competitiveness further. BEA's back-office operating centre in Guangzhou, incorporated under the name of East Asia Electronic Data Processing (Guangzhou) Limited, has enhanced operational efficiencies and BEA will also look to expand its operations and to identify appropriate operating functions for relocation to mainland China.

## BUSINESS OVERVIEW

BEA's core businesses are the acceptance of deposits and home mortgage lending in Hong Kong. As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, approximately 22.9%, 17.1%, 11.1% and 11.7%, respectively, of BEA's total advances to customers constituted advances to individuals for the purchase of residential property (including advances under GHOS, PSPS and TPS), and approximately 16.2%, 16.1%, 15.8% and 16.3%, respectively, comprised advances for property development and property investment. As at 30 September 2009, BEA had over 1.5 million retail customers in Hong Kong, which category includes retail customers and SMEs. BEA's general banking services include the provision of chequing and deposit accounts, ATMs and telephone banking, internet banking, mobile banking, foreign exchange services and money remittance. Other operations offered by BEA include consumer finance, credit cards, insurance, investment services, MPF services, trade finance, project finance, loan syndication, stock broking and asset management services.

As at 30 September 2009, BEA had 89 branches and 50 SupremeGold Centres in Hong Kong. BEA is a founding member of JETCO, which currently provides over 2,330 ATMs throughout Hong Kong, Macau and major cities in mainland China. BEA is also one of the founding members of EPSCO, which currently processes debit card transactions at more than 25,000 locations in Hong Kong, Macau and Shenzhen.

As at 30 September 2009, BEA had in total 48 branches, 52 sub-branches and 4 representative offices, as well as several affiliates and joint ventures outside of Hong Kong. In mainland China, Taiwan and Macau, BEA has 22 branches, 52 sub-branches and 3 representative offices. BEA (China) operates 18 branches and 49 sub-branches in mainland China and plans to expand its network in strategic locations in mainland China.

Services offered by BEA (China) in mainland China include Cyberbanking, Renminbi and foreign currency deposit-taking, remittance services, purchase and sale of foreign currencies, Renminbi forward services, SupremeGold accounts, Renminbi debit cards, Renminbi credit cards, credit card settlement services, private banking services, QDII services, derivative and investment products, agency services for general and life insurance

## Business of the Bank

products, wealth management services, cash management services, consumer loans, property mortgage loans, construction loans, property investment loans, working capital financing, project financing, trade finance facilities, accounts receivable financing, banker's acceptance, credit investigations, guarantees, standby letters of credit, entrusted loans, and cross border Renminbi trade settlement services. As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, approximately 18.6%, 24.9%, 29.8% and 28.7%, respectively, of the Group's assets and approximately 16.9%, 23.7%, 18,550%<sup>(1)</sup> and 44.7%, respectively, of BEA's consolidated profit before taxation for the years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009 were accounted for in mainland China, Taiwan and Macau.

At the conclusion of BEA's Annual General Meeting on 16 April 2009, Mr. Joseph Pang Yuk-wing, BEA's former Executive Director and Deputy Chief Executive, retired from his directorship. He was appointed as a Senior Advisor of BEA with a view to sharing his expertise with the senior management team and to supporting the future growth of BEA.

In April 2009, BEA restructured its senior management team by appointing two Senior Advisors, one Consultant, four Deputy Chief Executives and 11 General Managers with a view to further strengthening the management of the various business and operation units. Such appointments resulted in changes to the lines of reporting to the senior executive management as such to reflect the responsibility of resource allocation and performance assessment.

For the years ended 31 December 2006, 2007 and 2008, the Group's operating income and profit before taxation by business segment were as follows:

	Operating income/(loss)			Profit/(loss) before taxation		
	Years ended 31 December			Years ended 31 December		
	2006	2007	2008	2006	2007	2008
	(in HK\$ millions)			(in HK\$ millions)		
Personal Financial Services <sup>(1)</sup> .....	2,810	3,052	2,494	1,117	988	(41)
Corporate Banking <sup>(2)</sup> .....	2,288	3,416	4,890	1,270	1,934	2,467
Investment Banking <sup>(3)</sup> .....	1,735	1,288	(2,131)	1,554	1,525	(2,590)
Corporate Services <sup>(4)</sup> .....	599	760	817	238	314	305
Others <sup>(5)</sup> .....	116	270	327	123	346	(386)
Unallocated <sup>(6)</sup> .....	165	186	273	(42)	78	253
Inter-segment elimination .....	(149)	(158)	(213)	—	—	—
Total .....	<u>7,564</u>	<u>8,814</u>	<u>6,457</u>	<u>4,260</u>	<u>5,185</u>	<u>8</u>

### Notes:

- (1) Personal financial services includes branch operations, personal internet banking, consumer finance, property loans, credit card business and private banking to personal customers.
- (2) Corporate banking business includes corporate lending and loan syndication, asset based lending, commercial lending, enterprise lending, securities lending, trust services, MPF business and corporate internet banking.
- (3) Investment banking business includes treasury operations, securities broking and dealing, and provision of internet security trading services.
- (4) Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.
- (5) Other businesses include bancassurance, insurance business and property-related business.
- (6) Unallocated items mainly comprise the central management unit, bank premises, and any items which cannot be reasonably allocated to specific business segments.

### Note:

- (1) For the year ended 31 December 2008, the Group's financial performance was adversely affected by the one-off write down of HK\$3,549 million for its investments in CDOs and SIVs conducted in Hong Kong (see "Selected Statistical and Other Information — Asset Quality — Held-to-maturity Debt Securities"). The loss before taxation for Hong Kong operations for the period was HK\$1,876 million, and the Group's consolidated profit before taxation for the period was HK\$8 million. As a result, when the profit before taxation for the period for China operations (including Taiwan and Macau) (HK\$1,484 million) is compared against the Group's consolidated result, it accounts for 18,550% of the consolidated profit before taxation.

## Business of the Bank

The results for the year ended 31 December 2008 were severely affected by the global financial crisis following the collapse of Lehman Brothers. The difficult economic conditions led to a weak performance in the Personal Financial Services division where net interest income and non-interest income decreased by HK\$310 million and HK\$248 million respectively, and resulted in a HK\$41 million loss before taxation. For the Investment Banking business, the negative operating income and loss before taxation were a result of the one-off write off of CDOs and losses/reduced profits from the disposal of fixed assets, available for sale financial assets, held to maturity investments, subsidiaries and associates. The result from the Others segment mainly comprises a downward revaluation of investment properties.

After BEA restructured its senior management team in April 2009 and following BEA's adoption of the revised HKFRS 8 from 1 January 2009, the presentation of segment information in the notes to BEA's consolidated financial statements has been accordingly changed in a manner consistent with the way in which the information is reported internally to BEA's senior executive management for the purpose of resource allocation and performance assessment.

For the six months ended 30 June 2009, the Group's operating income and profit before taxation by business segment were as follows:

	Operating income/(loss)			Profit/(loss) before taxation		
	Six months ended 30 June			Six months ended 30 June		
	2009	2008	Increase/ (decrease)	2009	2008	Increase/ (decrease)
	<i>(in HK\$ millions, except percentage)</i>			<i>(in HK\$ millions, except percentage)</i>		
Hong Kong Region						
Personal Banking <sup>(1)</sup>	1,104	1,148	(3.8)%	331	535	(38.1)%
Corporate Banking <sup>(2)</sup>	805	355	126.8%	705	353	99.7%
Treasury Markets <sup>(3)</sup>	105	(590)	117.8%	84	(694)	112.1%
Wealth Management <sup>(4)</sup>	154	42	266.7%	81	(16)	606.3%
China Operations <sup>(5)</sup>	1,634	1,691	(3.4)%	731	841	(13.1)%
Overseas Operations <sup>(6)</sup>	565	454	24.4%	(37)	81	(145.7)%
Corporate Services <sup>(7)</sup>	400	408	(2.0)%	152	156	(2.6)%
Others <sup>(8)</sup>	347	321	8.1%	138	41	236.6%
Unallocated <sup>(9)</sup>	70	151	(53.6)%	(501)	(98)	411.2%
Inter-segment elimination	(233)	(295)	(21.0)%	(17)	(126)	(86.5)%
Total	<u>4,951</u>	<u>3,685</u>	<u>34.4%</u>	<u>1,667</u>	<u>1,073</u>	<u>55.4%</u>

### Notes:

- (1) Personal banking includes branch operations, personal internet banking, consumer finance, property loans and credit card business in Hong Kong.
- (2) Corporate banking includes corporate lending and loan syndication, asset based lending, commercial lending, and securities lending in Hong Kong.
- (3) Treasury markets includes treasury operations and securities dealing in Hong Kong.
- (4) Wealth management includes private banking business in Hong Kong.
- (5) China operations include branches and subsidiaries in China.
- (6) Overseas operations include overseas branches and subsidiaries.
- (7) Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.
- (8) Other businesses include insurance business and property-related business and other subsidiaries in Hong Kong.
- (9) Unallocated include supporting units of Hong Kong operation, investment properties, bank premises and investments in associates.

The results for the six months ended 30 June 2009 have improved significantly compared with the six months ended 30 June 2008 for a number of reasons. The Treasury Markets division recorded a significant mark-to-market gain on the equity and debt securities held by BEA and, compared to the year ended 31 December 2008, it did not record any substantial write-down or impairment on its portfolio. Similarly, the

## Business of the Bank

Corporate Banking division recorded substantially less impairment loss on its loans which BEA believes was due to effective credit control. The Corporate Banking division also made substantial profits as it was able to charge a higher margin for the loan facilities to its customers. The Wealth Management division recorded considerable growth due to the strong performance of its Private Banking business.

For the years ended 31 December 2006, 2007 and 2008, the Group's operating income and profit before taxation by geographical location were as follows:

	Operating income			Profit/(loss) before taxation		
	Years ended 31 December			Years ended 31 December		
	2006	2007	2008	2006	2007	2008
	<i>(in HK\$ millions)</i>			<i>(in HK\$ millions)</i>		
Hong Kong .....	5,756	5,938	2,962	3,069	3,568	(1,876)
People's Republic of China <sup>(1)</sup> .....	1,290	2,391	3,447	721	1,227	1,484
Other Asian Countries .....	363	446	525	238	229	381
Others .....	621	578	492	232	161	19
Inter-Segment Elimination .....	(466)	(539)	(969)	—	—	—
Total .....	<u>7,564</u>	<u>8,814</u>	<u>6,457</u>	<u>4,260</u>	<u>5,185</u>	<u>8</u>

For the six months ended 30 June 2009, the Group's operating income and profit before taxation by geographical location were as follows:

	Operating income			Profit before taxation		
	Six months ended 30 June			Six months ended 30 June		
	2009	2008	Increase/ (Decrease)	2009	2008	Increase/ (Decrease)
	<i>(in HK\$ millions)</i>			<i>(in HK\$ millions)</i>		
Hong Kong .....	2,701	1,565	72.6%	789	(16)	5,031.3%
People's Republic of China <sup>(1)</sup> .....	1,664	1,720	(3.3)%	745	856	(13.0)%
Other Asian Countries .....	295	273	8.1%	35	130	(73.1)%
Others .....	463	354	30.8%	98	103	(4.9)%
Inter-Segment Elimination .....	(172)	(227)	24.2%	—	—	—
Total .....	<u>4,951</u>	<u>3,685</u>	<u>34.4%</u>	<u>1,667</u>	<u>1,073</u>	<u>55.4%</u>

Note:

(1) This includes mainland China, Taiwan and Macau but excludes Hong Kong.

## HONG KONG

### Home Mortgages

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, home mortgages (including advances under GHOS, PSPS and TPS) in Hong Kong represented one of the most significant segments of the Group's total advances to customers, accounting for HK\$38,074 million, HK\$37,286 million, HK\$25,615 million and HK\$26,971 million, respectively, or approximately 22.9%, 17.1%, 11.1% and 11.7%, respectively, of the Group's total advances to customers. As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, advances under GHOS, PSPS and TPS accounted for HK\$1,118 million, HK\$1,041 million, HK\$1,318 million and HK\$1,635 million, respectively, or approximately 0.7%, 0.5%, 0.6% and 0.7%, respectively, of the Group's total advances to customers.

The majority of home mortgages are extended to buyers of housing units in Hong Kong who intend to occupy the premises, which include advances guaranteed by the Hong Kong Government under GHOS, PSPS and TPS to assist lower income families in purchasing homes. Other home mortgages are extended to individuals purchasing residential units for investment purposes.

As at 31 December 2008, the total advances outstanding for home mortgages decreased by HK\$11,671 million (31.3%) when compared against the corresponding figure as at 31 December 2007. This decrease was mainly due to the sale of HK\$9,302 million mortgage loans to The Hong Kong Mortgage Corporation Limited in December 2008. The sale of mortgage loans was part of BEA's normal procedures to manage the level of assets and liabilities of the Bank. The total advances outstanding for home mortgages increased by 5.3% to HK\$26,971 million as at 30 June 2009.

BEA intends to increase its market share in the mortgage business in 2009 by diversifying and customising the mortgage loans offered to its customers and providing tailor-made services to its existing and potential customers.

All home mortgage advances are secured by a first legal charge on the property and, in certain circumstances, BEA may also require personal guarantees as additional security. Home mortgages are mainly floating rate and repayable by instalments. In February 2009, BEA launched a fixed rate home mortgage plan which enables customers to lock in the existing low interest rate in 2009 and exercise better control over their financial planning. As at 30 June 2009, the average original advance maturity is approximately 19 years for home mortgages (excluding advances under GHOS, PSPS and TPS). The average size of a home mortgage advance (excluding advances under GHOS, PSPS and TPS) at origination is approximately HK\$1.6 million. For a discussion of BEA's loan-to-value lending limits applicable to home mortgage advances, see "*Selected Statistical and Other Information — Risk Management and Credit Policies*". For a discussion of BEA's lending rates applicable to home mortgage advances, see "*Selected Statistical and Other Information — Advance Portfolio — Advance Analysis*". BEA maintains close relationships with most property developers in Hong Kong, and this has enabled BEA to source a significant amount of home mortgage and commercial mortgage advance business.

### **Trade Finance and Commercial Mortgages**

Commercial mortgages comprise advances to individuals and SMEs to purchase retail shops, office space, factories and residential properties, whereas trade finance comprises loans to companies to accommodate their working capital requirements through overdraft facilities, short-term advances, trust receipts, invoice financing loans, corporate tax loans, export credit, packing loans and factoring facilities. BEA also provides treasury products and other trade finance related services to its customers, including advice on export documentary credits to be received by the customer, shipping guarantees, issuing all types of documentary credits, negotiation of bills under documentary credits and collection of bills.

All commercial mortgage advances are secured by a first legal charge over the property and, in some circumstances, by additional collateral such as time deposits, listed securities and other financial instruments that BEA deems acceptable. The average advance maturity is approximately 15 years for commercial mortgages. For a discussion of commercial mortgage advances, see "*Selected Statistical and Other Information — Advance Portfolio — Advance Analysis*".

The customers of BEA's trade finance services range from manufacturing companies to large trading companies and multinational corporations. BEA intends to continue to increase income contribution and market share from trade finance by providing its customers with more market-oriented products through its business managers. The trade finance sector in Hong Kong is well developed and, consequently, BEA is seeking to capitalise on its network in mainland China to market its trade finance services to the increasing number of customers with operations in mainland China.

Trade finance advances are made either on a fully or partially secured basis by way of a mortgage of property or cash collateral or on an unsecured basis. Factoring facilities are offered to exporters to provide financing through purchase of receivables as well as offering credit protection and receivables collection services. The receivables managed under factoring are assigned to BEA, and credit protection is supported by back-to-back credit insurance issued by accredited insurance agencies or covered by inter-factoring arrangements. BEA has guidelines in place for assessing mortgage credit, based on asset criteria (including, in the case of individual

customers, price, appraised value of the property, location, current market conditions and liquidity of the property) and customer criteria (including, in the case of individual customers, occupation, age, income and debt servicing ability). Trade finance advances typically have a relatively short maturity. For example, advances used to finance imports often have a maturity of only 90 to 120 days.

As at 30 June 2009, trade finance and commercial mortgages amounted to HK\$16,046 million, representing a decline, due to the adverse conditions in the financial markets and the global economy, of approximately 8% as compared to the corresponding period ended 30 June 2008, and accounted for approximately 6.9% of the Group's total advances to customers. As at 31 December 2008, trade finance and commercial mortgages amounted to HK\$16,390 million, representing a decline of approximately 0.8% as compared to the corresponding period ended 31 December 2007, and accounted for approximately 7.1% of the Group's total advances to customers. As at 31 December 2007, trade finance and commercial mortgages amounted to HK\$16,528 million, representing a growth of approximately 10.8% as compared to the corresponding period ended 31 December 2006, and accounted for approximately 7.6% of the Group's total advances to customers.

### **Consumer Finance**

The origination and marketing of consumer advances are managed by the Consumer Finance Department. Consumer advances include unsecured advances to individuals for purposes such as education, tax payments, travel and home improvement and decoration, and also include overdrafts. In addition, BEA also offers its consumers application facilities for personal advances through its Cyberbanking and ATM services.

BEA offers a series of lending programmes with varied product features including a personalised interest rate based on the relevant customer's credit standing, payment holidays and tax advance packages.

In response to the uncertain economic conditions in 2008 and the first half of 2009, BEA introduced stricter control over new customer advances in 2009. As at 30 June 2009, total customer advances outstanding amounted to HK\$930 million, representing a slight decrease of 0.2% as compared to 30 June 2008, and accounted for approximately 0.4% of the Group's total advances to customers as at 30 June 2009.

As at 31 December 2008, total customer advances outstanding amounted to HK\$1,010 million, representing a decline of approximately 5.0% as compared to 31 December 2007 as affected by the economic condition, and accounted for approximately 0.4% of the Group's total advances to customers as at 31 December 2008. As at 31 December 2007, the same amounted to HK\$1,063 million, representing a growth of approximately 4.8% as compared to 31 December 2006, and accounted for approximately 0.5% of the Group's total advances to customers as at 31 December 2007.

Credit Gain Finance Company Limited ("CGFC") is a wholly-owned subsidiary of BEA which has engaged in the Hong Kong sub-prime loan business since late 2006. As at 30 September 2009, CGFC operated through 13 branches across Hong Kong. In addition to unsecured loans, CGFC also offers various secured loan products to diversify its asset portfolio. The total portfolio balance of CGFC as at 31 December 2008 and as at 30 June 2009 was HK\$144 million and HK\$174 million, respectively, and represents 0.06% and 0.08%, respectively, of the total advances to customers of the Group.

### **Credit Cards**

As at 30 June 2009, credit card advances amounted to HK\$2,562 million which accounted for approximately 1.1% of the Group's total advances to customers and represented a growth of 3.2% as compared to 30 June 2008.

As at 31 December 2008, credit card advances amounted to HK\$2,997 million which accounted for approximately 1.3% of the Group's total advances to customers and represented a growth of 14.4% as compared to 31 December 2007. As at 31 December 2007, the same amounted to HK\$2,619 million which accounted for approximately 1.2% of the Group's total advances to customers and represented a growth of 8.7% as compared to 31 December 2006.

In February 2009, BEA launched a new premium card product, BEA World MasterCard, targeted at Private Banking and SupremeGold customers.

BEA has carried out promotional activities in 2009, with a focus on dining and entertainment in order to build habitual card usage and has also participated in offering promotional deals with restaurants and electronic merchants. The FLY&DINE Club features of BEA's credit cards have been overhauled with the aim of enhancing their appeal to the high-end credit card market.

BEA has also been focused on building up a younger client base, in particular the university student sector, as BEA believes the customers in this sector have the potential to become lifetime high-value customers of the Bank. Since 2007, BEA has extended its efforts to penetrate further into the young segment and lined up a series of exciting entertainment events to attract target customers from this segment.

BEA's increased focus on interest-generating segments is delivering results. By adopting a segmentation approach, BEA has been successful in improving interest income on its credit card business despite intense market competition.

BEA intends to continue to develop the credit card business and expects profits to increase as more customers are increasing their spending on BEA's credit cards.

### Insurance Products and Services

Blue Cross, acquired by BEA in December 1999, is a wholly-owned subsidiary of BEA and a part of BEA's bancassurance services. Blue Cross provides a comprehensive range of non-life products and services, including medical, travel, and general insurance, to cater for the needs of both individual and corporate customers. BEA believes that Blue Cross is one of the market leaders in the medical and travel insurance industry and has received major awards such as "Quality Life Award — Quality Insurance Service Award", "The Best Recommendation Awards", "Capital Weekly Service Award — Medical Insurance", "Caring Company", "The Most Popular Travel Insurance Company Award", "Hong Kong Top Service Brand Awards — Emerging Service Brand", "Superbrands", "High Flyer Achievement Award — Health Insurer", "M.I.S. Asia IT Excellence Award: Best Business Enabler — Banking & Finance" and "Hong Kong Award for Services — Innovation Award", throughout years in recognition of its contributions in the spheres of insurance provision and customer service.

In 2009, Blue Cross was rated "A- (Excellent)" for its financial strength and "a-" for its issuer credit rating by the rating agency A.M. Best Company, Inc.

BEA Life commenced its business in January 2008. BEA Life is a wholly-owned subsidiary of BEA and serves as BEA's life insurance arm. It underwrites and distributes a full range of life insurance products and services including whole life, endowment, annuity, term plans, and investment-linked products. In addition, BEA Life offers retirement and medical savings plans with varying features and scopes of coverage to meet the diverse needs of its customers.

Blue Cross and BEA Life distribute their products through 130 BEA branches and SupremeGold Centres, insurance agents, brokers, allied partners, and the BEA and Blue Cross websites. A number of new insurance plans, including "3-Year Quick Savings Insurance", "8-Year Smart Savings Insurance", "5-Year QuickPay Whole Life Insurance", "2-Year Fast Savings Insurance" and "Travel Protection" were launched in 2009 and have been well-received by customers.

To drive the growth of BEA's e-channel insurance business, four general insurance products (relating to travel, household, domestic helpers and personal accident) are available for direct purchase through the BEA insurance web page. BEA has also launched an insurance loyalty club as an incentive to customers for repeated purchases.

The total premium income of the insurance business for the six months ended 30 June 2009 was HK\$1,052 million, which increased by 0.3% as compared to the six months ended 30 June 2008. The non-life insurance premium income for the six months ended 30 June 2009 was HK\$429 million, a 7.5% increase as compared to the six months ended 30 June 2008. The life insurance premium income for the six months ended 30 June 2009 was HK\$623 million, a 4.2% decrease as compared to the six months ended 30 June 2008. For the life insurance business, premium income for the six months ended 30 June 2009, as calculated by New Business Index, an index defined as the total amount of all regular premium plus 10% of single premiums (life insurance policies which require one lump sum payment), was HK\$167 million, a 37.7% decrease as compared to the six months ended 30 June 2008. The decline in New Business Index was due to the slow recovery of customer confidence in buying investment and insurance products after the adverse conditions in the financial markets and the global economy.

### MPF Services and Other Trustee Services

In October 1999, Bank of East Asia (Trustees) Limited (“BEAT”), a wholly-owned subsidiary of BEA, was granted the status of an approved trustee under the Mandatory Provident Fund Schemes Ordinance (the “MPF Schemes Ordinance”). Through this subsidiary, BEA offers a full-range of MPF services, including trustee, scheme administration, investment management and custody services, to employers, employees and the self-employed persons. BEAT is one of two approved trustees under the MPF Schemes Ordinance licensed to offer both the Master Trust Scheme and Industry Scheme in Hong Kong.

BEAT has committed to offer its scheme members a wide range of investment choices. BEA (MPF) Master Trust Scheme currently offers ten constituent funds for investment namely, BEA (MPF) Growth Fund, BEA (MPF) Balanced Fund, BEA (MPF) Stable Fund, BEA (MPF) Asian Growth Fund, BEA (MPF) Greater China Growth Fund, BEA (MPF) Hong Kong Growth Fund, BEA (MPF) Japan Growth Fund, BEA (MPF) Global Bond Fund, BEA (MPF) Long Term Guaranteed Fund and BEA (MPF) Conservative Fund. With effect from 4 January 2010, BEA (MPF) Global Equity Fund and BEA (MPF) European Equity Fund are scheduled to be included as new constituent funds under the BEA (MPF) Master Trust Scheme. All constituent funds (except BEA (MPF) Long Term Guaranteed Fund and BEA (MPF) Conservative Fund) invest in two or more approved pooled investment funds based on the “fund-of-funds” approach. This investment strategy seeks to diversify risks and aims at enabling BEAT to obtain competitive investment returns for its MPF customers by taking advantage of the strengths of different fund houses.

Since their launch, BEA’s Master Trust Scheme and Industry Scheme have recorded stable growth in both membership and assets. Offering a wide range of products and providing some of the best investment returns in the market, BEA has built a reputation as one of Hong Kong’s premier MPF providers. For the four years from 2003 to 2006, BEA was consistently ranked as one of the top three MPF service providers according to the Yearly Mercer MPF Index. BEA also won the *AsianInvestor* magazine’s “Hong Kong MPF Master Trust of the Year” award as part of its 2007 Achievement Awards.

According to the latest Mercer MPF Index, for the three-month period ended 30 June 2009, BEA was ranked the Number One MPF service provider. Moreover, BEA Union Investment Management Limited, investment manager of the BEA MPF schemes, has won the “Best MPF Manager - 5 years” award as one of the Best of the Best Awards 2007, which was organised by *Asia Asset Management* magazine. In 2007, BEA also won the “Hong Kong MPF Master Fund of the Year” award, which was organized by *Asian Investor* magazine.

In addition to MPF services, BEAT also offers a complete range of trustee services to both individual and corporate clients. BEAT acts as executor and trustee of wills, administrator of estates and attorney administrator for overseas estates having assets in Hong Kong. BEAT also acts as trustee for family or other trusts and settlement, investment funds, unit trusts, charities, public funds and capital market issues. In addition, BEAT serves as an escrow agent for commercial transactions. For the six months ended 30 June 2009, BEAT recorded growth in revenue of approximately 22.3% as compared with the revenue levels for the six months ended 30 June 2008 from its private trust business.

### Internet Banking Services

Internet banking services provided by BEA include its Cyberbanking and Cybertrading services. Launched in September 1999, BEA’s Cyberbanking service allows customers to manage up to 12 separate bank accounts by accessing a single account on the internet, by fixed-line telephones and through mobile phones and PDAs. BEA’s Cyberbanking service offers a variety of banking functions, including balance enquiry, rate enquiry, funds transfer, placement and renewal of time deposit, bill payment, credit card transaction and redemption of bonus points for gifts, online application for mortgages and free property valuation services, gold trading using BEA’s online Passbook Gold Account, unit trust subscription and redemption, purchase of TravelSafe insurance and MPF account enquiry and contribution. In order to provide more flexibility for scheme members to manage their MPF accounts effectively, BEA launched a new service, Cyberbanking (MPF), in February 2008. Cyberbanking (MPF) enables scheme members to access their BEA MPF accounts via the internet to review their account balance, contribution and withdrawal history, current investments and obtain fund information.

As at 30 September 2009, BEA had over 464,000 registered Cyberbanking users. The average daily usage volume exceeded 267,000 transactions for the 12 months ended 30 September 2009. Corporate Cyberbanking has also recorded steady growth. As at 30 September 2009, over 22,500 corporate customers had registered with BEA’s corporate Cyberbanking, representing year-on-year growth of approximately 5.1% as compared to the corresponding figure on 30 September 2008.

In June 1999, BEA's Cybertrading service was launched by BEA's wholly-owned subsidiary, East Asia Securities. It was the first internet-based brokerage service offered by a bank in Hong Kong. The service allows customers to trade securities via the internet, Interactive Voice Recognition Trading System, mobile phone and PowerPhones, and by accessing the service at designated kiosks. In November 2000, East Asia Securities began to use its Broker Supplied System under AMS/3, which allowed its dealing operations to run under a fully automated straight-through processing environment.

For the six months ended 30 June 2009, East Asia Securities registered a 3% decrease in the number of Cybertrading accounts as compared to the six months ended 30 June 2008.

As at 30 June 2009, more than 60% of of East Asia Securities' securities clients had subscribed to Cybertrading. The volume of transactions executed via the Cybertrading platform, expressed as a percentage of total turnover, accounted for 61% of the number of trades and 45% of the gross transaction value for the six months ended 30 June 2009.

In June 2009, East Asia Securities launched a new promotional campaign for its securities trading services, intended to gain new securities clients and volume of transactions in anticipation of a potential recovery of the financial markets in 2009 and early 2010.

Futures Cybertrading Services was launched by BEA's wholly-owned subsidiary, East Asia Futures Limited ("East Asia Futures") in August 2004. BEA was the first bank in Hong Kong to offer online trading services for a wide range of futures and options that are traded on the Hong Kong Futures Exchange Limited. The Futures Cybertrading Services provides clients with access to the futures market, which in turn allows them to leverage their investment exposure, take advantage of price volatility in the market and hedge against existing positions, as well as exploit spread trading or arbitrage opportunities.

As at 30 June 2009, approximately 74% of East Asia Futures' clients had subscribed to the Futures Cybertrading Services. For the six months ended 30 June 2009, approximately 80% of BEA's total number of transactions relating to futures and options were traded on the Cybertrading platform. BEA believes that the high volume of online trading recorded by East Asia Futures and East Asia Securities suggests that online trading is becoming increasingly popular with retail investors.

In 2008, BEA upgraded the software and hardware of its Cybertrading platform with the intention of enhancing the performance and functionality of its online futures trading platform. East Asia Futures recorded a 19% increase in trading volume for the six months ended 30 June 2009 as compared to the six months ended 30 June 2008.

### **Bilateral Advances and Syndicated Advances**

BEA's corporate lending activities include meeting general corporate funding requirements, financing and refinancing of property development, as well as property investment and infrastructure projects. The majority of borrowers are medium- to large-sized Hong Kong companies, which typically use the funds for projects and investments in Hong Kong and mainland China.

BEA acts as arranger and participant in the Hong Kong syndicated lending market. The majority of BEA's syndicated advances are to local companies engaging in property development or investment in completed developments, large local conglomerates and large mainland Chinese private or state-owned enterprises. BEA's typical commitment per advance is between HK\$100 million and HK\$400 million. The Hong Kong corporate loan market exhibited weakness in 2008 and in the first half of 2009, as the impact of the adverse conditions in the financial markets and the global economy was felt through the Hong Kong economy. Liquidity tightened and loan demand slackened due to growing caution by local Hong Kong property investors and developers, and curtailed demand by mainland China enterprises due to weakening domestic demand in mainland China. Loan demand was mainly driven by refinancing needs and the syndicated lending market remained subdued until the third quarter of 2009.

Since the second quarter of 2009, the Hong Kong property and stock markets have staged a strong recovery, led by abundant liquidity in the financial markets and an improving Hong Kong credit environment. As a result, BEA registered single digit growth in corporate loan volume combined with relatively stable overall pricing for the six months ended 30 June 2009 as a whole.

During the six months ended 30 June 2009, interest margins on syndicated transactions continued to decline due to intense competition. In order to improve yield return and expand its client base prudentially, BEA has focused its marketing efforts on high quality local and mainland China enterprises and the provision of customised bilateral facilities.

The majority of the project financing in which BEA participates is extended on a recourse basis and is secured by the underlying project. Typically, BEA's commitments are between HK\$100 million and HK\$400 million per corporate advance and the average maturity between three and five years. Loan-to-value ratios for project financings are determined on a case-by-case basis. For construction projects, the maximum loan-to-value ratio is 60% of the total estimated completion value of the project. For most property financing, the advance is secured by a first legal charge over the underlying property and a charge over all receivables derived from the property. BEA has been targeting medium-sized borrowers as the margins of advances to these borrowers are generally more attractive than margins on unsecured syndicated advances to large property developers.

As at 30 June 2009, bilateral advances and syndicated advances outstanding totalled HK\$42,763 million, representing a growth of approximately 11.4% from 30 June 2008, and accounted for approximately 18.5% of the Group's total advances to customers as at 30 June 2009. As at 31 December 2008, bilateral advances and syndicated advances outstanding totalled HK\$37,452 million, representing a growth of approximately 2% from 31 December 2007, and accounted for approximately 16.3% of the Group's total advances to customers as at 31 December 2008. As at 31 December 2007, bilateral advances and syndicated advances outstanding totalled HK\$36,734 million, representing a growth of approximately 31.6% from 31 December 2006, and accounted for approximately 16.8% of the Group's total advances to customers as at 31 December 2007.

### **Wealth Management**

In July 2004, BEA's Wealth Management Division commenced operations with the objective of assisting clients to manage and accumulate their wealth by providing wealth management and financial planning services. By offering a wide range of products and services, the Wealth Management Division caters, in particular, to clients who are searching for better investment returns than bank deposits, better risk diversification than direct investment in stocks or bonds, or other tailor made investment solutions.

Services and products offered by the Wealth Management Division include, but are not limited to, investment advisory services, structured and treasury products, investment funds, insurance and premium financing, succession and estate planning services, services relating to the Capital Investment Entrance Scheme, asset custodian services, and discretionary asset management services. It also acts as the investment manager to authorised unit trusts including, but not limited to, lifestyle funds, Hong Kong equity funds and guaranteed funds.

BEA private banking services ("BEA Private Banking") was re-launched in late 2005, providing tailor made financial services to high net worth clients. The business has now been in operation for over 4 years and has achieved a critical mass in terms of clients and business turnover. BEA Private Banking increased the number of its clients by over 30% in 2008. BEA expects its private banking unit to become a significant part of its wealth management business.

BEA Private Banking has clients from many different countries although it continues to draw the majority of its clientele from mainland China. During the six months ended 30 June 2009, BEA acquired AIG Group's Taiwan wealth management business, which has been relaunched under the new name of BEA Wealth Management Services (Taiwan) Limited. BEA expects that there will be enhanced opportunities to promote wealth management services in Taiwan across the Group.

Since the collapse of Lehman Brothers, BEA has been focused on selling "vanilla" investment products to investors as interest in structured products has been low. In the second quarter of 2009 however, investors showed renewed interest in structured products and, as a result, the transaction volume in respect of structured products for the second quarter of 2009 was approximately twice the transaction volume in the first quarter. In June 2009, BEA also became the first bank in Hong Kong to obtain re-authorisation to offer equity-linked deposits.

In June 2009, BEA launched a global fixed income focused investment fund which invests in high-grade debt securities with a focus on sovereign issues, and an Asian biased equity and bond-blended product which seeks medium-term growth with short-term capital stability through exposure to a dynamically allocated portfolio of equity and debt securities. Both funds were launched in anticipation of greater demand for conservative asset classes and prudent approaches to diversification.

Over the 12 months preceding the date of this Offering Circular, BEA completed an upgrade of its financial planning system, which has enabled a wide range of information to be provided to the clients on their fund investments and returns.

As at 30 June 2009, the fund assets under custody of the Wealth Management Division increased by 23% as compared to the fund assets under custody as at 31 December of 2008. For the six months ended 30 June 2009, the division's operating income was HK\$154 million (up 267% from the six months ended 30 June 2008) and its profit before taxation was HK\$81 million (up 606% from the six months ended 30 June 2008).

Since the financial crisis and in response in the increase in claims against the banking sector for misselling of financial products in 2008 and 2009, the regulatory authorities in Hong Kong have introduced new guidelines and rules to protect investors. During the six months ended 30 June 2009, BEA reviewed its internal procedures and controls on risk exposures and implemented new measures governing the sale process for financial products. These measures include, for example, strict guidelines in categorising financial products based on objective criteria and standards. The increasing amount of regulation and investor protection measures has led to an increase in compliance cost. Considerable resources were also deployed by BEA Private Banking to enhance systems and controls.

### **Stock broking and Other Fee-based Activities**

In addition to the range of traditional banking products and services offered by BEA to its customers, BEA also provides equity and futures stock broking. Stock broking activities and dealings in Hang Seng Index futures, options and other derivative products are conducted through BEA and its wholly-owned subsidiaries, East Asia Securities and East Asia Futures Limited, on an agency basis for the execution of customers' orders.

The Group, through Tricor, provides business, corporate and investor services in the Asia Pacific region. These services include accounting, company formation, corporate compliance and company secretarial, executive search and selection, initial public offerings and share registration, payroll outsourcing and fund and trust administration.

Tricor is one of the key revenue contributors to the Group's fees and commission income. For the years ended 31 December 2006, 2007 and 2008 and for the six months ended 30 June 2009, fees and commission income attributable to Tricor was approximately 31.5%, 28.9%, 31.2% and 31.3%, respectively, of the Group's total fees and commission income. Tricor plans to further expand its scope of services in mainland China and in the Asia Pacific region. In early 2009, Tricor Malaysia acquired a majority interest in Roots Consulting, which provides training and consulting services in the field of corporate governance, performance management and risk management for companies. Tricor currently employs approximately 1,420 professional and support staff and provides services in 20 cities. Tricor will continue to look for business opportunities within the region.

BEA's other fee-based activities include corporate finance, merchant banking and other capital markets services, leasing, factoring, property agency and management services, insurance, trustee and share custodian services.

In June 2009, BEA entered into an agreement with the Industrial and Commercial Bank of China Limited ("ICBC") to acquire 75% interest in ICEA Finance Holdings Limited ("ICEA Finance") from ICBC. The transaction is expected to complete by the end of 2009, subject to the fulfillment of all the conditions precedent. BEA expects this acquisition will reinforce the Bank's position in the securities broking business. See "*Recent Developments*".

## **MAINLAND CHINA, TAIWAN AND MACAU**

BEA established its presence in mainland China when it set up its Shanghai branch in 1920. In 1979, BEA established the first Sino-foreign joint venture in mainland China and pioneered the provision of direct credit card settlement services in mainland China. In 1988, it became the first foreign bank to provide foreign currency mortgages for foreign individuals (including residents in Hong Kong, Taiwan and Macau). In 1995, BEA was awarded the “Best Foreign Bank in China” by Euromoney magazine. In 2002, BEA was the first foreign bank authorised to conduct internet banking business in mainland China and became the first foreign bank to obtain a licence to offer full foreign currency services at all its branches in mainland China. In 2005, BEA was among the first batch of the foreign banks that received approval to provide agency services for life insurance products in mainland China. In 2006, BEA was one of the first two foreign banks in mainland China to be granted QDII status and was the first foreign bank in mainland China to obtain a foreign exchange quota to conduct QDII business.

In 2007, BEA was one of the first foreign banks to establish a locally incorporated bank in mainland China and to conduct Renminbi business with local residents. BEA was awarded the “Best Foreign Retail Bank in China” by the Asian Bankers, one of the “Top 5 Foreign Banks” of the “China Business News Financial Brand Ranking 2007” as well as the “Best Foreign Subsidiary Bank in China” in the 2007 Asian Banks Competitive Rankings held during the 21st Century Annual Finance Summit of Asia.

In April 2008, BEA (China) launched a private banking service with the opening of private banking centres in Beijing, Shanghai, Guangzhou and Shenzhen. BEA (China) became the first foreign bank to launch Renminbi debit cards and Renminbi credit cards in China in May and December 2008, respectively. In 2008, BEA (China) was awarded the “2008 Best Internet Banking among Foreign Banks in China” by China Internet Weekly, the “Retail Financial Service Brand” in the 2008 China Business News Financial Brand Ranking and the “Best Foreign Retail Bank” in the 2008 Asian Banks Competitive Rankings held during the 21st Century Annual Finance Summit of Asia.

BEA (China)’s achievements were further recognised through a number of awards received during the six months ended 30 June 2009, including “Best Development Team for Information Technology”, “Best Information Technology Strategy Award” and “Best Technical Strategy Award” in 2008 from the National Information Evaluation Centre, “Best Financial Services in 2008” at the Golden-Shell Award of Finance hosted by the 21st Century Business Herald, and “30 Years of Reform and Opening-up - Leadership Award for Best Industry Contribution” from China Internet Week.

In July, 2009, BEA (China) issued RMB4 billion in aggregate principal amount of Renminbi bonds in Hong Kong, and was the first locally-incorporated foreign bank in mainland China to issue Renminbi bonds to retail investors in Hong Kong.

In September 2009, BEA (China) was granted the status of Domestic Settlement Bank and Domestic Agent Bank for cross border Renminbi trade settlement services.

As at 30 September 2009, BEA’s wholly-owned subsidiary, BEA (China), operated 18 branches in Shanghai, Shenzhen, Xiamen, Guangzhou, Zhuhai, Dalian, Xi’an, Beijing, Chengdu, Hangzhou, Chongqing, Qingdao, Shenyang, Wuhan, Nanjing, Tianjin, Hefei and Urumqi, as well as 49 sub-branches (9 in Shanghai, 8 in Shenzhen, 7 in Guangzhou, 4 in both Xiamen and Xi’an, 3 in each of Beijing, Chongqing, Dalian and Zhuhai, 2 in Chengdu, 1 in each of Hangzhou, Qingdao and Shenyang). BEA (China) also operates six 24-hour self-service banking centres and more than 310 automatic teller machines in major urban areas nationwide. In addition to the BEA (China) network, BEA also operates a branch in Shanghai to provide foreign exchange wholesale services to corporate customers in mainland China and has 3 representative offices in Fuzhou, Suzhou and Dongguan. BEA has also obtained preliminary approval to set up a new branch in Shijiazhuang, upgrade BEA’s Suzhou Representative Office into a full-service branch and establish 4 new sub-branches in mainland China. Under Supplement VI to the CEPA, with effect from 1 October 2009, banks in Hong Kong that have established branch outlets 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. To take advantage of these new measures, BEA has submitted and will submit further applications for the establishment of sub-branches in Guangdong.

## Business of the Bank

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BEA provides a full range of Renminbi and foreign currency banking services in mainland China, including, but not limited to, Cyberbanking, Renminbi and foreign currency deposit-taking, remittance services, purchase and sale of foreign currencies, Renminbi forward services, SupremeGold accounts, Renminbi debit and credit cards, credit card settlement services, private banking services, QDII services, derivative and investment products, agency services for general and life insurance products, wealth management services, cash management services, consumer loans, property mortgage loans, construction loans, property investment loans, working capital financing, project financing, trade finance facilities, accounts receivable financing, banker's acceptance, credit investigations, guarantees, standby letters of credit, entrusted loans, and cross border Renminbi trade settlement services.

In order to expand its presence in the mainland China market, BEA has been expanding the range of products and services it provides in mainland China and will seek to capitalise on the opportunities that it expects to arise following the PRC's accession to the WTO and from the CEPA between Hong Kong and mainland China.

BEA (China) intends to diversify its client base by extending its services coverage in mainland China via its Cyberbanking system and network of ATMs and 24-hour self service centres. Such automated systems will afford maximum convenience to its customers. BEA will also continue to extend its branch network prudently based on business demand.

BEA maintains two branches in Taiwan, which are located in Taipei and Kaohsiung. BEA completed the acquisition of BEA Wealth Management (Taiwan) Limited (formerly named AIG Wealth Management Services (Taiwan) Limited) in June 2009, which will provide a wide range of wealth management services, including securities brokerage, wealth management, insurance brokerage, and securities investment consultancy services for high net worth clients. The acquisition of an established platform complements BEA's existing commercial banking business and marks BEA's first step in wealth management in Taiwan. Other than the wealth management business, BEA in Taiwan also achieved moderate growth in both outstanding loans and deposits in the first half of 2009.

BEA maintains one branch, three sub-branches and 10 ATMs in Macau. To broaden its product range and increase commission income, BEA launched Cyberbanking and Securities Cybertrading services and distribute insurance products in Macau in the third quarter of 2009. In light of the unfavourable economic environment in 2009, BEA in Macau will continue to take a prudent approach in extending credit facilities to both corporate and retail customers.

For the years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, BEA's operations in mainland China, Taiwan and Macau accounted for approximately 16.9%, 23.7%, 18,550%<sup>(1)</sup> and 44.7%, respectively, of the Group's total profit before taxation and approximately 18.6%, 24.9%, 29.8%, 28.7%, respectively, of the Group's total assets as at 31 December 2006, 2007 and 2008 and as at 30 June 2009.

The main source of income for BEA's operations in mainland China, Taiwan and Macau is interest income on loans and the performance of this business area is largely driven by market conditions. As part of BEA's expansion plan, BEA aims to diversify into other business areas such as private banking such that BEA's dependence on interest income in these areas will gradually decrease in the future.

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**Note:**

- (1) For the year ended 31 December 2008, the Group's financial performance was adversely affected by the one-off write down of HK\$3,549 million for its investments in CDOs and SIVs conducted in Hong Kong (see "Selected Statistical and Other Information — Asset Quality — Held-to-maturity Debt Securities"). The loss before taxation for Hong Kong operations for the period was HK\$1,876 million, and the Group's consolidated profit before taxation for the period was HK\$8 million. As a result, when the profit before taxation for the period for China operations (including Taiwan and Macau) (HK\$1,484 million) is compared against the Group's consolidated result, it accounts for 18,550% of the consolidated profit before taxation.

## Business of the Bank

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, the total outstanding customer advances of mainland China, Taiwan and Macau branches were as follows:

	As at 31 December			As at 30 June
	2006	2007	2008	2009
	<i>(in HK\$ millions)</i>			
Trade Finance .....	122	150	105	86
Property Related Loans .....	16,523	37,639	43,181	42,111
Non-Property Related Loans .....	29,242	40,420	53,144	49,130
Others .....	311	357	456	386
Total .....	<u>46,198</u>	<u>78,566</u>	<u>96,886</u>	<u>91,713</u>

The primary strategic focus of BEA (China) is currently Renminbi-denominated lending, which as at 31 December 2006, 2007 and 2008 and as at 30 June 2009 amounted to HK\$26,531 million, HK\$57,058 million, HK\$70,337 million and HK\$72,403 million, respectively, or approximately 60.4%, 76%, 77% and 84%, respectively, of the total customer advances of BEA (China). Borrowers are companies registered to do business in mainland China and individual customers including local residents. BEA expects to further expand its Renminbi-denominated lending business as its existing customers continue to grow and demand for Renminbi advances remains strong.

Banking business in mainland China was opened to foreign banks in early 2007 as part of the PRC's WTO commitments. See "*Investment Considerations — Considerations Relating to BEA — Competition*". BEA believes that it has an advantage over other foreign banks planning to enter the mainland China banking market because its history and track record in mainland China provide BEA with extensive local knowledge and experienced local staff. Furthermore, although BEA (China) is considered to be a locally incorporated "foreign" bank in mainland China, BEA believes that banking with BEA (China) may be more attractive to some potential mainland China customers as compared to banking with other foreign banks which have a less extensive history of presence in China.

### International

BEA's international operations were commenced to meet the requirements of its core customers as their interests expand overseas from Hong Kong. BEA seeks to establish a presence in cities with large concentrations of overseas Chinese. The following table sets out BEA's branches, banking subsidiaries and representative offices outside Hong Kong, the PRC, Macau and Taiwan as at 30 September 2009.

Country	Location	Year Opened
Malaysia	Branch in Labuan; Representative office in Kuala Lumpur	1997 and 1997
Singapore	Branch in Singapore	1952
United States	Headquarters in New York; branch in New York Chinatown, Brooklyn and Flushing	1984, 2003, 2007 and 2007
	6 other branches in Los Angeles, California, namely Los Angeles, Alhambra, Temple City, Torrance, San Gabriel, Hacienda Heights	1991, 2001, 2003, 2005, 2008 and 2008
	5 branches in San Francisco, California, namely Clement, Noriega, South San Francisco, San Francisco Chinatown and Oakland	2006, 2006, 2008, 2008 and 2009
United Kingdom	Branches in London and Birmingham	1990 and 1997
Canada	Headquarters and branch in Richmond Hill, Ontario	1992
	3 other branches in Ontario, namely Scarborough, Markham and Mississauga	1996, 1997 and 1998
	2 branches in British Columbia, namely Richmond and Vancouver City	1994 and 2005
British Virgin Islands	Banking subsidiary in Tortola	1993

## Business of the Bank

BEA continues to strengthen its presence in the United States through its wholly-owned banking subsidiary, The Bank of East Asia (U.S.A.) N.A. (“BEAUSA”). BEAUSA opened a new branch in Oakland, California in January 2009, making a total of 13 branches in the United States (10 branches in California and 3 branches in New York).

BEA’s two wholesale branches in New York and Los Angeles grew operating income by 175% and 65% respectively, for the six months ended 30 June 2009 as compared to the six months ended 30 June 2008.

For a discussion of the risks relating to BEA’s operations in the United States, see “*Investment Considerations — Considerations relating to BEA — United States Operations*”.

In June 2009, BEA entered into an agreement with ICBC to sell a 70% interest in BEA’s subsidiary in Canada, The Bank of East Asia (Canada) (“BEA Canada”), to ICBC. BEA believes that the transaction will enable the Bank’s Canadian operation to leverage ICBC’s extensive global network. The transaction is expected to complete by the end of 2009 subject to the fulfillment of all the conditions precedent. See “*Recent Developments*”.

The Singapore branch of BEA completed the purchase of its new building at 60 Robinson Road in June 2009. The new building signifies BEA’s commitment to Singapore and Southeast Asia.

In Malaysia, BEA’s representative office in Kuala Lumpur continues to take an active role in cross referrals of business between Tricor Malaysia and AFFIN Bank Berhad, a subsidiary of AFFIN Holdings Berhad, in which BEA has a 20.85% shareholding.

BEA’s international strategy is to continue to focus on providing retail banking services to overseas Chinese individuals and SMEs.

### Group Structure

BEA is the holding company and the principal operating company of the Group. In addition, BEA has a number of significant subsidiaries and associated companies through which the Group conducts various operations such as stock broking, asset management and certain fee-based activities.

In 2008, the Group’s financial performance was severely affected by the adverse conditions in the financial markets and the deterioration in the global economy. As a result, for the year ended 31 December 2008, several of BEA’s subsidiaries each accounted for more than 10% of the consolidated net profit and loss of the Group, although BEA (China) was the only subsidiary which had a book value in excess of 10% of the Group’s consolidated total assets.

For the six months ended and as at 30 June 2009, except for BEA (China), none of BEA’s subsidiaries accounted for more than 10% of the consolidated net profit and loss of the Group or had a book value in excess of 10% of the Group’s consolidated total assets.

As at 30 June 2009, the Group’s principal subsidiaries were as follows:

Name of subsidiary	Place of incorporation and operation	Issued and paid-up capital	% held by		Nature of business
			The Bank	The Group	
Bank of East Asia (Trustees) Limited .....	Hong Kong	HK\$150,000,000	100%		Trustee
BEA Life Limited .....	Hong Kong	HK\$500,000,000	100%		Life insurance
BEA Pacific Asia Limited .....	Hong Kong	US\$13,000,000		100%	Investment holding
BEA Pacific Holding Company Limited .....	Bermuda	HK\$10,000	100%		Investment holding
Blue Cross (Asia-Pacific) Insurance Limited .....	Hong Kong	HK\$750,000,000	100%		Insurance
BEA Union Investment Management Limited .....	Hong Kong	HK\$10,000,000	51%		Asset management
Central Town Limited .....	Hong Kong	HK\$2	100%		Property investment
Credit Gain Finance Company Limited .....	Hong Kong	HK\$1	100%		Money lenders
East Asia Corporate Services (BVI) Limited.....	BVI	US\$250,000		75.61%	Registered agent and trustee services

## Business of the Bank

Name of subsidiary	Place of incorporation and operation	Issued and paid-up capital	% held by		Nature of business
			The Bank	The Group	
East Asia Facility Management Limited .....	Hong Kong	HK\$10,000		100%	Facility management
East Asia Financial Services (BVI) Ltd. ....	BVI	US\$24,096,000	100%		Investment holding
East Asia Futures Limited .....	Hong Kong	HK\$7,000,000	100%		Futures and options trading
East Asia Holding Company, Inc.* .....	USA	US\$5	100%		Bank holding company
East Asia Indonesian Holdings Limited .....	Seychelles	US\$100,000		100%	Investment holding
East Asia Investments Holdings (BVI) Ltd.....	BVI	HK\$186,038,725	100%		Investment holding
East Asia Investment Holdings Limited .....	Hong Kong	HK\$100,000,000	100%		Investment holding
East Asia Marketing Limited .....	BVI	US\$1		75.61%	Marketing services
East Asia Properties (US), Inc.* .....	USA	US\$5		100%	Property holding
East Asia Property Agency Company Limited.....	Hong Kong	HK\$1,000,000	100%		Property agency
East Asia Secretaries (BVI) Limited.....	BVI	HK\$300,000,000		75.61%	Investment holding
East Asia Securities Company Limited .....	Hong Kong	HK\$25,000,000	100%		Securities broking
East Asia Strategic Holdings Limited.....	BVI	US\$50,000,000	100%		Investment holding
Flowery World Corporation.....	BVI	US\$1		75.61%	Holding company
Skyray Holdings Limited.....	BVI	HK\$450,000,000	100%		Investment holding
Speedfull Limited.....	BVI	HK\$450,000,000		100%	Investment holding
The Bank of East Asia (Canada) .....	Canada	C\$58,000,000	100%		Banking services
The Bank of East Asia (China) Limited <sup>1</sup> .....	PRC	RMB¥8,000,000,000	100%		Banking and related financial services
The Bank of East Asia (U.S.A.) N.A.* .....	USA	US\$4,500		100%	Banking
Tricor Consultancy (Beijing) Limited <sup>1</sup> .....	PRC	US\$1,850,000		75.61%	Business consultancy in China
Tricor Holdings Limited .....	BVI	US\$7,001		75.61%	Investment holding
Tricor Holdings Pte. Limited.....	Singapore	S\$2		75.61%	Investment holding
Tricor Investor Services Limited .....	Hong Kong	HK\$2		75.61%	Investor services
Tricor Outsourcing (Thailand) Limited.....	Thailand	THB10,000,000		57.46%	Business outsourcing
Tricor Services Limited .....	Hong Kong	HK\$2		75.61%	Business, corporate and investor services
Tricor Singapore Pte. Ltd. ....	Singapore	S\$100,000		75.61%	Business management and consultancy services, and employment agency
Vitaway (Mauritius) Limited.....	Mauritius	US\$1		75.61%	Regional treasurer

### Notes

1. Represents a wholly foreign owned enterprise.
  2. BVI denotes the British Virgin Islands and PRC denotes the People's Republic of China.
- \* Companies not audited by KPMG. The accounts of the subsidiaries not audited by KPMG reflect total net assets and total income constituting approximately 1.6% and 2.2% respectively of the related consolidated totals.

## ORGANISATION

The Board of Directors of BEA is responsible for the overall management of the Group. To assist the Board of Directors in managing the Group, a number of committees have been established, including the Executive Committee, the Audit Committee, the Remuneration Committee and the Nomination Committee. The Executive Committee is responsible for reviewing all major functions and critical issues relating to the businesses and operations of the Group. The Audit Committee is responsible for reviewing the financial controls, internal control and risk management systems, annual report and accounts, and half-year interim report. The Remuneration Committee is responsible for making recommendations to the Board of Directors regarding BEA's

remuneration policy, and for the formulation and review of the specific remuneration packages of all Executive Directors and division heads of BEA. The Nomination Committee is responsible for recommending to the Board of Directors all new appointments and re-election of directors and division heads of BEA, and for the review of management succession plans for Executive Directors and division heads of BEA.

In addition to the Executive Committee, the Audit Committee, the Remuneration Committee and the Nomination Committee, BEA has a number of other committees which assist management in the operation of BEA. These include the Risk Management Committee, which is responsible for dealing with risk management related issues of the Group; Credit Committee, which is responsible for dealing with all credit risk related issues of the Group; the Asset and Liability Management Committee (“ALCO”), which is responsible for dealing with all issues relating to the market, interest rates, liquidity, strategic risks and capital management of the Group; Operational Risk Management Committee, which is responsible for dealing with all issues relating to the operational, legal and reputation risks of the Group; the Investment Committee, which is responsible for making investment decisions for, and reviewing, the proprietary positions of, BEA, East Asia Investment Holdings Limited and BEA Employees Provident Funds in respect of equity and equity-related investments as well as fixed income investments; the Policy Committee, which is responsible for discussing and formulating various strategies and policies for managing businesses and operations of the Group; and the Crisis Management Committee, which is responsible for developing and reviewing the Group’s strategy for managing crisis scenarios and taking charge of crisis situations which jeopardise or have the potential to jeopardise the Group and its reputation, liquidity/financial position and business continuity.

BEA has eleven divisions, each of which is responsible for a specific operational function. The divisions are the Personal Banking Division, the Corporate Banking Division, the Wealth Management Division, the Treasury Markets Division, the China Division, the International Division, the Strategic Planning & Control Division, the Operations Support Division, the Human Resources & Corporate Communications Division, Risk Management Division and Legal, Secretarial & Tax Division.

### PROPERTIES

BEA currently owns properties with aggregate floor areas of approximately 425,439 square feet, 471,737 square feet and 40,979 square feet on Hong Kong Island, in Kowloon and in the New Territories, respectively. Most of BEA’s properties are used as banking offices, as branches or for storage. The remainder are currently leased to third parties. In addition, BEA also leases properties with aggregate floor areas of approximately 60,798 square feet, 132,925 square feet and 62,825 square feet, on Hong Kong Island, in Kowloon and in the New Territories, respectively. These leased properties are used as banking offices, as branches or for storage. As at 30 June 2009, the fair value for BEA’s investment properties and bank premises amounted to HK\$2,218 million and HK\$7,880 million, respectively.

### INTELLECTUAL PROPERTY

The Group relies on domain name registrations to establish and protect its internet domain names. The Group has registered a number of internet domain names. The Group has also registered “The Bank of East Asia Limited cyber banking” as a trademark with the Hong Kong government.

### INSURANCE

BEA currently maintains insurance coverage to mitigate its risk. Such insurance can broadly be categorised into property insurance to cover the loss of or damage to building structure and content, electronic equipment and motor vehicles; public liability insurance to cover legal liability as a result of physical bodily injury and/or property damage caused to third parties; bankers blanket bonds insurance to cover the loss resulting from fraudulent acts by employees, loss of money on premises and in transit and forgery of bank instruments; professional indemnity insurance to indemnify BEA for loss arising out of claims for wrongful or negligent professional act; and directors’ and officers’ liability insurance to cover the personal liability of BEA’s directors and officers against any claims resulting from any wrongful act. There is a centralised independent function within BEA that handles the validity and adequacy of insurance coverage. BEA also requires borrowers to obtain appropriate insurance coverage for security provided by them.

## **COMPETITION**

The Hong Kong banking industry is mature and BEA faces competition from a number of Hong Kong incorporated banks and branches of international banks. In particular, competition in the credit card and in the residential mortgage lending businesses is intense. In addition, BEA faces competition from local finance companies in certain areas of its business, such as credit cards and hire purchase.

Although BEA is the largest independent local bank in Hong Kong in terms of assets, given increasing competition among the local banks in Hong Kong, the Group has placed greater focus on diversifying its revenue sources and increasing its fee based income, particularly from its wealth management and retail investment businesses. In addition, the Group is also focused on expanding its presence in mainland China through the establishment of BEA (China) and additional branches, sub-branches and representative offices in major cities in mainland China. However, in view of the fact that banking business in mainland China was opened to foreign banks in early 2007 as part of the PRC's WTO commitments, BEA expects competition in mainland China to continue to increase.

For a further discussion of the risks of competition faced by the Group in Hong Kong and China, see "*Investment Considerations — Considerations Relating to BEA — Competition*".

## **LITIGATION**

Save as disclosed below, neither BEA nor any of its subsidiaries is currently involved in any material litigation, arbitration or similar proceedings, and BEA is not aware of any such proceedings pending or threatened against it or any of its subsidiaries, which are or might be material in the context of the issue of the Notes.

### *Claim by a private banking client*

In two connected court proceedings initiated in September 2009 in the High Court of Hong Kong, a private banking client made a claim against BEA and another bank in Hong Kong for, among other things, damages in respect of investment losses allegedly resulting from certain misconduct of a former employee of BEA acting as the client relationship manager.

BEA intends to defend these proceedings rigorously and is in the course of preparing the relevant court documents. If BEA is unsuccessful in defending the claim, BEA estimates the maximum amount of exposure is approximately HK\$150 million. No provisions have been made by BEA as at 30 June 2009.

### *Repurchase of Lehman Brothers Mini-bonds subscribed or purchased through BEA*

On 22 July 2009, on a without liability basis, BEA entered into an agreement with the HKMA, the SFC and 15 other distributing banks pursuant to which BEA has made an offer to eligible persons to repurchase their holdings in structured investment products issued by Pacific International Finance Limited and arranged by Lehman Brothers group companies, commonly known as Lehman Brothers Mini-bonds, subscribed or purchased through BEA. BEA made an announcement on the same date setting out the details of the offer.

In the event that all eligible persons accept the offer and there is no future recovery from the underlying collateral of the outstanding Lehman Brothers Mini-bonds, the maximum commitment of BEA towards such purchase is HK\$109 million in accordance with the available information up to 13 October 2009. On this basis, BEA has already made full provision in its financial statements for the expected cost in respect of the repurchase of the above mentioned structured investment products.

As at 21 October 2009, approximately 96.8% of the eligible persons have accepted the offer. As at the date of this Offering Circular, no monetary or compensatory claim is outstanding against BEA in relation to the Lehman Brothers Mini-bonds subscribed or purchased through BEA. BEA is not subject to any investigation by any of the regulatory authorities in Hong Kong in relation to the Lehman Brothers Mini-bonds.

**EMPLOYEES**

As at 30 September 2009, the Group had a total of 10,454 employees as set forth in the following table:

	<u>No. of employees</u>
Commercial and retail banking .....	2,312
Head office and operational support .....	1,864
Overseas (mainland China only) .....	3,993
(excluding mainland China) .....	1,261
Subsidiaries .....	<u>1,024</u>
Total .....	<u><u>10,454</u></u>

As at 30 September 2009, approximately 23% of BEA's employees performed managerial and management functions.

Management believes that BEA maintains a good relationship with its employees and has not experienced any employment disputes. Other than certain local employees at its Singapore branch, none of BEA's employees are members of a trade union. BEA provides various benefits to its employees including housing, life and medical insurance benefits. While Hong Kong employees enjoy retirement benefits under either the MPF Scheme or the MPF exempted ORSO Scheme, BEA also maintains a pension fund scheme for its overseas employees in accordance with the relevant local practice and regulations. BEA also operates share option schemes under which options to purchase shares in BEA have been granted to eligible employees and executive directors. As at 30 September 2009, approximately 23,525,000 shares, representing approximately 1.26% of BEA's issued capital on a fully diluted basis, were issuable upon the exercise of options granted under BEA's share option schemes.

**PROTECTION OF DEPOSITORS**

BEA is a member of the Deposit Protection Scheme (the "Scheme"), which was launched in September 2006. Accordingly, all eligible depositors of BEA are automatically protected under the Scheme. On 14 October 2008, the Hong Kong government announced the use of the Exchange Fund to guarantee repayment of all customer deposits held with authorised institutions in Hong Kong, including the Bank, subject to the rules laid down in the Scheme. The guarantee took immediate effect and is scheduled to remain in force until the end of 2010.

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## Recent Developments

### **ACQUISITION OF SHARES IN ICEA FINANCE HOLDINGS LIMITED AND DISPOSAL OF SHARES IN THE BANK OF EAST ASIA (CANADA)**

In June 2009, BEA entered into an agreement with ICBC to acquire a 75% interest in ICEA Finance from ICBC for a total consideration of HK\$372.2 million (the “**Acquisition**”). Concurrently, BEA entered into an agreement with ICBC to sell a 70% interest in BEA’s subsidiary in Canada, BEA (Canada), to ICBC for a total consideration of C\$80.3 million (the “**Disposal**”). The two transactions are inter-conditional and completion of the transactions is expected to take place by the end of 2009, subject to the satisfaction of or compliance with all the conditions precedent, including receipt of relevant approvals from the regulators in Hong Kong, mainland China and Canada.

Upon completion of the Acquisition, ICEA Finance will become a wholly-owned subsidiary of BEA. Upon completion of the Disposal, BEA (Canada) will cease to be a subsidiary of BEA and will be held as to 30% by BEA and 70% by ICBC, and BEA and ICBC will continue to cooperate in the operations and management of BEA (Canada).

BEA believes that the two transactions will further strengthen BEA’s overall financial services capability and in particular the securities broking business. BEA also aims to leverage on the global strength of ICBC to reinforce the development of BEA (Canada).

### **STRATEGIC CO-OPERATION WITH CRITERIA**

In June 2009, BEA entered into a number of strategic co-operation agreements with Criteria CaixaCorp, S.A. (“**Criteria**”), a Spanish listed holding company controlled by “la Caixa”, a major shareholder of BEA and a leading financial institution in Spain. The agreements set out the framework and conditions on which any future changes in Criteria’s investment in BEA would be effected whilst preserving the Bank’s independence. The alliance with “la Caixa” Group enhances the Bank’s access to the financial industry in Spain, Europe and Latin America, and creates opportunities for potential joint business development in the Asia-Pacific region.

## Selected Statistical and Other Information

The selected statistical and other information set forth below relates only to the Group and has, except where otherwise indicated, been compiled as at and for each of the years ended 31 December 2006, 2007 and 2008 and as at and for each of the six months ended 30 June 2008 and 2009, and should be read in conjunction with the information contained elsewhere in this Offering Circular, including “*Business of the Bank*”.

### ADVANCE PORTFOLIO

#### Overview

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, the Group’s total outstanding advances to customers were HK\$166,178 million, HK\$218,184 million, HK\$230,339 million and HK\$231,392 million, respectively, which represented approximately 56.5%, 55.4%, 55.5% and 56.2%, respectively, of its total assets.

The majority of the Group’s advances are in respect of home mortgages and advances for property investment and development, which together, as at 31 December 2006, 2007 and 2008 and as at 30 June 2009, represented approximately 38.4%, 32.7%, 26.3% and 27.3%, respectively, (excluding advances under GHOS, PSPS and TPS) of the Group’s total advances to customers.

The table below sets forth a summary of the Group’s gross advances by sector as at the dates indicated.

#### The Group

	As at 31 December				As at 30 June			
	Percentage 2006	Percentage of total	Percentage 2007	Percentage of total	Percentage 2008	Percentage of total	Percentage 2009	Percentage of total
<i>(in HK\$ millions, except percentages)</i>								
Loans for use in Hong Kong Industrial, commercial and financial								
- Property development .....	6,423	3.9%	9,080	4.2%	8,855	3.9%	8,311	3.6%
- Property investment .....	20,465	12.3%	26,023	11.9%	27,431	11.9%	29,447	12.7%
- Financial concerns .....	1,865	1.1%	1,932	0.9%	2,542	1.1%	2,258	1.0%
- Stockbrokers .....	259	0.2%	659	0.3%	550	0.2%	3,493	1.5%
- Wholesale and retail trade .....	1,323	0.8%	1,469	0.7%	2,405	1.0%	2,193	1.0%
- Manufacturing .....	1,885	1.1%	1,934	0.9%	2,055	0.9%	2,113	0.9%
- Transport and transport equipment .....	4,118	2.5%	4,345	2.0%	3,642	1.6%	3,303	1.4%
- Recreational activities .....	316	0.2%	285	0.1%	285	0.1%	283	0.1%
- Information technology .....	3	—	5	—	4	—	9	—
- Others <sup>(1)</sup> .....	6,712	4.0%	9,673	4.4%	9,954	4.3%	11,960	5.2%
- Sub-total.....	<u>43,369</u>	<u>26.1%</u>	<u>55,405</u>	<u>25.4%</u>	<u>57,723</u>	<u>25.0%</u>	<u>63,370</u>	<u>27.4%</u>
Individuals								
- Loans for the purchase of flats in the GHOS, PSPS and TPS .....	1,118	0.7%	1,041	0.5%	1,318	0.6%	1,635	0.7%
- Loans for the purchase of other residential properties .....	36,956	22.2%	36,245	16.6%	24,297	10.5%	25,336	10.9%
- Credit card advances .....	2,409	1.5%	2,619	1.2%	2,997	1.4%	2,562	1.1%
- Others <sup>(2)</sup> .....	4,728	2.8%	5,450	2.5%	6,553	2.8%	7,084	3.1%
- Sub-total .....	<u>45,211</u>	<u>27.2%</u>	<u>45,355</u>	<u>20.8%</u>	<u>35,165</u>	<u>15.3%</u>	<u>36,617</u>	<u>15.8%</u>
Total loans for use in Hong Kong .....	88,580	53.3%	100,760	46.2%	92,888	40.3%	99,987	43.2%
Trade finance .....	3,465	2.1%	3,714	1.7%	2,905	1.3%	2,490	1.1%
Loans for use outside Hong Kong <sup>(3)</sup> .....	74,133	44.6%	113,710	52.1%	134,546	58.4%	128,915	55.7%
Total advances to customers .....	<u>166,178</u>	<u>100.0%</u>	<u>218,184</u>	<u>100.0%</u>	<u>230,339</u>	<u>100.0%</u>	<u>231,392</u>	<u>100.0%</u>

#### Notes:

- (1) “Others” includes the industry sectors of civil engineering works, electricity and gas, hotels, boarding houses and catering, non-stockbroking companies and individuals for the purchase of shares, professional and private individuals for other business purposes and all others not specified.
- (2) “Others” includes professional and private individuals for other private purposes.
- (3) This refers to loans to customers the proceeds of which are not used in Hong Kong.

## Selected Statistical and Other Information

### Geographical Concentration

The table below sets forth a summary of the Group's gross advances to customers by geographical location as at the dates indicated.<sup>(1)</sup>

	As at 31 December						As at 30 June	
	2006	Percentage of total	2007	Percentage of total	2008	Percentage of total	2009	Percentage of total
<i>(in HK\$ millions, except percentages)</i>								
Hong Kong .....	105,270	63.3%	123,539	56.6%	112,038	48.7%	118,160	51.1%
People's Republic of China <sup>(2)</sup> .....	35,323	21.3%	62,518	28.7%	85,741	37.2%	80,169	34.6%
Other Asian Countries <sup>(3)</sup> ..	9,090	5.5%	10,340	4.7%	10,798	4.7%	10,185	4.4%
Others <sup>(4)</sup> .....	16,495	9.9%	21,787	10.0%	21,762	9.4%	22,878	9.9%
Total .....	<u>166,178</u>	<u>100.0%</u>	<u>218,184</u>	<u>100.0%</u>	<u>230,339</u>	<u>100.0%</u>	<u>231,392</u>	<u>100.0%</u>

#### Notes:

- (1) The above geographical analysis has been classified by the location of the counterparties, after taking into account any transfer of risk.
- (2) This includes mainland China, Taiwan and Macau but excludes Hong Kong.
- (3) This includes all Asian countries other than mainland China, Taiwan, Macau and Hong Kong.
- (4) This includes North America, Western Europe and other countries outside Asia.

### Customer Advance Concentrations

The Banking Ordinance generally prohibits any bank incorporated in Hong Kong from maintaining a financial exposure to any single person or group of connected persons in excess of 25% of its capital base. For a discussion of "financial exposure", see "Regulation and Supervision — Regulation and Supervision in Hong Kong — Principal Obligations of Licensed Banks — Financial Exposure to Any One Customer". As at 30 June 2009, the Group's exposure to its 20 largest borrowers (including groups of individuals and companies) amounted to approximately HK\$36,364 million, or approximately 15.7% of the Group's gross advances, with the largest accounting for HK\$3,546 million, or approximately 1.5% of the Group's gross advances. As at 31 December 2008, the Group's exposure to its 20 largest borrowers (including groups of individuals and companies) amounted to approximately HK\$35,710 million, or approximately 15.5% of the Group's gross advances, with the largest accounting for HK\$4,034 million, or approximately 1.8% of the Group's gross advances. As at 31 December 2007, the Group's exposure to its 20 largest borrowers (including groups of individuals and companies) amounted to approximately HK\$32,517 million, or approximately 14.9% of the Group's gross advances, with the largest accounting for HK\$3,394 million, or approximately 1.6% of the Group's gross advances. As at 31 December 2006, the Group's exposure to its 20 largest borrowers (including groups of individuals and companies) amounted to approximately HK\$26,225 million, or approximately 15.8% of the Group's gross advances, with the largest accounting for HK\$3,484 million, or approximately 2.1% of the Group's gross advances.

### Advance Analysis

As a significant proportion of the Group's gross advances are made for the purchase of residential property, as at 31 December 2006, 2007 and 2008 and as at 30 June 2009, approximately 31.8%, 28.4%, 24.1% and 25.6% of advances had a remaining maturity of more than five years, respectively.

## Selected Statistical and Other Information

The table below sets forth a summary of the Group's gross advances by remaining maturity as at the dates indicated.

	As at 31 December						As at 30 June	
	2006	Percentage of total	2007	Percentage of total	2008	Percentage of total	2009	Percentage of total
<i>(in HK\$ millions, except percentages)</i>								
Repayable on demand <sup>(1)</sup> ..	4,110	2.5%	4,200	1.9%	4,437	1.9%	4,738	2.0%
3 months or less .....	30,385	18.3%	35,394	16.2%	42,013	18.2%	43,502	18.8%
1 year or less but over								
3 months .....	23,065	13.9%	33,382	15.3%	40,712	17.7%	32,101	13.9%
5 years or less but over								
1 year .....	54,202	32.6%	82,678	37.9%	85,835	37.3%	90,778	39.2%
After 5 years .....	52,827	31.8%	61,831	28.4%	55,411	24.1%	59,207	25.6%
Undated .....	1,589	0.9%	699	0.3%	1,931	0.8%	1,066	0.5%
Gross advances to customers .....	<u>166,178</u>	<u>100.0%</u>	<u>218,184</u>	<u>100.0%</u>	<u>230,339</u>	<u>100.0%</u>	<u>231,392</u>	<u>100.0%</u>

Note:

(1) Includes overdrafts.

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, approximately 85.8%, 87.2%, 93.4% and 94.2% of advances made by the Group were at floating rates of interest, respectively. See “— *Asset and Liability Management*”. The rate for home mortgage advances and commercial mortgage advances in Hong Kong is typically 2.75% below the prime rate (which is currently 5.25%). The interest rate for Hong Kong dollar consumer finance advances (other than overdrafts) is typically calculated on the initial principal amounts of such advances and typically ranges from 0.3% to 1.3% per month flat. The interest rate for Hong Kong dollar trade finance advances made by the Group is typically a margin over the prime rate. The interest rate for project finance lending and syndicated lending is typically a margin over the Hong Kong interbank offer rate (“HIBOR”). As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, approximately 58.0%, 50.5%, 44.8% and 47.3%, respectively, of advances made by the Group were denominated in Hong Kong dollars, approximately 17.3%, 15.2%, 17.6% and 14.2%, respectively, were denominated in U.S. dollars and approximately 16.0%, 26.2%, 30.5% and 31.3%, respectively, were denominated in Renminbi. Rates which are lower than the above rates may be offered by the Group under appropriate circumstances subject to internal approvals.

An important component of the Group's asset and liability policy is its management of interest rate risk, which is the relationship between market interest rates and the Group's interest rates on its interest-earning assets and interest-bearing liabilities. See “— *Asset and Liability Management*”

As at 31 December 2006, the amounts, in Hong Kong dollars, and percentages represented by fixed and floating-rate advances denominated in Hong Kong dollars and foreign currencies, respectively, were as follows:

	Advances outstanding as at 31 December 2006					
	HK dollar advances		Foreign currency advances		Total	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
<i>(in HK\$ millions, except percentages)</i>						
Fixed rate .....	11,888	12.3%	11,739	16.8%	23,627	14.2%
Floating rate .....	84,573	87.7%	57,978	83.2%	142,551	85.8%
Total .....	<u>96,461</u>	<u>100.0%</u>	<u>69,717</u>	<u>100.0%</u>	<u>166,178</u>	<u>100.0%</u>

## Selected Statistical and Other Information

As at 31 December 2007, the amounts, in Hong Kong dollars, and percentages represented by fixed and floating-rate advances denominated in Hong Kong dollars and foreign currencies, respectively, were as follows:

Advances outstanding as at 31 December 2007						
	HK dollar advances		Foreign currency advances		Total	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
<i>(in HK\$ millions, except percentages)</i>						
Fixed rate .....	14,252	13.2%	13,622	12.3%	27,874	12.8%
Floating rate .....	93,489	86.8%	96,821	87.7%	190,310	87.2%
Total .....	<u>107,741</u>	<u>100.0%</u>	<u>110,443</u>	<u>100.0%</u>	<u>218,184</u>	<u>100.0%</u>

As at 31 December 2008, the amounts, in Hong Kong dollars, and percentages represented by fixed and floating-rate advances denominated in Hong Kong dollars and foreign currencies, respectively, were as follows:

Advances outstanding as at 31 December 2008						
	HK dollar advances		Foreign currency advances		Total	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
<i>(in HK\$ millions, except percentages)</i>						
Fixed rate .....	6,644	6.8%	8,453	6.4%	15,097	6.6%
Floating rate .....	91,005	93.2%	124,237	93.6%	215,242	93.4%
Total .....	<u>97,649</u>	<u>100.0%</u>	<u>132,690</u>	<u>100.0%</u>	<u>230,339</u>	<u>100.0%</u>

As at 30 June 2009, the amounts, in Hong Kong dollars, and percentages represented by fixed and floating-rate advances denominated in Hong Kong dollars and foreign currencies, respectively, were as follows:

Advances outstanding as at 30 June 2009						
	HK dollar advances		Foreign currency advances		Total	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
<i>(in HK\$ millions, except percentages)</i>						
Fixed rate .....	6,064	5.8%	7,340	5.8%	13,404	5.8%
Floating rate .....	98,456	94.2%	119,533	94.2%	217,989	94.2%
Total .....	<u>104,520</u>	<u>100.0%</u>	<u>126,873</u>	<u>100.0%</u>	<u>231,393</u>	<u>100.0%</u>

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, at least 70% of the Group's advances were secured by collateral. Home mortgages are secured by a first legal charge over the underlying property. Working capital advances for businesses are typically secured by fixed and floating charges over land, buildings, machinery, inventory and receivables. Term advances for specific projects or developments are typically secured against the underlying project's assets and its receivables, while additional guarantees are typically provided by the sponsors or shareholders. The Group also receives guarantees in relation to certain of its other advances to cover, in the case of trade finance, any shortfall in security or, in the case of consumer advances to younger or less financially secure customers, to provide security on what are normally unsecured advances.

All forms of security taken as collateral against credit facilities are monitored by the respective departments which extended the advances. In general, the collateral is periodically valued by an independent valuer to determine whether any additional collateral is required.

## **RISK MANAGEMENT AND CREDIT POLICIES**

The Group's lending policies have been formulated on the basis of its own experience, the Banking Ordinance, HKMA guidelines and policies issued by the Hong Kong Association of Banks and other statutory requirements (and, in the case of overseas branches and subsidiaries, the relevant local laws and regulations). BEA believes it has a history of, and reputation for, prudent lending practices. The majority of the Group's lending is on a secured basis, and the Group has established loan-to-value lending limits based on the appraised market value of the relevant collateral.

### ***Risk Management***

In April 2009, BEA established an enterprise-wide risk structure with a centralised risk management unit (the "Risk Management Division").

The Risk Management Division is headed by the Group Chief Risk Officer & General Manager, who reports directly to the Chairman & Chief Executive and is responsible for initiating, implementing and monitoring risk management policies throughout the Group with regard to different types of risk. The Risk Management Division assesses regulatory requirements, in particular the requirements under the Supervisory Policy Manuals issued by the HKMA, and is responsible for:

- (i) formulating risk management policies and guidelines and performing regular reviews in order to ensure that such policies and guidelines are kept up to date;
- (ii) monitoring risk exposure and compliance with the risk management framework using a risk-based approach that incorporates independent risk assessment and review of regular reports and new products/specific issues;
- (iii) co-ordinating risk-related projects;
- (iv) reporting monitoring results and significant risk related issues to the specialised risk management committees, namely, Credit Committee, ALCO and Operational Risk Management Committee, and/or Risk Management Committee and/or the Board, where appropriate, so as to assist them to discharge their duty of oversight of risk management activities. Departments within the Risk Management Division have been assigned responsibility for different types of risk, including credit risk, interest rate risk, legal risk, liquidity risk, market risk, operational risk, reputational risk and strategic risk.

For interest rate risk, ALCO sets the strategy and policy for managing interest rate risk and the means for ensuring that such strategy and policy are implemented. The Risk Management Division is responsible for monitoring interest rate related activities to ensure compliance with the related bank policies, rules and regulations. The Internal Audit Department performs periodic review, to make sure the interest rate risk management functions are effectively carried out.

For the banking book, additional monitoring focuses on the repricing mismatches. Gap analysis provides a static view of the maturity and repricing characteristics of BEA's balance sheet positions. Repricing gap limits are set to control BEA's interest rate risk.

Sensitivity analysis on earnings and economic value to interest rate changes is assessed through a hypothetical interest rate shock of 200 basis points across the yield curve on both sides of the balance sheet and performed on a monthly basis. Sensitivity limits are set to control the Bank's interest rate risk exposure under both earnings and economic value perspectives. The ALCO monitors the results thereof and decides remedial action if required.

In addition to the above, the ALCO sets the strategy and policy for managing liquidity risk and the means for ensuring that such strategy and policy are implemented.

BEA monitors its liquidity position on a daily basis to ensure the Group's funding needs can be met and the statutory liquidity ratio is complied with. The average consolidated liquidity ratio was approximately 44.0%, 43.5%, 38.4% and 43.8% for the years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, respectively, which is above the statutory minimum ratio of 25%.

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By holding sufficient liquid assets (e.g. cash and short term funds and securities) of appropriate quality, BEA ensures that short term funding requirements are covered within prudent limits. Adequate standby facilities are maintained to provide strategic liquidity to meet unexpected and material cash outflows in the ordinary course of business.

Stress testing is regularly conducted to analyse liquidity risk. A contingency plan is in place which sets out a strategy for dealing with a liquidity problem and the procedures for making up cash flow deficits in emergency situations.

### Credit Policies

The Group's primary credit approval body is the Credit Committee, which comprises two Senior Advisors, four Deputy Chief Executives, two General Managers (one of whom is the Group Chief Risk Officer). The Credit Committee has overall responsibility for the Group's credit policies and oversees the credit quality of the Group's advance portfolio. Under the oversight of the Credit Committee, officers of the Group are authorised to approve credit based on the size of the advance, the collateral provided, the credit standing of the applicant and other prescribed credit guidelines. The following table sets out the credit approval limits for various types of advances in Hong Kong.

	Hong Kong		
	Trade finance	Advances secured by collateral	Unsecured consumer advances
<i>(in HK\$ millions)</i>			
Credit Committee .....	Any amount	Any amount	Any amount
Division Head .....	80 (20) <sup>(1)</sup>	80	20
Department Head .....	30 (5) <sup>(1)</sup>	30	2
Manager (Levels M4 to SM2) .....	1.5 (0.5) to 7.5 (3.5) <sup>(1)</sup>	4 to 20	0.2 to 0.9

Note:

(1) The numbers in parentheses represent credit limits for unsecured portions of advances.

The Credit Risk Management Department under the Risk Management Division is responsible for reviewing credit applications for significant loan amounts. When a customer fills out an advance application or requests a credit line, the branch or lending department account officer collects information through customer interviews, documentation requests and feasibility studies as well as other sources. After a thorough evaluation, the account officer may approve the application if the amount is within his lending authority. If the amount exceeds his lending authority, then the application is submitted to the appropriate person having a higher level of lending authority.

BEA has adopted lending policies with loan-to-value limits which apply to advances secured by a legal charge over an asset or property. Loan-to-value ratios on home mortgages (excluding advances under GHOS, PPS and TPS) are limited to 70%. Underlying property values are based on the lower of the purchase price and the independently appraised value of the property. BEA's lending policies also limit the maximum monthly repayment amount to 60% of the gross household income of the borrower. For commercial mortgage advances, BEA's policy is to limit the advance to 70% of the lower of the purchase price and the independently appraised value of the property.

Hong Kong has adopted the Basel II Accord capital adequacy standards from the beginning of 2007. In December 2007, BEA received the approval from the HKMA to adopt the advanced approaches under the Basel II Accord, namely the Foundation Internal Ratings-based ("IRB") Approach for credit risk, the Internal Models Approach for market risk and the Standardised Approach for operational risk. Since 31 December 2007, BEA has used the IRB Approach to determine its credit risk weighted assets for calculating the Capital Adequacy Ratio. The business benefits of adopting these advanced approaches are significant, including enhanced risk management, more efficient use of capital and higher transparency in the disclosure of risk-related information.

### ASSET QUALITY

#### Overview

The performance of the Hong Kong economy is heavily dependent on the property sector, and, as at 31 December 2006, 2007 and 2008 and as at 30 June 2009, property lending (excluding advances under GHOS, PSTS and TPS) accounted for approximately 38.4%, 32.7%, 26.3% and 27.3%, respectively, of the Group's total advances to customers. As a result, the Group's asset quality is vulnerable to deflation in property prices. The ability of borrowers, including homeowners, to make timely repayment of their advances may be adversely affected by rising interest rates or a slowdown in economic growth. See "*Investment Considerations — Considerations Relating to BEA — Hong Kong Economy*" and "*Investment Considerations — Considerations Relating to BEA — Interest Rate Risk*". As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, home mortgage advances (including advances under GHOS, PSPS and TPS) in Hong Kong amounted to HK\$38,074 million, HK\$37,286 million, HK\$25,615 million and HK\$26,971 million, respectively, or approximately 22.9%, 17.1%, 11.1% and 11.7%, respectively, of the Group's total advances to customers and was one of the most significant segments of the Group's total advances to customers. See "*Investment Considerations — Considerations Relating to BEA — Concentration Risk — Exposure to the Property Market*".

The Group is committed to expanding its business and operations in the PRC and remains susceptible to risks associated with lending in the PRC, which could lead to an increase in the Group's classified advances. As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, BEA's PRC exposure is approximately 27.8%, 36.0%, 42.1% and 39.6%, respectively, of the Group's total advances and its PRC classified advances account for approximately 0.2%, 0.3%, 0.3% and 0.3%, respectively, of its total PRC exposure. See "*Investment Considerations — Considerations Relating to BEA — Exposure to Mainland China Market*".

#### Advance classification

The Group classifies the advances in a "two dimensional" structure: one dimension reflects exclusively the borrower's repayment ability and another dimension reflects the transaction specific characteristics.

The dimension that reflects the borrower's repayment ability is classified into the following grading:

- Grades 1 through 15 — pass;
- Grade 16-17 — special mention;
- Grade 18 — sub-standard;
- Grade 19 — doubtful; and
- Grade 20 — loss.

In classifying the individual borrowers into one of the 20 gradings, the Group considers relevant factors including: (i) estimation of probability of default from the internal rating systems comprising statistical measurement and expert judgement with consideration of quantitative and qualitative elements such as the borrower's financial condition, the management and operation of the borrower's business, market conditions affecting the borrower's industry and demographic characteristics; (ii) the payment history of the borrower; and (iii) the history of the Group's dealings with the borrower concerned.

Another dimension that reflects the transaction specific characteristics considers relevant factors including: (i) type of advance; (ii) seniority of the advance; and (iii) credit mitigation such as collateral and guarantee.

BEA believes that its advance classification policy is in compliance with the Banking Ordinance and the applicable guidelines of the HKMA.

#### Recognition of impaired loans

The Group's impaired loans are sub-divided into three categories: "sub-standard" (Grade 18), "doubtful" (Grade 19) and "loss" (Grade 20). When the repayment of an advance is uncertain (for example, there is a past-due record of 90 days or more), the Group downgrades the advance to sub-standard. If full recovery of the advance

## **Selected Statistical and Other Information**

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is in doubt and the Group expects to sustain a loss of principal or interest, the Group classifies the advance as doubtful. Loss advances are those which are considered non-collectible after exhausting all collection efforts, such as the realisation of collateral and the institution of legal proceedings, and the liquidator or official receiver has ascertained the relevant recovery ratio.

### **Accrual of interest**

Prior to 1 January 2005, the Group followed the HKMA guidelines on “Recognition of Interest”, under which interest accrual was suspended if there was a reasonable doubt on the ultimate collectibility of the advances, taking into consideration both qualitative and quantitative factors. In particular, if the advances were overdue for over three months and the net realisable value of the security was insufficient to cover the principal and accrued interest, then interest accrual would have been suspended.

However, since 1 January 2005, following the coming into effect of HKAS 39, interest suspension is no longer permitted. For impaired loans, the accrual of interest income based on the original terms of the loan is discontinued, but any increase in the present value of impaired loans due to the passage of time is reported as interest income.

### **Impairment of Loans and Receivables**

At each balance sheet date, the carrying amount of the Group’s assets are reviewed to determine whether there is objective evidence of impairment. If internal and external sources of information indicate such evidence exists, the carrying amount is reduced to the estimated recoverable amount and an impairment loss is recognised in the profit and loss account.

The total allowance for impairment losses consists of two components: individual impairment allowances, and collective impairment allowances.

The individual impairment allowance is based upon management’s best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgments about the borrower’s financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Group. Each impaired asset is assessed on its own merits.

In assessing the need for collective loan loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Group makes assumptions both to define the way the Group models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the impairment allowances the Group makes depends on how well the Group can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Group believes that the impairment allowances on loans and advances to customers are reasonable and supportable and that its provisioning policies are in compliance with the Banking Ordinance and the applicable guidelines of the HKMA.

Where there is no reasonable prospect of recovery, the loan and the related interest receivables are written off.

Since 1 January 2005, following the coming into effect of HKAS 39, general provisions (not less than 1% of the total advances to customers) have become portfolio provisions, which are calculated monthly by collective assessment at a rate determined according to historical loss experience on a semi-annual basis. The assessable advance portfolio excludes those impaired loans under individual assessment for impairment loss.

## Selected Statistical and Other Information

The table below sets forth a summary of the Group's impairment allowance for the periods indicated:

	Years ended 31 December			Six months ended 30 June	
	2006	2007	2008	2008	2009
<i>(in HK\$ millions, except percentages)</i>					
<b>Provisions for impairment allowance:</b>					
Beginning balance .....	813	732	728	728	1,076
Provision during the period/year .....	412	414	779	213	532
Bad debts charges recovered .....	(168)	(198)	(221)	(124)	(58)
Loans written-off .....	(423)	(341)	(351)	(262)	(256)
Other movements .....	98	121	141	118	45
Closing balance.....	<u>732</u>	<u>728</u>	<u>1,076</u>	<u>673</u>	<u>1,339</u>
<b>Provisions for impairment allowance as a percentage of:</b>					
Total loans at period/year end .....	0.4%	0.3%	0.5%	0.3%	0.6%
Total impaired loans at period/year end .....	56.6%	58.6%	67.8%	51.3%	56.6%
<b>Write-offs as a percentage of:</b>					
Average total loans during the period/year .....	0.3%	0.2%	0.2%	0.1%	0.1%
Total loans at period/year end .....	0.3%	0.2%	0.2%	0.1%	0.1%
Total impaired loans at period/year end .....	32.7%	27.5%	22.1%	20.0%	10.8%

As at 30 June 2009, the provision for impairment allowance was HK\$1,339 million which had increased by HK\$263 million and HK\$666 million as compared to the provision as at 31 December 2008 (HK\$1,076 million) and 30 June 2008 (HK\$673 million) respectively. A larger provision was recorded as at 30 June 2009 as there was an increase in both the collective impairment allowance and the individual impairment allowance which reflected an overall increase in the credit risk in the market. BEA believes its provisions for impaired loans are appropriate and adequate in the current uncertain economic environment.

For the six months ended 30 June 2009, HK\$58 million of bad debts had been recovered, which represents a decrease of HK\$66 million as compared against the bad debts recovered for the six months ended 30 June 2008. The decrease in recovery reflects the increasing difficulty in recovering bad debts since the onset of the financial crisis.

### Top Ten Impaired Loans

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, the Group's ten largest impaired loans accounted for approximately 0.4%, 0.3%, 0.3% and 0.5%, respectively, of its total advances and approximately 46.0%, 52.7%, 43.4% and 53.6%, respectively, of its gross impaired loan portfolio. The majority of the borrowers of such ten largest impaired loans were engaged in property development and recreational activities and accounted for approximately 71.3%, 71.1%, 45.8% and 53.5% of the aggregate exposure relating to such ten largest impaired loans as at 31 December 2006, 2007 and 2008 and as at 30 June 2009, respectively. As at 30 June 2009, the Group's exposure under its ten largest impaired loans ranged from HK\$53 million to HK\$523 million per impaired loan, and amounted to approximately HK\$1,268 million in the aggregate. As at 31 December 2008, the Group's exposure under its ten largest impaired loans ranged from HK\$48 million to HK\$156 million per impaired loan, and amounted to approximately HK\$688 million in the aggregate.

### Impaired Loans That Have Been Restructured

The Group's classified advances/impaired loans are restructured on a case-by-case basis, subject to the approval of the appropriate lending parties for both the restructured limits and recovery measures. The Group believes that it maintains a prudent reclassification policy. For example, if payments under an advance are rescheduled, that advance will not be reclassified and will remain under adverse classification (either as a "sub-standard" or "doubtful" advance) and may only be upgraded to a pass advance if the revised payment terms are honoured for a period of six months, in the case of monthly payments, and 12 months, in the case of quarterly or semi-annual repayments.

## Selected Statistical and Other Information

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009 the Group's impaired loans including those that have been restructured through the rescheduling of principal repayments and deferral or waiver of interest were as follows:

	As at December		As at 30 June	
	2006	2007	2008	2009
	<i>(in HK\$ millions, except percentages)</i>			
Gross impaired loans .....	1,294	1,242	1,586	2,366
Aggregate individual impairment loss allowance .....	254	264	523	667
Net impaired loans .....	<u>1,040</u>	<u>978</u>	<u>1,063</u>	<u>1,699</u>
Gross impaired loans as a percentage of total loan portfolio ....	0.8%	0.6%	0.7%	1.0%
Net impaired loans as a percentage of total loan portfolio .....	0.6%	0.4%	0.5%	0.7%

### Held-to-maturity Debt Securities

The Group's held-to-maturity debt securities included listed and unlisted debt securities. As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, the book value of these securities were HK\$10,249 million, HK\$10,761 million, HK\$5,006 million and HK\$7,374 million, respectively, which represented approximately 30.5%, 30.5%, 16.9% and 17.8% of the Group's total investments in securities, respectively. These debt securities included both Hong Kong dollar and U.S. dollar denominated bonds and notes. See "*— Asset and Liability Management*".

In September 2008, rumours that BEA believes to be unfounded were disseminated in Hong Kong questioning the liquidity and stability of BEA. Those rumours triggered a bank run on BEA and, in response, BEA sold its holding of U.S.\$470 million principal amount of United States Treasury Notes as a precautionary measure to maintain the liquidity position of the Bank (see "*Investment Considerations — Considerations relating to BEA — Maintaining the Growth Rate in Customer Deposits*"). The proceeds of the sale, however, was not required as the bank run was contained after two days. The decrease in the amount of held-to-maturity debt securities as at 31 December 2008 was largely accounted for by this sale of United States Treasury Notes.

All, except two, of the CDOs held by BEA were disposed of during the year ended 31 December 2008. The two residual CDOs relate to a subsidiary of Lehman Brothers. The fair value of such CDOs was written down to zero as at 31 December 2008. Losses arising from one-off write down of the CDOs portfolio for the year ended 31 December 2008 amounted to HK\$3,549 million. The fair value of the CDOs held by BEA as at 30 June 2009, amounted to zero. As it is now infeasible to dispose of the two residual CDOs pending the conclusion of the proceedings relating to Lehman Brothers, BEA intends to hold them until their respective disposal become possible. It is expected that part of the write down losses may be recovered at the ultimate disposal of the two CDOs.

The fair value of all, except one, of the SIVs held by BEA as at 31 December 2008 were written down to zero as at 31 December 2008, which led to one-off write-down losses of HK\$243 million. The fair value of the remaining SIV held by BEA as at 30 June 2009, amounted to HK\$413,400 (U.S.\$53,000).

The CDOs and SIVs were purchased according to BEA's investment guidelines. BEA has not made any additional investments in CDOs and SIVs since July 2007 and April 2007, respectively.

## Selected Statistical and Other Information

The table below sets forth a summary of the carrying values of the Group's held-to-maturity debt securities, categorised by the types of issuers as at the dates indicated:

	As at 31 December						As at 30 June	
	2006		2007		2008		2009	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
<i>(in HK\$ millions, except percentages)</i>								
Held-to-maturity securities issued by:								
Central governments and central banks .....	5,417	52.9%	5,411	50.3%	243	4.8%	673	9.1%
Public sector entities .....	746	7.3%	664	6.2%	318	6.4%	554	7.5%
Banks and other financial institutions .....	2,882	28.1%	3,508	32.6%	3,344	66.8%	5,182	70.3%
Corporate entities .....	1,204	11.7%	1,178	10.9%	1,101	22.0%	965	13.1%
<b>Total .....</b>	<b>10,249</b>	<b>100.0%</b>	<b>10,761</b>	<b>100.0%</b>	<b>5,006</b>	<b>100.0%</b>	<b>7,374</b>	<b>100.0%</b>

## ASSET AND LIABILITY MANAGEMENT

The Group's objective on asset and liability management is to maximise its net interest income and return on assets and equity while providing for liquidity and effective risk management. Recommendations to management on liquidity, interest rate policy and other significant asset and liability management matters are made by ALCO, which consists of (1) two Senior Advisors; (2) one Consultant; (3) four Deputy Chief Executives; (4) Head of Risk Management Division; (5) Head of Strategic Planning & Control Division and (6) Head of Treasury Markets Division. The Head of Asset and Liability Management Department acts as the secretary of ALCO.

One of the key components of the Group's asset and liability management is the management of market risk, interest rate risk, liquidity risk and strategic risk. The Group's policies regarding the management of these risks are formulated, and their implementation are co-ordinated, by ALCO. ALCO meets on a weekly basis to formulate the asset and liability strategy, such as the deposit rates and advance pricing strategies. The Treasury Markets Division is responsible for the daily operating management of the discretionary portion of BEA's assets and liabilities within the approved internal limits, including re-pricing gap limits. The derivative transactions entered into by the Group are substantially in response to customer demands, in addition to BEA book hedging, and no significant positions are maintained by the Group.

BEA measures the exposure of its assets and liabilities to fluctuations in interest rates primarily by way of gap analysis which provides BEA with a static view of the maturity and re-pricing characteristics of balance sheet positions. An interest rate gap report is prepared by classifying all assets and liabilities into various time period categories according to contracted maturities or anticipated re-pricing dates whichever is earlier. The difference in the amount of assets and liabilities maturing or being re-priced in any time period category would then give BEA an indication of the extent to which BEA is exposed to the risk of potential changes in the net interest income.

## Selected Statistical and Other Information

As at 31 December 2008, the combined currency asset-liability gap position for BEA's local operations (head office and all local branches) were as follows:

	Total	Up to 1 month	1 month to 3 months	3 months to 6 months	6 months to 12 months	Greater than 1 year
<i>(in HK\$ millions)</i>						
<b>ASSETS</b>						
Total loans .....	100,670	84,364	12,828	2,044	575	859
Total investments .....	15,446	1,766	5,563	512	2,954	4,651
Placements .....	108,514	54,539	39,444	13,821	507	203
Others .....	17,246	7,202	4,993	4,791	253	7
Total assets .....	<u>241,876</u>	<u>147,871</u>	<u>62,828</u>	<u>21,168</u>	<u>4,289</u>	<u>5,720</u>
<b>LIABILITIES</b>						
Total deposits .....	218,078	151,152	52,814	12,088	1,898	126
Acceptances .....	3,555	2,224	1,157	107	67	—
Certificates of deposit and Subordinated notes .....	17,589	305	6,415	650	—	10,219
Others .....	968	738	30	100	100	—
Total liabilities .....	<u>240,190</u>	<u>154,419</u>	<u>60,416</u>	<u>12,945</u>	<u>2,065</u>	<u>10,345</u>
Off-balance-sheet items ...	—	32	(4,823)	(3,651)	(206)	8,648
Asset-Liability Gap .....	<u>1,686</u>	<u>(6,516)</u>	<u>(2,411)</u>	<u>4,572</u>	<u>2,018</u>	<u>4,023</u>

As at 30 June 2009, the combined currency asset-liability gap position for BEA's local operations (head office and all local branches) were as follows:

	Total	Up to 1 month	1 month to 3 months	3 months to 6 months	6 months to 12 months	Greater than 1 year
<i>(in HK\$ millions)</i>						
<b>ASSETS</b>						
Total loans .....	107,734	95,049	8,720	1,686	824	1,455
Total investments .....	22,239	2,640	7,619	2,571	866	8,543
Placements .....	95,964	48,188	27,430	14,634	5,550	162
Others .....	13,065	10,674	1,819	195	340	37
Total assets .....	<u>239,002</u>	<u>156,551</u>	<u>45,588</u>	<u>19,086</u>	<u>7,580</u>	<u>10,197</u>
<b>LIABILITIES</b>						
Total deposits .....	211,840	147,660	48,982	11,402	3,705	91
Acceptances .....	2,458	1,724	231	255	248	—
Certificates of deposit and Subordinated notes .....	15,905	305	5,025	—	1,188	9,387
Others .....	1,184	784	400	—	—	—
Total liabilities .....	<u>231,387</u>	<u>150,473</u>	<u>54,638</u>	<u>11,657</u>	<u>5,141</u>	<u>9,478</u>
Off-balance-sheet items .....	—	112	(2,707)	(4,810)	1,174	6,231
Asset-Liability Gap .....	<u>7,615</u>	<u>6,190</u>	<u>(11,757)</u>	<u>2,619</u>	<u>3,613</u>	<u>6,950</u>

The following table sets out BEA sensitivity analysis on interest rate risk as at 30 June 2009 and 31 December 2008, which measures the potential effect of changes in interest rates on its net interest income and economic value change:

## Selected Statistical and Other Information

	As at 30 June 2009			As at 31 December 2008		
	HKD	USD	CNY	HKD	USD	CNY
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Impact on earnings over the next 12 months if interest rates rise by 200 basis points .....	129	(39)	(59)	64	(26)	185
Impact on economic value if interest rates rise by 200 basis points .....	(168)	(205)	(77)	(98)	(203)	113

Given the re-pricing position of the assets and liabilities for BEA as at 30 June 2009, if interest rates increased by 200 basis points (a basis point being a unit that is equal to one hundredth of 1%), BEA would expect that the annualised net interest income in respect of its dealings in Hong Kong dollar, U.S. dollar and Renminbi (CNY) to increase by HK\$129 million and decrease by HK\$39 million and HK\$59 million, respectively, and the economic value for BEA to decrease by HK\$168 million, HK\$205 million and HK\$77 million, respectively. As at 31 December 2008, if interest rate increased by 200 basis points, BEA would expect the annualised net interest income in respect of its dealings in Hong Kong dollar, U.S. dollar and Renminbi to increase by HK\$64 million, decrease by HK\$26 million and increase by HK\$185 million, respectively, and the economic value for BEA to decrease by HK\$98 million and HK\$203 million, and increase by HK\$113 million, respectively.

The analysis is based on the following assumptions:

- (i) there is a parallel shift in the yield curve and in interest rates;
- (ii) there are no other changes to the portfolio;
- (iii) no loan prepayment is assumed as the majority of loans is on a floating rate basis; and
- (iv) deposits without fixed maturity dates are assumed to be repriced on the next day.

Liquidity risk is the risk that the Group cannot meet its current obligations. To manage liquidity risk, the Group has established a liquidity risk management policy which is reviewed by ALCO and approved by BEA's Board of Directors. The Group measures its liquidity through statutory liquidity ratio, loan-to-deposit ratio and the maturity mismatch portfolio.

The Group monitors its liquidity position on a daily basis to ensure the Group's funding needs can be met and the statutory liquidity ratio is complied with. The average consolidated liquidity ratio was approximately 44.0%, 43.5%, 38.4% and 43.8% for the years ended 31 December 2006, 2007 and 2008 and for the six months ended 30 June 2009, respectively, which is above the statutory minimum ratio of 25%. As such, during the bank run in September 2008 (see "*Investment Considerations — Considerations Relating to BEA — Liquidity and Short-Term Funding*"), the Bank was able to monitor its liquidity and, when required, took necessary steps to raise funds in order to maintain an adequate liquidity level. For a discussion on the action taken by BEA during the bank run in September 2008, see "*Held-to-maturity Debt Securities*".

As at 31 December 2006, 2007 and 2008 and as at 30 June 2009, approximately 85.8%, 87.2%, 93.4% and 94.2%, respectively, of the Group's advances were made at floating rates of interest. The Group's interest earning assets have floating interest rates fixed by reference to BEA's BLR, prime rate and interbank rates, and the Group's interest-bearing liabilities have floating interest rates by reference to interbank rates and savings deposit rates. ALCO continuously monitors the gap between HIBOR and the BLR and, consequently, the net interest margin. If the net interest margin declines due to the squeeze of the spread between BEA's BLR and HIBOR, ALCO may recommend the adjustment of BEA's BLR charged on advances and/or the expansion of higher-yield lending business.

## Selected Statistical and Other Information

The following table sets out the Group's average balances of interest-earning assets and interest-bearing liabilities, interest and related average interest rates for the years ended 31 December 2006, 2007 and 2008. Average balances of interest-earning assets and interest-bearing liabilities for the years ended 31 December 2006, 2007 and 2008 are based on the arithmetic mean of the respective balances at the beginning and the end of such periods.

	Years ended 31 December								
	2006			2007			2008		
	Average balance	Interest	Average rate (%)	Average balance	Interest	Average rate (%)	Average balance	Interest	Average rate (%)
<i>(in HK\$ millions, except percentages)</i>									
<b>ASSETS</b>									
<b>Interest-earning assets</b>									
Customer loans and credit advances									
to customers .....	153,730			198,373			237,112		
Trade bills less provision .....	570			703			1,121		
Total .....	<u>154,300</u>	<u>9,101</u>	5.9%	<u>199,076</u>	<u>11,960</u>	6.0%	<u>238,233</u>	<u>12,099</u>	5.1%
<b>Interbank placements and loans</b>									
Cash and balances with banks .....	5,722			8,397			20,451		
Money at call and short notice .....	42,734			55,299			45,309		
Placements .....	13,257			21,627			33,174		
Advances to banks .....	2,476			2,852			1,071		
Total .....	<u>64,189</u>	<u>3,016</u>	4.7%	<u>88,175</u>	<u>4,167</u>	4.7%	<u>100,005</u>	<u>3,033</u>	3.0%
<b>Securities</b>									
Treasury bills .....	4,475			5,206			4,781		
Certificates of deposit .....	2,801			2,692			2,347		
Debt securities .....	23,266			22,825			22,514		
Total .....	<u>30,542</u>	<u>740</u>	2.4%	<u>30,723</u>	<u>1,375</u>	4.5%	<u>29,642</u>	<u>1,242</u>	4.2%
<b>Total interest-earning assets</b> .....	<b>249,031</b>	<b>12,857</b>	<b>5.2%</b>	<b>317,974</b>	<b>17,502</b>	<b>5.5%</b>	<b>367,880</b>	<b>16,374</b>	<b>4.5%</b>
Allowance for possible loan losses ..	(720)			(740)			(735)		
Non-interest earning assets .....	17,769			25,710			29,755		
<b>Total assets</b> .....	<b><u>266,080</u></b>			<b><u>342,944</u></b>			<b><u>396,900</u></b>		
<b>LIABILITIES</b>									
<b>Interest-bearing liabilities</b>									
<b>Deposits</b>									
Deposits from customers .....	195,274	6,877	3.5%	239,206	9,128	3.8%	291,922	7,678	2.6%
Deposits and balances of banks ..	20,493	709	3.5%	39,656	1,144	2.9%	34,346	901	2.6%
Total deposits .....	<u>215,767</u>	<u>7,586</u>	3.5%	<u>278,862</u>	<u>10,272</u>	3.7%	<u>326,268</u>	<u>8,579</u>	2.6%
<b>Other liabilities</b>									
Certificates of deposit .....	8,328			9,002			9,138		
Loan capital .....	6,986			12,201			12,932		
Total .....	<u>15,314</u>	<u>412</u>	2.7%	<u>21,203</u>	<u>425</u>	2.0%	<u>22,070</u>	<u>301</u>	1.4%
<b>Total interest-bearing liabilities</b> .....	<b>231,081</b>	<b>7,998</b>	<b>3.5%</b>	<b>300,065</b>	<b>10,697</b>	<b>3.6%</b>	<b>348,338</b>	<b>8,880</b>	<b>2.5%</b>
Non interest-bearing liabilities .....	9,415			14,391			15,272		
<b>Total liabilities</b> .....	<b><u>240,496</u></b>			<b><u>314,456</u></b>			<b><u>363,610</u></b>		
<b>NET INTEREST INCOME</b> .....		<b><u>4,859</u></b>			<b><u>6,805</u></b>			<b><u>7,494</u></b>	
<b>NET INTEREST SPREAD</b> .....			<b><u>1.7%</u></b>			<b><u>1.9%</u></b>			<b><u>2.0%</u></b>

## Selected Statistical and Other Information

The table below sets out the Group's average balances of interest-earning assets and interest-bearing liabilities, interest and related average interest rates for the six months ended 30 June 2008 and 2009. Average balances of interest-earning assets and interest-bearing liabilities as at 30 June 2009 and 2008 are based on the arithmetic mean of the respective balances at the beginning and the end of such periods.

	Six months ended 30 June					
	2008			2009		
	Average balance	Interest	Average rate (%)	Average balance	Interest	Average rate (%)
<i>(in HK\$ millions, except percentages)</i>						
<b>ASSETS</b>						
<b>Interest-earning assets</b>						
Customer loans and credit advances to customers .....	231,574			226,033		
Trade bills less provision .....	950			1,137		
<b>Total .....</b>	<b>232,524</b>	<b>11,918</b>	<b>5.1%</b>	<b>227,170</b>	<b>9,062</b>	<b>4.0%</b>
<b>Interbank placements and loans</b>						
Cash and balances with banks .....	17,163			19,473		
Money at call and short notice .....	49,658			42,553		
Placements .....	34,884			47,348		
Advances to banks .....	1,272			1,434		
<b>Total .....</b>	<b>102,977</b>	<b>3,649</b>	<b>3.5%</b>	<b>110,808</b>	<b>1,725</b>	<b>1.6%</b>
<b>Securities</b>						
Treasury bills .....	4,226			11,940		
Certificates of deposit .....	2,399			2,986		
Debt securities .....	25,165			17,756		
<b>Total .....</b>	<b>31,790</b>	<b>1,262</b>	<b>4.0%</b>	<b>32,682</b>	<b>903</b>	<b>2.8%</b>
<b>Total interest-earning assets .....</b>	<b>367,291</b>	<b>16,829</b>	<b>4.6%</b>	<b>370,660</b>	<b>11,690</b>	<b>3.2%</b>
Allowance for possible loan losses .....	(677)			(1,130)		
Non-interest earning assets .....	29,518			31,807		
<b>Total assets .....</b>	<b>396,132</b>			<b>401,337</b>		
<b>LIABILITIES</b>						
<b>Interest-bearing liabilities</b>						
<b>Deposits</b>						
Deposits from customers .....	288,033	7,769	2.7%	311,665	4,369	1.4%
Deposits and balances of banks .....	35,302	900	2.5%	24,178	341	1.4%
<b>Total deposits .....</b>	<b>323,335</b>	<b>8,669</b>	<b>2.7%</b>	<b>335,843</b>	<b>4,710</b>	<b>1.4%</b>
<b>Other liabilities</b>						
Certificates of deposit .....	10,545			3,716		
Loan capital .....	13,544			11,462		
<b>Total .....</b>	<b>24,089</b>	<b>336</b>	<b>1.4%</b>	<b>15,178</b>	<b>103</b>	<b>0.7%</b>
<b>Total interest-bearing liabilities .....</b>	<b>347,424</b>	<b>9,005</b>	<b>2.6%</b>	<b>351,021</b>	<b>4,813</b>	<b>1.4%</b>
Non interest-bearing liabilities .....	15,137			17,431		
<b>Total liabilities .....</b>	<b>362,561</b>			<b>368,452</b>		
<b>NET INTEREST INCOME .....</b>		<b>7,824</b>			<b>6,877</b>	
<b>NET INTEREST SPREAD .....</b>			<b>2.0%</b>			<b>1.8%</b>

### **INTERNAL AUDIT**

The Internal Audit Department has responsibility for auditing the Group's operations, including BEA (China). Through regular audits of all of the departments, subsidiaries and branches of BEA, the Internal Audit Department reviews and evaluates the adequacy and effectiveness of internal controls, safeguards the Group's assets, reviews operations in terms of efficiency and effectiveness, secures the accuracy and reliability of information and reviews compliance with established policies, procedures and relevant statutory requirements. The results of an internal audit are reported to the head of the audited department, subsidiary or branch, and any internal audit recommendations are generally expected to be implemented shortly after the issuance of the internal audit report. Significant findings arising from an internal audit are summarised by the Group Chief Auditor in bi-monthly reports to the Chairman of the Audit Committee and top management, and in semi-annual reports submitted to the full Audit Committee and top management. The Internal Audit Department also shares its findings with the HKMA and KPMG, BEA's external auditors, on a regular basis.

Upon the incorporation of BEA (China) in April 2007, BEA (China) established a separate Internal Audit Department that reports to its own Audit Committee established under the board. The reporting process adopted is similar to BEA's reporting process described above.

### **COMPLIANCE**

The Compliance Department was established in 2001 to administer legal and regulatory compliance issues concerning the Group's business. It is responsible for reviewing new products and business proposals, conducts periodic review of the Group's activities and advises senior management of the Group in accordance with applicable laws, rules and regulations. Another key function of the Compliance Department is to raise compliance awareness amongst staff members. A Compliance Policy has been issued to relevant staff members of the Group. A Group Policy on the Prevention of Money Laundering, which adheres to those anti-money laundering requirements laid down by the HKMA, has also been issued to relevant staff members of the Group. In addition, the Group's internal controls are also reviewed by its internal auditors. Regular training sessions are conducted and newsletters are issued to update the Group's staff members on any significant legal and regulatory changes relevant to the operations of the Group.

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## Dividend Policy

Subject to the Companies Ordinance (Cap. 32), Laws of Hong Kong, the Articles of Association of BEA provide that the shareholders in general meeting may from time to time declare dividends to be paid to the shareholders out of the profits available for distribution, but no dividend shall be declared in excess of the amount recommended by the Board of Directors.

The declaration of dividends is subject to the discretion of the Board of Directors, and the amounts of dividends actually declared and paid will depend on the general business condition, the financial results, the capital requirements; the interests of shareholders and any other factors which the Board of Directors may deem relevant.

BEA's dividends attributable to the years ended 31 December 2006, 2007 and 2008, were HK\$2,265 million, HK\$2,614 million and HK\$515 million, respectively. BEA's dividends per share for the years ended 31 December 2006, 2007 and 2008, without adjusting for the bonus issue in 2009, were HK\$1.46, HK\$1.66 and HK\$0.25, respectively.

At the Annual General Meeting held on 16 April 2009, the members resolved to declare a final dividend of HK\$0.02 per share for the year ended 31 December 2008, which, together with the interim dividend of HK\$0.23 per share paid in September 2008, constituted a total dividend of HK\$0.25 per share for the full year. This represents a decrease of 84.9% over the total dividend of HK\$1.66 per share for the year ended 31 December 2007.

In celebration of BEA's 90th Anniversary, in April 2009, a bonus issue of shares was approved and made to its shareholders on the basis of one new ordinary shares of HK\$2.50 each for every ten ordinary shares held.

BEA's past dividend payment history is not, and should not be taken as an indication of potential future practice with respect to dividend payments. Please also see "*Investment Considerations — Considerations Relating to the Securities — Interest on the Notes may be deferred and dividends on the Preference Shares and the Substitute Preference Shares may not be payable in certain circumstances*".

## Board of Directors and Senior Management

### BOARD OF DIRECTORS

BEA is managed by its Board of Directors, which is responsible for the direction and management of BEA. The Articles of Association of BEA require that there must be not less than five Directors, unless and until otherwise determined by an ordinary resolution of the shareholders of BEA. Directors are appointed at any time either at a general meeting of shareholders or by the Board of Directors.

As at 30 September 2009, the Board of Directors of BEA comprised the following individuals:

<u>Name</u>	<u>Age</u>	<u>Title</u>	<u>Address</u>
Dr. The Hon. Sir David Li Kwok-po ....	70	Chairman & Chief Executive	10 Des Voeux Road Central, Hong Kong
Professor Arthur Li Kwok-cheung.....	64	Deputy Chairman & Non-executive Director	Room 1304B, 13th Floor, United Chinese Bank Building, 31-37 Des Voeux Road Central, Hong Kong
Dr. Allan Wong Chi-yun .....	58	Deputy Chairman & Independent Non-executive Director	23rd Floor, Block 1, Tai Ping Industrial Centre, 57 Ting Kok Road, Tai Po, New Territories
Mr. Wong Chung-hin .....	76	Independent Non-executive Director	Prince's Building, 12th Floor, 10 Chater Road, Hong Kong
Dr. Lee Shau-kee .....	80	Independent Non-executive Director	76th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong
Mr. Aubrey Li Kwok-sing .....	59	Non-executive Director	19th Floor, St. George's Building, 2 Ice House Street, Central, Hong Kong
Dr. William Mong Man-wai .....	81	Non-executive Director	15th Floor, New East Ocean Centre, 9 Science Museum Road, Tsimshatsui East, Kowloon
Mr. Winston Lo Yau-lai .....	68	Independent Non-executive Director	3/F, No. 1 Kin Wong Street, Tuen Mun, New Territories
Tan Sri Dr. Khoo Kay-peng .....	70	Non-executive Director	5th Floor, Menara PMI, No. 2 Jalan Changkat Ceylon, 50200 Kuala Lumpur, Malaysia
Mr. Thomas Kwok Ping-kwong .....	57	Independent Non-executive Director	46/F., Sun Hung Kai Centre, 30 Harbour Road, Hong Kong
Mr. Richard Li Tzar-kai .....	42	Non-executive Director	42/F., PCCW Tower, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong
Mr. Kenneth Lo Chin-ming .....	67	Independent Non-executive Director	99, Sec. 2, Tiding Blvd., Neihu District, Taipei, Taiwan
Mr. Eric Li Fook-chuen .....	80	Non-executive Director	5/F., Kowloon Dairy Building, 17-19 On Lan Street, Central, Hong Kong
Mr. Stephen Charles Li Kwok-sze .....	49	Non-executive Director	Unit 26-F, StarCrest — Tower 1, 9 Star Street, Hong Kong
Mr. William Doo Wai-hoi.....	65	Independent Non-executive Director	Room 3401, New World Tower, 16-18 Queen's Road, Central, Hong Kong
Mr. Kuok Khoon-ean.....	54	Independent Non-executive Director	21/F, Citic Tower, 1 Tim Mei Avenue, Central, Hong Kong
Mr. Valiant Cheung Kin-piu .....	63	Independent Non-executive Director	14A Yukon Court, No. 2 Conduit Road, Hong Kong
Dr. Isidro Fainé Casas.....	67	Non-executive Director	Avenida Diagonal 621-629, 08028 Barcelona, Spain

## Board of Directors and Senior Management

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**Dr. The Hon. Sir David LI Kwok-po**, GBM, GBS, OBE, MA *Cantab.* (*Economics & Law*), Hon. DSc. (*Imperial*), Hon. DBA (*Napier*), Hon. D.Hum.Litt. (*Trinity, USA*), Hon. DSocSc (*Lingnan*), Hon. LLD (*Hong Kong*), Hon. LLD (*Warwick*), Hon. LLD (*Cantab*), FCA, FCPA, FCPA (*Aust.*), FCIB, FHKIB, FBCS, CITP, FCI Arb, JP, *Officier de L'Ordre de la Couronne*, *Grand Officer of the Order of the Star of Italian Solidarity*, *The Order of the Rising Sun*, *Gold Rays with Neck Ribbon*, *Officier de la Légion d'Honneur*  
*Chairman & Chief Executive and Member of the Nomination Committee*

Sir David, aged 70, joined the Bank in 1969. He was appointed as a Director in 1977, Chief Executive in 1981, Deputy Chairman in 1995 and Chairman in 1997. Sir David is the chairman or a director of various companies in the Group, and is also the chairman or a member of various committees appointed by the Board of Directors.

Sir David is a Member of the Legislative Council of Hong Kong. He is a Member of the Banking Advisory Committee and a Member of the Council of the Treasury Markets Association. Sir David is the Pro-Chancellor of The University of Hong Kong, an Honorary Adviser of the Business and Economics Association of HKUSU and an Advisory Committee Member of the Chinese University of Hong Kong S.H. Ho College.

Sir David is the Chairman of The Chinese Banks' Association, Limited and the Hong Kong Management Association. He is the Honorary Advisor of The International Chamber of Commerce — Hong Kong, China and the First Honorary Chairman of the Hong Kong Chamber of Commerce in China. He is also the Honorary Chairman of the Chamber of Hong Kong Listed Companies. Sir David is Vice President of the Council of the Hong Kong Institute of Bankers, Chairman of the Saint Joseph's College Foundation Limited and Chairman of the Advisory Council to the Australian International School. He is also an Emeritus Trustee of the Cambridge Foundation and a Trustee of the Cambridge Overseas Trust. Sir David is Chairman of the Advisory Board of The Salvation Army, Hong Kong and Macau Command, Chairman of the Executive Committee of St. James' Settlement and he also serves on the Hong Kong Red Cross Advisory Board. He is a Council Member of the Employers' Federation of Hong Kong, a director of the David Li Kwok-po Charitable Foundation Limited, a Founder Member and an Executive Committee Member of the Heung Yee Kuk Foundation Limited.

Sir David is a director of China Overseas Land & Investment Limited, COSCO Pacific Limited, Criteria CaixaCorp, S.A., Guangdong Investment Limited, The Hong Kong and China Gas Company Limited, The Hongkong and Shanghai Hotels, Limited, Hong Kong Interbank Clearing Limited, The Hong Kong Mortgage Corporation Limited, PCCW Limited, San Miguel Brewery Hong Kong Limited, SCMP Group Limited, Vitasoy International Holdings Limited, AFFIN Holdings Berhad and IMG Worldwide Inc. He was a director of AviChina Industry & Technology Company Limited, China Merchants China Direct Investments Limited and Dow Jones & Company, Inc.

Sir David is a member of the Board of Trustees of the Asia Society International Council and Asia Business Council, a member of Deutsche Bank Asia Pacific Advisory Board, and member of the Asian Youth Orchestra Board. He serves on the international advisory boards of Carlos P. Romulo Foundation for Peace and Development, Federal Reserve Bank of New York International Advisory Committee, Hospital for Special Surgery, Scripps International Network and Crédit Agricole S.A. Sir David is the Chairman of INSEAD East Asia National Council, the Non-executive Chairman for Edelman Asia-Pacific and a Senior Adviser of Metrobank.

**Professor Arthur LI Kwok-cheung**, GBS, MA, MD, M.B.B.Chir (*Cantab*), DSc (*Hon*), DLitt (*Hon*), Hon DSc(*Med*), LLD (*Hon*), Hon Doc (*Soka*), FRCS (*Eng & Edin*), FRACS, Hon FACS, Hon FRCS (*Glasg & I*), Hon FRSM, Hon FPCS, Hon FCSHK, Hon FRCP (*Lond*), JP  
*Deputy Chairman and Non-executive Director*

Professor Li, aged 64, had been a Director of BEA (1995-2002) and was re-appointed a Director in January 2008. He is a director of AFFIN Holdings Berhad. He is also a member of the National Committee of the Chinese People's Political Consultative Conference.

Professor Li was the Secretary for Education and Manpower of the Government of HKSAR and a Member of the Executive Council (2002-June 2007). Before these appointments, he was the Vice Chancellor of the Chinese University of Hong Kong (1996-2002) and was the Chairman of Department of Surgery and the Dean of Faculty of Medicine of the Chinese University of Hong Kong.

Professor Li had held many important positions in various social service organisations, medical associations, and educational bodies, including the Education Commission, Committee on Science and Technology, the Hospital

## Board of Directors and Senior Management

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Authority, the Hong Kong Medical Council, the University Grants Committee, the College of Surgeons of Hong Kong, and the United Christian Medical Services Board. He was a member of the Board of Directors of the Hong Kong Science and Technology Parks Corporation and the Hong Kong Applied Science and Technology Research Institute, and Vice President of the Association of University Presidents of China. He was a Hong Kong Affairs Adviser to China.

**Dr. Allan WONG Chi-yun**, GBS, MBE, BSc, MSEE, Hon. DTech, JP  
*Deputy Chairman, Independent Non-executive Director, Chairman of the Remuneration Committee, Member of the Audit Committee and the Nomination Committee*

Dr. Wong, aged 58, was appointed as a Director in 1995. He is the Chairman and Group Chief Executive Officer of VTech Holdings Limited. Dr. Wong is an independent non-executive director of China-Hongkong Photo Products Holdings Ltd. and Li & Fung Ltd.

Dr. Wong holds a Bachelor of Science degree in electrical engineering from the University of Hong Kong, a Master of Science degree in electrical and computer engineering from the University of Wisconsin and an honorary degree of Doctor of Technology from the Hong Kong Polytechnic University.

**Mr. WONG Chung-hin**, CBE, JP  
*Independent Non-executive Director and Member of the Audit Committee*

Mr. Wong, aged 76, is a solicitor. He was appointed as a Director in 1977. Mr. Wong is the Consultant of P.C. Woo & Co. He is also a director of Hongkong Electric Holdings Limited and Hutchison Whampoa Limited.

**Dr. LEE Shau-kee**, GBM, Hon. DBA, Hon. DSSc, Hon. LLD  
*Independent Non-executive Director and Member of the Nomination Committee*

Dr. Lee, aged 80, was appointed as a Director in 1987. He is the Chairman and Managing Director of Henderson Land Development Company Limited and Henderson Investment Limited. Dr. Lee is also the Chairman of The Hong Kong and China Gas Company Limited and Miramar Hotel and Investment Company, Limited. He is the Vice Chairman of Sun Hung Kai Properties Limited and a director of Hong Kong Ferry (Holdings) Company Limited.

**Mr. Aubrey LI Kwok-sing**, BSc, MBA  
*Non-executive Director, Member of the Nomination Committee and the Remuneration Committee*

Mr. Li, aged 59, was appointed as a Director in 1995. He is Chairman of MCL Partners Limited. Mr. Li possesses extensive experience in the fields of investment banking, merchant banking and capital markets. He is also a director of Cafe de Coral Holdings Limited, China Everbright International Limited, CNPC (Hong Kong) Limited, Kowloon Development Co. Ltd, Pokfulam Development Company Limited and AFFIN Bank Berhad. He was a director of ABC Communications (Holdings) Limited and Value Partners China Greenchip Fund Limited.

**Dr. William MONG Man-wai**, GBS, Hon. DBA, Hon. LLD, Hon. DSSc, Hon. DEng, The Order of the Sacred Treasure, Gold Rays with Rosette  
*Non-executive Director*

Dr. Mong, aged 81, was appointed as a Director in 1995. He is the Chairman and Senior Managing Director of Shun Hing Group. Dr. Mong is the Honorary Chairman of Hong Kong Electrical Appliances Manufacturers Association. He is the Honorary Chairman of the Board of Trustee of Nanjing University, the Honorary Trustee of the Court of Tsinghua University, a director of the Centre for Advanced Study Foundation of Tsinghua University, an Honorary Trustee of the Court of Peking University, and an Honorary Member of its Education Fund. Dr. Mong is an Honorary Member of the Board of Trustees of Shanghai Jiao Tong University, a member of the Board of Directors of Jinan University in Guangdong, an Honorary Member of the Court of the Hong Kong University of Science and Technology and an Honorary Member of the Court of the Hong Kong Baptist University.

## Board of Directors and Senior Management

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**Mr. Winston LO Yau-lai, SBS, BSc, MSc**

*Independent Non-executive Director, Chairman of the Audit Committee and Member of the Remuneration Committee*

Mr. Lo, aged 68, was appointed as a Director in 2000. He is the Executive Chairman of Vitasoy International Holdings Limited.

Mr. Lo graduated from the University of Illinois with a Bachelor of Science degree in Food Science and gained his Master of Science degree in Food Science from Cornell University.

Mr. Lo is Member of the National Committee of the Chinese People's Political Consultative Conference. He is a director of Ping Ping Investment Company Ltd.

**Tan Sri Dr. KHOO Kay-peng, PSM, DPMJ, KMN, JP, Hon. DLitt, Hon. LLD**

*Non-executive Director*

Tan Sri Dr. Khoo, aged 70, was appointed as a Director in 2001. Dr. Khoo is the Chairman and Chief Executive of The MUI Group, a Malaysia-based corporation with diversified business operations in the Asia Pacific, the United States and the United Kingdom. He is the Chairman and Chief Executive of Malayan United Industries Berhad and MUI Properties Berhad in Malaysia. Dr. Khoo is also the Chairman of Laura Ashley Holdings plc and Corus Hotels Limited in the United Kingdom, and Morning Star Resources Limited in Hong Kong. He is also a director of SCMP Group Limited in Hong Kong and Pan Malaysian Industries Berhad in Malaysia.

Dr. Khoo is a trustee of Regent University, Virginia, United States, and a board member of Northwest University, Seattle, United States. He also serves as a Council Member of the Malaysian-British Business Council, the Malaysia-China Business Council and the Asia Business Council. Previously, Dr. Khoo had served as the Chairman of the Malaysian Tourist Development Corporation (a Government Agency), the Vice Chairman of Malayan Banking Berhad (Maybank) and a trustee of the National Welfare Foundation, Malaysia.

**Mr. Thomas KWOK Ping-kwong, SBS, MSc (Bus Adm), BSc (Eng), FCPA, JP**

*Independent Non-executive Director and Member of the Remuneration Committee*

Mr. Kwok, aged 57, was appointed as a Director in 2001. Mr. Kwok is the Vice Chairman and Managing Director of Sun Hung Kai Properties Limited, Chairman of Route 3 (CPS) Company Limited, Joint Chairman of IFC Development Limited and an Executive Director of SUNeVision Holdings Ltd. He is the Chairman of the Board of Directors of the Faculty of Business and Economics of The University of Hong Kong and Executive Vice President and a member of the Executive Committee of The Real Estate Developers Association of Hong Kong. He also serves as a government appointed Member of the Exchange Fund Advisory Committee, Construction Industry Council and the Commission on Strategic Development and a non-official member of the Provisional Minimum Wage Commission. In July 2007, the Government of the Hong Kong Special Administrative Region awarded Mr. Kwok the Silver Bauhinia Star for his distinguished community service. He is an Honorary Citizen of Guangzhou and a Standing Committee Member of the Ninth Chinese People's Political Consultative Conference Shanghai Committee.

Mr. Kwok holds a Master's degree in Business Administration from The London Business School, University of London and a Bachelor's degree in Civil Engineering from Imperial College, University of London. He is a fellow of The Hong Kong Management Association.

In the past, he served as a Member of the Economic and Employment Council, the Business Advisory Group, the Land & Building Advisory Committee, the Registered Contractors' Disciplinary Board, the General Chamber of Commerce Industrial Affairs Committee, Business Facilitation Advisory Committee and the Council for Sustainable Development. He was also Chairman of the Property Management Committee of the Building Contractors' Association and a Council Member of the Hong Kong Construction Association.

He previously served as a Board member of the Community Chest of Hong Kong and as a member of the Social Welfare Policies & Services Committee, and on the Council of The Open University of Hong Kong.

**Mr. Richard LI Tzar-kai**

*Non-executive Director*

Mr. Li, aged 42, was appointed as a Director in 2001. Mr. Li is the Chairman of PCCW Limited, one of Asia's leading companies in Information and Communications Technologies (ICT). He is also the Chairman and Chief Executive of the Pacific Century Group, the Chairman of Pacific Century Premium Developments Limited and Singapore-based Pacific Century Regional Developments Limited. He is a representative of Hong Kong, China to the Asia Pacific Economic Co-operation (APEC) Business Advisory Council, a member of the Center for Strategic and International Studies' International Councillors' Group in Washington, D.C. and a member of the Global Information Infrastructure Commission.

**Mr. Kenneth LO Chin-ming, MA, BA**

*Independent Non-Executive Director and Member of the Audit Committee*

Mr. Lo, aged 67, was appointed as a Director in 2005. Mr. Lo is the Chairman and Chief Executive Officer of the Industrial Bank of Taiwan, the Chairman of IBT Venture Co. and the Honourable Chairman of the Chailease Group. He is also a director of Boston Life Science Venture Corp., Taiwan Cement Corp. and Gainwell Securities Co., Ltd. (Hong Kong). He has worked in the banking and finance industry for over 40 years and had abundant experience in securities, trust, leasing, commercial banking, investment banking and venture capital. He was the President of Chinatrust Commercial Bank, the President of Chailease Group, the Vice Chairman of China Trust Bank (USA), the Managing Director of International Bank of Taipei, and a director of Hua Nan Commercial Bank.

In addition to his highly recognized professional accomplishments, Mr. Lo is also active in public service. He is the Vice Chairman of the Chinese National Association of Industry and Commerce, the Director of the ROC Bankers Association, a member of Asia Executive Board of the Sloan School of Business at the Massachusetts Institute of Technology, and a member of the National Palace Museum Advisory Committee and Taipei Fine Arts Museum Advisory Committee. He was the President of Asian Leasing Association, the Charter Chairman of Taipei Presidents' Organization, and the Supervisor of the ROC Bankers Association.

Mr. Lo holds a B.A. in Economics from National Taiwan University and an M.A. in Finance from the University of Alabama.

**Mr. Eric LI Fook-chuen, BscEE, MscEE, MBA, FIM**

*Non-Executive Director, Chairman of the Nomination Committee and Member of the Remuneration Committee*

Mr. Li, aged 80, was appointed as a Director in 2006. Mr. Li is a non-executive director of BEA Life Limited and Blue Cross (Asia-Pacific) Insurance Limited, both are wholly-owned subsidiaries of the Bank. Mr. Li is currently the Chairman and Chief Executive Officer of the Kowloon Dairy Limited. He is a director of Joyce Boutique Holdings Limited.

Mr. Li holds a Bachelor of Science Degree in Electrical Engineering from the University of Arkansas, United States, a Master of Science Degree in Electrical Engineering from the University of Michigan, United States, and a Master Degree in Business Administration from the University of California, United States. He is also a Fellow of the Chartered Management Institute.

**Mr. Stephen Charles LI Kwok-sze, BSc (Hons.), ACA**

*Non-executive Director*

Mr. Li, aged 49, was appointed as a Director in 2006. He is a member of the Institute of Chartered Accountants in England and Wales. Mr. Li holds a Bachelor of Science (Hons.) Degree in Mathematics from King's College, University of London, United Kingdom. He currently holds directorships in several funds managed by INTL Consilium, LLC. He is also a director of AFFIN Bank Berhad and AFFIN Investment Bank Berhad. He has extensive experience in investment banking, having held senior capital markets positions with international investment banks in London and Hong Kong.

## Board of Directors and Senior Management

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**Mr. William DOO Wai-hoi, BSc, MSc, G.G., JP**

*Independent Non-executive Director and Member of the Audit Committee*

Mr. Doo, aged 64, was appointed as a Director in January 2008. He is currently the vice-chairman of New World China Land Limited, the deputy chairman of NWS Holdings Limited and Taifook Securities Group Limited. He is an executive director of Lifestyle International Holdings Limited, a director of New World Hotels (Holdings) Limited and Fung Seng Diamond Company Limited. He was an executive director of New World Mobile Holdings Ltd.

Mr. Doo is Member to the Standing Committee of the Eleventh Shanghai Municipal Committee of the Chinese People's Political Consultative Conference and Convenor of the Hong Kong and Macau Members. He is a Governor of the Canadian Chamber of Commerce in Hong Kong and the Honorary Consul of the Kingdom of Morocco in Hong Kong.

Mr. Doo holds a Degree of Bachelor of Science from the University of Toronto, Canada and a Master Degree in Science from the University of California, United States. He also holds a Diploma of Graduate Gemologist from the Gemologist Institute of America.

**Mr. KUOK Khoon-ean**

*Independent Non-executive Director and Member of the Audit Committee*

Mr. Kuok, aged 53, was appointed as a Director in January 2008. He is currently the chairman and executive director of Shangri-La Asia Limited, a non-executive director of SCMP Group Limited, a director of Kerry Group Limited and Kerry Holdings Limited. Mr. Kuok is also a director of Wilmar International Limited listed in Singapore and a director of Shangri-La Hotel Public Company Limited and The Post Publishing Public Company Limited, both listed in Thailand.

Mr. Kuok is a trustee of Singapore Management University. Mr. Kuok is a graduate in Economics from the Nottingham University, United Kingdom.

**Mr. Valiant CHEUNG Kin-piu, FCPA, FCA**

*Independent Non-executive Director and Member of the Audit Committee*

Mr. Cheung, aged 63, was appointed as a Director in December 2008. He was a partner at KPMG, a leading international accounting firm in Hong Kong, until his retirement in 2001. Mr. Cheung has extensive experience in assurance and corporate finance work, particularly in trading and manufacturing corporations in Hong Kong and the PRC. He is a fellow member of the Institute of Chartered Accountants in England and Wales and the Hong Kong Institute of Certified Public Accountants.

Mr. Cheung is an independent non-executive director of Pacific Century Premium Developments Limited and Dah Chong Hong Holdings Limited. He was an independent non-executive director of Dream International Limited and Wing Shan International Limited.

Mr. Cheung is currently an independent non-executive director, the chairman of the audit committee and the chairman of the Connected Transactions Control Committee of The Bank of East Asia (China) Limited, a wholly-owned subsidiary of the Bank.

**Dr. Isidro FAINÉ CASAS**

*Non-executive Director and Member of the Nomination Committee*

Dr. Fainé, aged 67, was appointed as a Director in June 2009. He is the Chairman of (i) Criteria CaixaCorp, S.A., (the holding company of the largest industrial and financial investment group in Spain which has been listed on the Spanish Stock Exchange since 2007), (ii) Caja de Ahorros y Pensiones de Barcelona "la Caixa" (the first Spanish and European savings bank and the controlling shareholder of Criteria CaixaCorp, S.A.) and (iii) "la Caixa" Foundation.

Dr. Fainé is also (i) the Deputy Chairman of Abertis Infraestructuras, S.A. (infrastructure manager, listed in Spain), (ii) the Deputy Chairman of Telefónica, S.A. (integrated telecommunication operator, listed in Spain), (iii)

## Board of Directors and Senior Management

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the Second Deputy Chairman of Repsol YPF, S.A. (oil company, listed in Spain), (iv) a director of Banco BPI, S.A. (financial and multi-specialist group focusing on the banking business, listed in Portugal) and (v) a director of Grupo Financiero Inbursa, S.A.B. de C.V. (financial and banking group, listed in Mexico). Dr. Fainé was also a director of Brisa Auto-Estradas de Portugal, S.A. from 2003 to 2008 (listed in Portugal).

Dr. Fainé is a member of the Royal Academy of Economics and Finance and of the Royal Academy of Doctors, First Deputy Chairman of the Association of Spanish Savings Banks (CECA) and Chairman of the Association of Catalan Savings Banks.

Dr. Fainé began his professional banking career as Investment Manager for Banco Atlántico in 1964, later becoming General Manager of Banco de Asunción in Paraguay in 1969. On his return to Barcelona, he held various managerial posts in financial entities: Head of Personnel at Banca Riva y García (1973), Director and General Manager of Banca Jover (1974) and General Manager of Banco Unión (1978).

Dr. Fainé joined Caja de Ahorros y Pensiones de Barcelona and was appointed Deputy Executive General Manager in 1982. He was appointed General Manager in 1999 and was further appointed Chairman of Caja de Ahorros y Pensiones de Barcelona in 2007.

Among other academic and professional qualifications, Dr. Fainé holds a PhD in Economic and Business Sciences, an International Senior Managers Program (ISMP) in Business Administration from Harvard University, and a Diploma in Senior Business Management from the IESE Business School.

### SENIOR MANAGEMENT

**Mr. Adrian David LI Man-kiu, MA (Cantab), MBA, LPC, JP**  
*Deputy Chief Executive*

Mr. Adrian Li, aged 36, joined the Bank in 2000 as General Manager & Head of Corporate Banking Division. He was promoted to Deputy Chief Executive for Hong Kong Business in April 2009. Mr. Adrian Li is primarily responsible for the overall management and control of the BEA's businesses in Hong Kong, including corporate banking, personal banking, and wealth management. He is also a director of various members of the Group and a member of various committees appointed by the Board.

Mr. Adrian Li is currently an Independent Non-executive Director of Sino Land Company Limited, Tsim Sha Tsui Properties Limited, Sino Hotels (Holdings) Limited and China State Construction International Holdings Limited. He is an Alternate Independent Non-Executive Director of San Miguel Brewery Hong Kong Limited. Further, he is an Alternate Non-Independent Non-Executive Director of AFFIN Holdings Berhad, a company listed on the main board of the Malaysia Stock Exchange.

Mr. Adrian Li is a member of the Ninth and Tenth Guangdong Provincial Committee and was formerly a member of the Ninth and Tenth Guangzhou Committee of the Chinese People's Political Consultative Conference, PRC. He is also a committee member of the Ninth and Tenth All-China Youth Federation, the Deputy Chairman of the Ninth Beijing Municipality Youth Federation and a Counsellor of Hong Kong United Youth Association Limited. In addition, he is a Council Member of the Vocational Training Council and the Chairman of its Banking and Finance Industry Training Board, and a member of Mandatory Provident Fund Industry Schemes Committee of the Mandatory Provident Fund Schemes Authority. Mr. Li was formerly a board member of Ocean Park Corporation and an advisory board member of the Hong Kong Export Credit Insurance Corporation.

Mr. Adrian Li holds a Master Degree in Management from Kellogg Graduate School of Management, Northwestern University, Evanston, Illinois, United States, and a Master Degree of Arts and a Bachelor Degree of Arts in Law from the University of Cambridge. He is a member of The Law Society of England and Wales and The Law Society of Hong Kong.

**Mr. Brian David LI Man-bun, MA (Cantab), MBA, ACA**  
*Deputy Chief Executive*

Mr. Brian Li, aged 34, joined the Group in 2002. He was General Manager & Head of Wealth Management Division from 2004 to March 2009. He was promoted to Deputy Chief Executive for China and International Business in April 2009. Mr. Brian Li is primarily responsible for the Bank's China and international businesses, as well as the management of BEA Union Investment Management Limited. He is also a director of various members of the Group and a member of various committees appointed by the Board.

## Board of Directors and Senior Management

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Mr. Brian Li is currently an independent non-executive director of Towngas China Company Limited and an Alternate Director of AFFIN Bank Berhad.

Mr. Brian Li holds a number of public and honorary positions, including being a Member of the Eleventh National Committee of the Chinese People's Political Consultative Conference, a Member of the Eleventh Beijing Municipal Committee of the Chinese People's Political Consultative Conference, a Member of Hong Kong Consumer Council, a Member of HKSAR Energy Advisory Committee, a Member of HKSAR Standing Committee on Judicial Salaries and Conditions of Service, a Member of HKSAR Financial Reporting Review Panel and a Member of HKSAR Traffic Accident Victims Assistance Advisory Committee, etc.

Mr. Brian Li is a Member of the Hong Kong Institute of Certified Public Accountants and a Member of Treasury Markets Association. He is an Associate of The Institute of Chartered Accountants in England and Wales and holds an MBA from Stanford University as well as MA and BA from the University of Cambridge.

**Mr. Samson LI Kai-cheong, FCCA, CPA, FCIS, FCS, HKSI**  
*Deputy Chief Executive & Chief Investment Officer*

Mr. Li, aged 49, joined the Bank in 1987 as Chief Internal Auditor. He was promoted to Assistant General Manager in 1992 and Deputy General Manager in 1995. Mr. Li was a General Manager of the Bank from 1997 to March 2009. He was promoted to Deputy Chief Executive & Chief Investment Officer in April 2009. Mr. Samson Li is primarily responsible for the Bank's investment activities and treasury & broking operations including treasury markets, as well as the management of East Asia Securities Company Limited and East Asia Futures Limited. He is also a director of various members of the Group and a member of various committees appointed by the Board.

Mr. Samson Li is currently an independent non-executive director and the Chairman of Audit Committee of China Merchants China Direct Investments Limited.

Mr. Samson Li is a Fellow of The Hong Kong Institute of Chartered Secretaries, the Institute of Chartered Secretaries & Administrators, and The Association of Chartered Certified Accountants. In addition, he is an Associate of the Hong Kong Institute of Certified Public Accountants and a Member of the Hong Kong Securities Institute. Mr. Samson Li received his Professional Diploma in Accountancy from The Hong Kong Polytechnic University.

**Mr. TONG Hon-shing, BSc, ACIB, AHKIB, FCIS, FCS**  
*Deputy Chief Executive, Chief Operating Officer & Chief Compliance Officer*

Mr. Tong, aged 50, joined the Bank in 1975. He was promoted to Assistant General Manager in 1995 and to General Manager in 2000. He was General Manager & Head of Personal Banking Division from 2001 to March 2009. He was further promoted to Deputy Chief Executive and Chief Operating Officer in April 2009. Mr. Tong is primarily responsible for strategic planning and control, operations support, compliance, human resources, and corporate communications of the Bank. He is also a director of various members of BEA Group and a member of various committees appointed by the Board. Mr. Tong is a Fellow of The Hong Kong Institute of Chartered Secretaries and the Institute of Chartered Secretaries & Administrators as well as an Associate of The Hong Kong Institute of Bankers and The Chartered Institute of Bankers. He holds a BSc from the University of Manchester.

## Material Related Party Transactions

BEA enters into a number of transactions with related parties, including its associates, key management personnel and their close family members and companies controlled or significantly influenced by them. The transactions include accepting deposits from and extending credit facilities to them. Other than outstanding interest-free shareholder's advances extended to one associate amounting to HK\$6,500,000, as at 31 December 2006, HK\$7,000,000 as at 31 December 2007 and 2008, and HK\$7,000,000 as at 30 June 2009, all interest rates in connection with the deposits taken and credit facilities extended are under terms and conditions normally applicable to customers of comparable standing.

The interest received from and interest paid to BEA's related parties for the years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, the outstanding balances of amounts due from and due to them as at 31 December 2006, 2007 and 2008 and as at 30 June 2009 and maximum outstanding balance of amounts due from and due to them during the year are aggregated as follows:

	Years ended 31 December								
	Key management personnel			Subsidiaries			Associates		
	2008	2007	2006	2008	2007	2006	2008	2007	2006
<i>(in HK\$ Mn)</i>			<i>(in HK\$ Mn)</i>			<i>(in HK\$ Mn)</i>			
Interest income .....	264	155	167	1,079	833	34	8	9	11
Interest expense .....	88	134	109	148	204	200	—	—	—
Amounts due from .....	8,209	10,448	4,270	16,398	17,964	1,834	124	213	225
Amounts due to .....	3,696	3,961	3,052	1,994	1,634	1,702	7	10	9
Maximum amounts due from ...	12,429	11,361	6,770	22,072	23,699	3,013	446	422	463
Maximum amounts due to .....	8,527	8,593	7,781	2,850	1,894	9,848	34	62	33

	Six months ended 30 June 2009		
	Key management personnel	Subsidiaries	Associates
	<i>(in HK\$ Mn)</i>	<i>(in HK\$ Mn)</i>	<i>(in HK\$ Mn)</i>
Interest income.....	106	266	1
Interest expense.....	18	52	—
Amounts due from.....	7,307	10,671	50
Amounts due to .....	3,624	1,622	6
Maximum amounts due from .....	8,702	15,953	282
Maximum amounts due to .....	7,574	2,295	18

## Principal Shareholders' and Directors' Interests

### REGISTERED SHAREHOLDERS

As at 30 September 2009, the following corporations were holding 5% or more of the issued shares of BEA according to its Register of Members:

Name of Shareholder	Number of shares held	Percentage of shares
HKSCC Nominees Limited .....	1,349,412,512	73.26
The Bank of East Asia (Nominees) Limited .....	170,791,164	9.27

### INTERESTS OF SUBSTANTIAL SHAREHOLDERS AND OTHER PERSONS

As at 30 September 2009, the following interests and short positions of Substantial Shareholders and Other Persons of BEA in the shares and underlying shares of BEA were recorded in the Register required to be kept by BEA under section 336 of the Securities and Futures Ordinance (Cap. 571 of Hong Kong) (the "SFO"):

#### Long positions in shares of the Bank:

Name	Capacity and nature	No. of shares	Disclosure pursuant to Part XV of SFO	
			% of issued share capital	Disclosure Date
Negocio de Finanzas e Inversiones I, S.L.U.	Beneficial owner	151,063,572 <sup>1</sup>	9.04	30.5.2008
Criteria CaixaCorp, S.A.	Interest of corporation	151,063,572 <sup>1</sup>	9.04	30.5.2008
Caja de Ahorros y Pensiones de Barcelona	Interest of corporation	151,063,572 <sup>1</sup>	9.04	30.5.2008
Guoco Management Company Limited	Beneficial owner	129,264,540 <sup>2,3</sup>	7.02	Remark
Guoco Group Limited	Interest of corporation	129,264,540 <sup>2</sup>	7.02	28.8.2009
GuoLine Overseas Limited	Interest of corporation	129,264,540 <sup>2</sup>	7.02	Remark
GuoLine Capital Assets Limited	Interest of corporation	129,264,540 <sup>2</sup>	7.02	Remark
Hong Leong Company (Malaysia) Berhad	Interest of corporation	129,264,540 <sup>2,3</sup>	7.02	28.8.2009
HL Holdings Sdn Bhd	Interest of corporation	129,264,540 <sup>2</sup>	7.02	28.8.2009
Quek Leng Chan	Interest of corporation	129,264,540 <sup>2</sup>	7.02	28.8.2009
Hong Leong Investment Holdings Pte. Ltd.	Interest of corporation	129,264,540 <sup>3</sup>	7.02	31.8.2009
Davos Investment Holdings Private Limited	Interest of corporation	129,264,540 <sup>3</sup>	7.02	31.8.2009
Kwek Leng Kee	Interest of corporation	129,264,540 <sup>3</sup>	7.02	4.9.2009

#### Notes:-

1 The Bank was notified that, as at 30 June 2009, Caja de Ahorros y Pensiones de Barcelona was holding a 79.45% interest in Criteria CaixaCorp, S.A. which was the sole shareholder of Negocio de Finanzas e Inversiones I, S.L.U. Caja de Ahorros y Pensiones de Barcelona and Criteria CaixaCorp, S.A. were deemed to be interested in the 151,063,572 shares held by Negocio de Finanzas e Inversiones I, S.L.U.

The Bank was notified that the shareholdings of the above three corporations had been increased to 164,928,972 shares as at 31 December 2008 (equivalent to approximately 9.86% of the issued share capital of the Bank on such date). The Bank was subsequently

## Principal Shareholders' and Directors' Interests

notified that the shareholdings of the above three corporations had been increased to 181,421,869 shares as at 30 June 2009 (equivalent to approximately 9.85% of the issued share capital of the Bank on such date), attributable to the 1 for 10 bonus issue of the Bank in April 2009. These 181,421,869 shares are equivalent to approximately 9.85% of the issued share capital of the Bank as at 30 September 2009. Such increases in shareholdings were not required to be disclosed under Part XV of the SFO.

- 2 The references to 129,264,540 shares (of which 1,692,240 shares were physically settled unlisted derivatives) of the Bank in Notes 2 and 3 relate to the same block of shares. Guoco Management Company Limited was the beneficial owner of 129,264,540 shares (equivalent to approximately 7.02% of the issued share capital of the Bank at the time of disclosure pursuant to Part XV of the SFO and 7.02% as at 30 September 2009). Hong Leong Company (Malaysia) Berhad was deemed to be interested in the 129,264,540 shares held by Guoco Management Company Limited by virtue of its 100% interest in GuoLine Capital Assets Limited which owned a 100% interest in GuoLine Overseas Limited. GuoLine Overseas Limited held a 71.48% interest in Guoco Group Limited which in turn was the sole shareholder of Guoco Management Company Limited. GuoLine Capital Assets Limited, GuoLine Overseas Limited and Guoco Group Limited were all deemed to be interested in the 129,264,540 shares held by Guoco Management Company Limited.

Quek Leng Chan was deemed to be interested in the 129,264,540 shares held by Guoco Management Company Limited by virtue of his 100% interest in HL Holdings Sdn Bhd which in turn held 49.11% interest in Hong Leong Company (Malaysia) Berhad.

- 3 The references to 129,264,540 shares (of which 1,692,240 shares were physically settled unlisted derivatives) of the Bank in Notes 2 and 3 relate to the same block of shares. Hong Leong Company (Malaysia) Berhad was 34.49% held by Hong Leong Investment Holdings Pte. Ltd. which was 33.59% held by Davos Investment Holdings Private Limited. Hong Leong Investment Holdings Pte. Ltd. and Davos Investment Holdings Private Limited were deemed to be interested in the 129,264,540 shares (equivalent to approximately 7.02% of the issued share capital of the Bank at the time of disclosure pursuant to XV of the SFO and 7.02% as at 30 September 2009) held by Guoco Management Company Limited by virtue of their interests in Hong Leong Company (Malaysia) Berhad.

Kuek Leng Kee was deemed to be interested in the 129,264,540 shares held by Guoco Management Company Limited by virtue of his 41.92% interest in Davos Investment Holdings Private Limited.

### Remark:

GuoLine Overseas Limited, GuoLine Capital Assets Limited and Guoco Management Company Limited are wholly owned subsidiaries of Hong Leong Company (Malaysia) Bhd and Guoco Group Limited respectively. With the filing of the substantial shareholder notices by Hong Leong Company (Malaysia) Bhd and Guoco Group Limited, these companies do not need to file their respective substantial shareholder notices under the "wholly owned group exemption" as provided in the SFO.

Save as disclosed above, no other interest or short position in the shares, underlying shares or debentures of BEA were recorded in the Register.

## DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS

As at 30 September 2009, the interests and short positions of the Directors and Chief Executive of the Bank in the shares, underlying shares and debentures of the Bank and its associated corporations as recorded in the Register required to be kept under section 352 of the SFO were as follows:

### I. Long positions in shares of the Bank:

Name	Capacity and nature	No. of shares	Total	% of issued share capital
David LI Kwok-po	Beneficial owner	44,634,830		
	Interest of spouse	1,489,625	46,124,455 <sup>1</sup>	2.50
Arthur LI Kwok-cheung	Beneficial owner	9,538,052		
	Founder of discretionary trust	13,127,966	22,666,018 <sup>2</sup>	1.23
Allan WONG Chi-yun	Beneficial owner	333,687		
	Interest of spouse	136		
	Founder of discretionary trust	12,513,316	12,847,139 <sup>3</sup>	0.70

## Principal Shareholders' and Directors' Interests

Name	Capacity and nature	No. of shares	Total	% of issued share capital
WONG Chung-hin	Beneficial owner	51,491		
	Interest of spouse	378,544	430,035 <sup>4</sup>	0.02
LEE Shau-kee	Beneficial owner	2,092,183		
	Interest of corporation	1,100,000	3,192,183 <sup>5</sup>	0.17
Aubrey LI Kwok-sing	Beneficial owner	25,730		
	Interest of spouse	18,490		
	Beneficiary of discretionary trust	33,738,005	33,782,225 <sup>6</sup>	1.83
William MONG Man-wai	Beneficial owner	2,042,950		
	Interest of spouse	33,000		
	Interest of corporation	6,041,926	8,117,876 <sup>7</sup>	0.44
Winston LO Yau-lai	—	—	Nil	Nil
KHOO Kay-peng	Interest of corporation	5,201,008	5,201,008 <sup>8</sup>	0.28
Thomas KWOK Ping-kwong	—	—	Nil	Nil
Richard LI Tzar-kai	—	—	Nil	Nil
Kenneth LO Chin-ming	—	—	Nil	Nil
Eric LI Fook-chuen	Beneficial owner	4,221,662		
	Founder and beneficiary of discretionary trust	21,101,802		
	Interest of corporation	8,675,999	33,999,463 <sup>9</sup>	1.85
Stephen Charles LI Kwok-sze	Beneficial owner	11,413,388		
	Interest of children	522,072		
	Beneficiary of discretionary trusts	2,182,372	14,117,832 <sup>10</sup>	0.77
William DOO Wai-hoi	—	—	Nil	Nil

## Principal Shareholders' and Directors' Interests

Name	Capacity and nature	No. of shares	Total	% of issued share capital
KUOK Khoon-ean	—	—	Nil	Nil
Valiant CHEUNG Kin-piu	—	—	Nil	Nil
Isidro FAINÉ CASAS	—	—	Nil	Nil

### Notes:

- <sup>1</sup> David LI Kwok-po was the beneficial owner of 44,634,830 shares and he was deemed to be interested in 1,489,625 shares through the interests of his spouse, Penny POON Kam-chui.
- <sup>2</sup> Arthur LI Kwok-cheung was the beneficial owner of 9,538,052 shares. Arthur LI Kwok-cheung made a voluntary disclosure of 13,127,966 shares held by a discretionary trust of which he is the founder but has no influence on how the trustee exercises his discretion.
- <sup>3</sup> Allan WONG Chi-yun was the beneficial owner of 333,687 shares and he was deemed to be interested in 136 shares through the interests of his spouse, Margaret KWOK Chi-wai. He was also deemed to be interested in 12,513,316 shares held by a discretionary trust, The Wong Chung Man 1984 Trust, of which Allan WONG Chi-yun was a founder.
- <sup>4</sup> WONG Chung-bin was the beneficial owner of 51,491 shares and he was deemed to be interested in 378,544 shares through the interests of his spouse, LAM Mei-lin.
- <sup>5</sup> LEE Shau-kee was the beneficial owner of 2,092,183 shares.  
LEE Shau-kee was deemed to be interested in 1,100,000 shares held through Superfun Enterprises Limited ("Superfun"). Superfun was wholly owned by The Hong Kong and China Gas Company Limited which was 39.86% held by Henderson Land Development Company Limited ("Henderson Land").  
Henderson Land was 53.47% held by Henderson Development Limited ("Henderson Development"). Hopkins (Cayman) Limited ("Hopkins") as trustee of a unit trust (the "Unit Trust") owned all the issued ordinary shares of Henderson Development. Rimmer (Cayman) Limited ("Rimmer") and Riddick (Cayman) Limited ("Riddick"), as trustees of respective discretionary trusts, held units in the Unit Trust. The entire issued share capital of Hopkins, Rimmer and Riddick were owned by LEE Shau-kee.
- <sup>6</sup> Aubrey LI Kwok-sing was the beneficial owner of 25,730 shares and he was deemed to be interested in 18,490 shares through the interests of his spouse, Elizabeth WOO. The remaining 33,738,005 shares were held by The Fook Wo Trust, a discretionary trust in which Aubrey LI Kwok-sing was one of the discretionary beneficiaries.
- <sup>7</sup> William MONG Man-wai was the beneficial owner of 2,042,950 shares and he was deemed to be interested in 33,000 shares through the interests of his spouse, WONG Pui-fan. Of the remaining 6,041,926 shares, (i) 5,228,077 shares were held through Shun Hing Electronic Trading Co. Ltd., (ii) 735,155 shares were held through Shun Hing Technology Co. Ltd., and (iii) 78,694 shares were held through Shun Hing Advertising Co. Ltd. Such corporations are accustomed to act in accordance with the directions or instructions of William MONG Man-wai who is the Chairman of these corporations.
- <sup>8</sup> KHOO Kay-peng was deemed to be interested in 5,201,008 shares out of which (a) 1,159,694 shares were held through Bonham Industries Limited, a company in which he held 99.9% of the issued capital, and (b) 4,041,314 shares were held through the Malayan United Industries Berhad Group of which he is the Chairman and Chief Executive and a deemed substantial shareholder.
- <sup>9</sup> Eric LI Fook-chuen was the beneficial owner of 4,221,662 shares, and 21,101,802 shares were held by New Jerico (PTC) Limited in the capacity of trustee of The Jerico Unit Trust. Eric LI Fook-chuen is the sole director of New Jerico (PTC) Limited. All the units in The Jerico Unit Trust are held by The New Elico Trust, of which Eric LI Fook-chuen is the founder and a discretionary beneficiary. Eric LI Fook-chuen was also deemed to be interested in 8,675,999 shares held by The Kowloon Dairy Limited of which he is the Chairman and Chief Executive Officer.
- <sup>10</sup> Stephen Charles LI Kwok-sze was the beneficial owner of 11,413,388 shares, and he was deemed to be interested in 522,072 shares through the interests of his children under the age of 18. Of the remaining 2,182,372 shares, (i) 2,001,600 shares were held by a discretionary trust, Settlement of Dr. Simon F. S. Li, of which Stephen Charles LI Kwok-sze, his spouse and his children under the age of 18 were beneficiaries and (ii) 180,772 shares were held by a discretionary trust, Longevity Trust, of which his children under the age of 18 were beneficiaries.

## Principal Shareholders' and Directors' Interests

### II. Long positions in (in respect of equity derivatives) underlying shares of the Bank:

Shares options, being unlisted physically settled equity derivatives, to subscribe for the ordinary shares of the Bank were granted to David LI Kwok-po pursuant to the approved Staff Share Option Schemes. As at 30 September 2009, the outstanding share options were as follows:

Name	Date of Grant	Exercise Period	Exercise Price per share (in HK\$)	Number of shares in the options
David LI Kwok-po	3 May 2005	3 May 2006 to 3 May 2010	20.86	1,100,000
	3 May 2006	3 May 2007 to 3 May 2011	30.04	1,100,000
	10 May 2007	10 May 2008 to 10 May 2012	42.84	1,100,000
	5 May 2008	5 May 2009 to 5 May 2013	40.09	2,200,000
	5 May 2009	5 May 2010 to 5 May 2014	21.25	2,000,000

### III. Interest in debentures of the Bank:

Name	Capacity and nature	Amount of debentures
David LI Kwok-po .....	Beneficial owner	£1,000,000
William MONG Man-wai .....	Interest of corporation ( <i>Note</i> )	U.S.\$2,000,000

*Note:*

*These interests were held through Shun Hing Electronic Trading Company Limited of which William MONG Man-wai is the Chairman. Shun Hing Electronic Trading Company Limited is accustomed to act in accordance with the directions or instructions of William MONG Man-wai.*

### IV. Interests in debentures of associated corporation of the Bank:

Name	Issuer	Capacity and nature	Amount of debentures
Eric LI Fook-chuen .....	The Bank of East Asia (China) Limited	Beneficial owner	CNY10,000,000
Allan WONG Chi-yun.....	The Bank of East Asia (China) Limited	Interest of spouse ( <i>Note</i> )	CNY20,000,000

*Note:*

*Allan WONG Chi-yun was deemed to be interested in these debentures through the interests of his spouse, Margaret KWOK Chi-wai.*

Save as disclosed above, no other interest or short position in the shares, underlying shares or debentures of BEA or any of its associated corporations were recorded in the Register.

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## Description of Innovate

### GENERAL

Innovate, a company limited by shares, was incorporated in the British Virgin Islands on 28 October 2009 under the BVI Business Companies Act, 2004 (as amended) with registration number 1553808. Innovate is a wholly-owned subsidiary of the Bank. Innovate has been incorporated solely for the purposes of issuing the Preference Shares and undertaking transactions related to the issue of the Preference Shares. The registered office of Innovate is situated at the offices of Tricor Services (BVI) Limited, P.O. Box 3340, 2/F Palm Grove House, Road Town, Tortola, British Virgin Islands. Innovate is authorised to issue a maximum of 500,050,000 shares divided into 50,000 ordinary shares of no par value and 500,000,000 preference shares of no par value, of which 1 ordinary share has been issued. The one issued ordinary share is fully-paid and is owned by the Bank.

### BUSINESS OF THE COMPANY

As Innovate is a company incorporated solely for the issue of Preference Shares, the principal objects of Innovate set forth in Clause 5.2 of its Memorandum of Association state that it shall not:

- engage in any business other than (1) issuing and allotting the Preference Shares, (2) applying the proceeds of the issue of the Preference Shares to acquire an assignment right in respect of the Notes under the Assignment Deed, (3) issuing and allotting the Ordinary Shares to the Bank; (4) redeeming the Preference Shares as required or permitted in the Memorandum and Articles of Association (5) paying dividends as permitted by the Memorandum and Articles of Association, and (6) entering into related agreements and transactions and performing any act incidental to or necessary in connection with any of the foregoing;
- create any mortgage, charge or other security interest or right of recourse in respect of any of its assets, present or future;
- have any Company Subsidiaries (as defined in “*Preference Share Terms — Definitions*”);
- consolidate or merge with any other person or convey or transfer its properties or assets substantially as an entirety to any person;
- have any employees;
- issue any shares other than the Ordinary Shares and the Preference Shares;
- open or have any interest in any account with any bank or financial institution, other than any account opened and operated by the Company for the purpose of receiving and funding payments under or in respect of the Preference Shares or the Notes;
- declare any dividends on the Ordinary Shares other than an Ordinary Share Dividend;
- incur any indebtedness; or
- purchase, own, lease or otherwise acquire any real property.

**DIRECTORS**

The directors of Innovate are:

1. Mr. Adrian David LI Man-kiu, Deputy Chief Executive;
2. Mr. Brian David LI Man-bun, Deputy Chief Executive;
3. Mr. Samson LI Kai-cheong, Deputy Chief Executive;
4. Mr. TONG Hon-shing, Deputy Chief Executive;
5. Mr. William CHENG Chuk-man, General Manager and Group Chief Financial Officer of the Bank; and
6. Ms. Jenny CHEUNG King-yu, General Manager and Head of Legal, Secretarial and Tax Division of the Bank.

The business address of each of the directors is The Bank of East Asia, Limited, 10 Des Voeux Rd Central, Hong Kong.

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# The Banking Industry in Hong Kong

*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 at 30 September 2009 and the HKMA Annual Report 2008, which is in turn based on returns submitted to the HKMA by reporting authorised institutions. BEA has not independently verified or checked such information and statistics and does not assume any responsibility for the accuracy or completeness thereof. Reporting authorised institutions as at 30 September 2009 comprised of all the licensed banks, restricted licence banks and deposit-taking companies in Hong Kong. References to assets, liabilities, loans, advances, deposits and negotiable certificates of deposit of banks or authorised institutions relate to assets, liabilities, loans, advances, deposits and negotiable certificates of deposit of only reporting licensed banks or other reporting authorised institutions.*

## INTRODUCTION

The banking industry in Hong Kong has a three-tier system of authorised institutions, comprising licensed banks, restricted licence banks and deposit-taking companies. As at 30 September 2009, there were 146 licensed banks, 26 restricted licence banks and 28 deposit-taking companies operating in Hong Kong; 23 of the licensed banks were incorporated in Hong Kong (including BEA), with the balance of 123 incorporated overseas. Furthermore, there were 72 representative offices of overseas banks.

Primary supervision of Hong Kong incorporated authorised institutions is the responsibility of the HKMA, whereas overseas incorporated banks are subject both to the HKMA and home country supervision. The HKMA obtains regular returns from and sends examination teams to all authorised institutions. Off-site reviews, on-site examinations and prudential meetings are the methods usually adopted for the supervision of authorised institutions. Prudential meetings can also take the form of tripartite meetings between the management of an authorised 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 31 December 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 at 30 June 2009 the Group's capital adequacy ratio was approximately 13.0%. The Banking (Amendment) Ordinance 2005, enacted on 6 July 2005, has put in place a legislative framework for the implementation in Hong Kong of revised capital adequacy standards (commonly known as "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. A summary of banking regulation in Hong Kong is set out in "*Regulation and Supervision*".

## RECENT TRENDS

### Assets

The total assets of all authorised institutions in Hong Kong increased approximately 3.66% from HK\$10,350 billion as at 31 December 2007 to HK\$10,729 billion as at 31 December 2008.

### Loans and Advances

As at 31 December 2008, loans and advances to customers represented approximately 30.6% of the total assets of all authorised institutions in Hong Kong. The total Hong Kong dollar value of loans and advances to customers extended by all authorised institutions in Hong Kong has increased approximately 13.9% from HK\$2,962 billion as at 31 December 2007 to HK\$3,284 billion as at 31 December 2008. Approximately 71.7% of loans and advances to customers extended by all authorised institutions in Hong Kong were denominated in Hong Kong dollars as at 31 December 2008, with the rest in foreign currencies. As at that date, of the total loans and advances to customers of HK\$3,284 billion extended by all authorised institutions, approximately 82.5%

## The Banking Industry in Hong Kong

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was classified as “Loans and Advances for use in Hong Kong plus trade finance” and approximately 17.5% was extended for use outside Hong Kong or where the place of use was not known. The table below illustrates the breakdown of loans classified as “Loans and Advances for use in Hong Kong plus trade finance” by economic sector extended by all authorised institutions in Hong Kong as at 31 December 2008.

Sector	Percentage of Total
Building, Construction, Property Development and Investment .....	25.35
Financial Concerns (other than authorised institution) .....	10.44
Hong Kong’s visible trade.....	6.86
Manufacturing .....	5.42
Wholesale and Retail Trade .....	5.61
Transport and Transport Equipment .....	5.72
Individuals:	
- to purchase flats in GHOS, PSPS and TPS.....	2.10
- to purchase other residential properties .....	21.88
- other purposes .....	8.34
Others .....	8.23
Total .....	100

### Other Assets

The other assets of authorised institutions in Hong Kong comprise predominantly interbank lending to both authorised institutions in Hong Kong and to banks overseas, as well as negotiable debt instruments, investments in shareholding and fixed assets. As at 31 December 2008, interbank lending represented approximately 37.5% of the total assets of all authorised institutions in Hong Kong, with approximately 86.4% of such lending being to banks outside Hong Kong.

## FUNDING

### Deposits from Customers

As at 31 December 2008, deposits from customers represented approximately 56.5% of the total liabilities of all authorised institutions in Hong Kong. Total deposits from customers of all authorised institutions increased approximately 3.3% from HK\$5,869 billion as at 31 December 2007 to HK\$6,060 billion as at 31 December 2008, of which approximately 50% of total customer deposits with authorised institutions were denominated in Hong Kong dollars. Hong Kong dollar deposits decreased approximately 1.3% while deposits denominated in foreign currencies increased approximately 8.3%, in each case from 31 December 2007 to 31 December 2008. As at 31 December 2008, deposits from customers with licensed banks represented approximately 99.5% of deposits from customers with all authorised institutions in Hong Kong. As at 31 December 2008, time deposit accounts, demand accounts and savings accounts accounted for approximately 60%, 7.8%, and 32.1%, respectively, of total deposits by customers with licensed banks in Hong Kong.

### Interbank Funds

Interbank transactions are significant in funding the Hong Kong banking system. As at 31 December 2008, interbank liabilities represented approximately 27.4% of the total liabilities of all authorised institutions in Hong Kong. A portion of the interbank funding for the Hong Kong banking system is sourced from banks outside Hong Kong and, as at 31 December 2008, approximately 81.3% of all interbank 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 at 31 July 2009, the total outstanding value of negotiable certificates of deposit issued by authorised institutions in Hong Kong amounted to HK\$93,412 million, of which approximately 73.3% was denominated in Hong Kong dollars.

### **Deposit Protection Scheme**

On 14 October 2008, the Hong Kong government announced the use of the Exchange Fund to guarantee repayment of all customer deposits held with all Authorised Institutions in Hong Kong subject to the rules laid down in the Deposit Protection Scheme. The guarantee took immediate effect and is scheduled to remain in force until the end of 2010.

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## The Banking Industry in the PRC

*Unless otherwise expressly stated, the information and statistics set out in this section are derived directly from publicly available information. BEA has not independently verified or checked such information and statistics and does not assume any responsibility for the accuracy or completeness thereof.*

### **HISTORY AND DEVELOPMENT OF THE PRC'S BANKING SECTOR**

Between 1949 and the late 1970s, the PRC's banking industry functioned as part of the centrally planned economy and the People's Bank of China ("PBOC") was the PRC'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 specialised banks, while the PBOC focused on acting as the PRC's central bank and as the principal regulator and supervisor of PRC'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 the 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 the PRC'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 the PRC.

Foreign banks' presence in the PRC has a history of over 100 years. BEA set up its first branch in Shanghai in 1920. The growth of foreign banks in the PRC market has continued to accelerate with the introduction of local incorporation of foreign banks marking a key stage in the development of the PRC banking industry. See "*Recent Trends and Developments — Participation of Foreign Banks in the PRC*" below for details.

### **RECENT TRENDS AND DEVELOPMENTS**

#### **Enhanced Regulation and Supervision**

In recent years, the CBRC and other PRC 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 1 January 2007. On 3 July 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 3 July 2007;

*Establishing a general provision requirement for risk-bearing assets.* Starting from July 2005, commercial banks in the PRC are required by the Ministry of Finance ("MOF") 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 statutory reserve requirement.* Between 1 January 2007 to 25 June 2008, the PBOC increased the requirement for statutory Renminbi deposit reserve 15 times, from 9.0% to 17.5%, 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 3 July 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 liberalise interest rates and move towards a more market-based interest rate regime. The on-going interest rate liberalisation 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 the PRC 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 the PRC and their respective Compound Annual Growth Rates for the periods indicated.

	For the year ended 31 December					Compound Annual Growth Rate (2004-2008)
	2004	2005	2006	2007	2008	
	<i>(in RMB, except percentages)</i>					
GDP per capita .....	10,561.0	13,943.6	15,930.8	18,934.0	22,698.0	21.08%
Annual disposable income of urban households per capita .....	9,421.6	10,493.0	11,759.0	13,786.0	15,781.0	13.76%
Annual net income of rural households per capita .....	3,234.2	3,255.0	3,587.0	4,140.0	4,761.0	10.15%

Sources: National Bureau of Statistics of China, PBOC.

**Participation of Foreign Banks in the PRC**

The opening-up of the PRC 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 the PRC were subject to significant restrictions, e.g. geographic restrictions and customer restrictions.

After PRC’s accession to the World Trade Organization (“WTO”) in December 2001, the Chinese government has opened up more business areas to the foreign-funded banks. Pursuant to its WTO accession commitments, the PRC 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 (the “Regulations”). Under the Regulations, with effect from 11 December 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 the PRC (“Wholly Foreign Funded Banks”) can now provide full-scope Renminbi retail banking services to local residents with a local currency business licence, while previously, Renminbi business could only be provided to foreign individuals in the PRC.

BEA (China) successfully incorporated under the Regulations in March 2007, and received approval from the CBRC to carry out Renminbi business with local residents on 20 April 2007. Since then BEA has expanded rapidly, and as at 30 September 2009, BEA (China) has 18 branches and 49 sub-branches in mainland China.

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# Regulation and Supervision

## REGULATION AND SUPERVISION IN HONG KONG

The banking sector 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 licence (“**licence**”) 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 operations in Hong Kong 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 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, a common name or a concert party arrangement to promote the licensed bank’s business;
- (4) in addition, 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 institution. 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 licence or certain conditions in the Banking Ordinance; and
- (4) 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, after consultation with the Financial Secretary, may 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 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 adviser approved by the HKMA;
- (3) to assume control of and carry on the business of the licensed bank, or direct some other person to assume control of and carry on the business 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 Licence

The HKMA also has powers to recommend the revocation or suspension of a licence. 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 grounds for suspension or revocation include the following:

- (1) the licensed bank no longer fulfills the criteria for authorisation 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 licence;
- (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 licence be revoked; or
- (7) the licensed bank is engaging in practices likely to prejudice Hong Kong as an international financial centre or in practices (specified in the HKMA guidelines) that should not be engaged in.

Revocation or suspension of a licence 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%, 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 on a consolidated basis, or on both a consolidated and an unconsolidated basis, or 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 offence 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, all its paid-up capital and reserves, its profit and loss account including its current year's profit or loss, together with perpetual and term subordinated debt meeting prescribed conditions, general provisions against doubtful debts subject to certain limitations and 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. Investments in, advances to and guarantees of liabilities of certain connected companies, shareholdings in subsidiaries or holding companies and in other companies in which more than 20% of voting power is held and investments in other banks (except for those which are not subject to a cross-holding arrangement or not otherwise a strategic investment) must be deducted.

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 at the period-end.

Risk-weight factors are specified in the Banking Ordinance 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 as being percentages varying between 0% to 100% as being 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 standardised 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 standardised 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, operation risk is also required to be included in the determination of the capital adequacy ratio. Even with the inclusion of operation risk in the calculation, the minimum capital adequacy ratio remains unchanged at 8%. For the calculation of operation risk, there are three approaches, namely, basic indicator approach, standardised approach and the advanced measurement approach.

### **Liquidity**

Authorised institutions 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 on a consolidated basis, or both on a consolidated basis and an unconsolidated basis, or 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 offence 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 financial exposure to the Hong Kong government or authorised 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 an authorised institution is financially exposed is a trustee of more than one trust, the HKMA may by notice in writing extend the limit of the institution'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 and 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 7 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; or
- (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 advisers 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 SFO, which came into operation in April 2003, introduced a substantial change to the conduct of securities business by banks. Banks are no longer exempted from the relevant regulations when they engage in securities business. Instead they are required 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 brokerage 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. 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 brokers and their staff in case they are guilty of misconduct or otherwise not fit and proper.

With the introduction of a new 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 Authorised Institutions that are registered under the SFO.

## **REGULATION AND SUPERVISION IN THE PRC**

The banking industry is heavily regulated in the PRC, with the CBRC and the PBOC acting as the principal regulatory authorities. The CBRC is responsible for supervising and regulating banking institutions, and the PBOC, as the central bank of the PRC, is responsible for formulating and implementing monetary policies. The applicable laws and regulations governing activities in the PRC's banking industry consist principally of the PRC PBOC Law, the PRC Commercial Banking Law, PRC Banking Regulation and Supervision Law, and the rules and regulations promulgated thereunder.

The PRC's CEPA with Hong Kong and Macau allows banks from these jurisdictions to operate in mainland China. Further, under Supplement VI to the CEPA, with effect from 1 October 2009, banks in Hong Kong that have established branch outlets 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.

### **Principal Regulators**

Prior to April 2003, the PBOC acted as both the PRC's central bank and the principal supervisor and regulator of the banking industry in the PRC. In April 2003, the CBRC was established to serve as the primary banking industry regulator and it assumed the majority of bank regulatory functions from the PBOC. The PBOC retained its role as the central bank but now has a smaller role in the regulation of banking institutions.

### ***The CBRC***

#### ***Functions and Powers***

The CBRC is the primary supervisory authority responsible for the regulation of banking institutions operating in the PRC, including branches and representative offices established by foreign financial institutions in the PRC.

According to the PRC Banking Regulations and Supervision Law, the main responsibilities of the CBRC include:

- (1) setting and promulgating rules and regulations governing banking institutions and their business activities;
- (2) regulating the establishment, change, dissolution and business scope of banking institutions, as well as granting banking licenses for commercial banks and their branches;
- (3) regulating the establishment, change, dissolution and business scope of foreign bank branches;
- (4) regulating the business activities of banking institutions, including the products and services they offer;
- (5) setting qualification requirements for, and approving or overseeing the nomination of, directors and senior management personnel of banking institutions;
- (6) setting guidelines and standards for internal controls, risk exposure and corporate governance of, and disclosure requirements for, banking institutions;
- (7) conducting on-site inspection and off-site surveillance of the business activities of banking institutions;
- (8) monitoring the financial condition of banking institutions, including establishing standards or requirements for capital adequacy, asset quality and other financial metrics; and
- (9) imposing corrective and punitive measures for violations of applicable banking regulations.

### *Examination and Supervision*

The CBRC, through its head office in Beijing and offices in each province, provincial-level municipality and autonomous region, monitors the operations of commercial banks and their branches through on-site inspections and off-site surveillance. On-site inspections generally include visiting the banks' premises, interviewing bank employees and, for significant issues relating to banks' operations or risk management, senior management and directors, as well as reviewing documents and materials maintained by the banks. The CBRC also conducts off-site surveillance by reviewing financial and other reports regularly submitted by the banks. Off-site surveillance generally includes the surveillance of banks' business activities and risk exposure status to evaluate and analyse the operational risk of the banks. If a banking institution is not in compliance with a regulation, the CBRC has the power to issue corrective and punitive measures, including imposition of fines, suspension of certain business activities, restrictions on distributions of dividends and other income and asset transfers, closure of the institution and other penalties.

### **The PBOC**

As the central bank of the PRC, the PBOC is responsible for formulating and implementing monetary policies and maintaining the stability of the financial markets. According to the PRC PBOC Law, the PBOC is empowered to:

- (1) formulate and implement monetary policies by establishing benchmark interest rates, setting the deposit reserve ratios for commercial banks, extending loans to commercial banks, accepting discounted bills and conducting open market operations;
- (2) issue PRC treasury bills and other government bonds to financial institutions, as the agent of the MOF;
- (3) issue the currency of Renminbi and regulate the flow of Renminbi;
- (4) regulate the inter-bank lending market, inter-bank bond market and inter-bank foreign exchange market;
- (5) set foreign exchange rate policies and manage the PRC's foreign exchange reserves and gold reserves;
- (6) manage the state treasury;
- (7) maintain the normal operation of payment and settlement systems;

## Regulation and Supervision

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- (8) regulate and examine foreign exchange activities;
- (9) establish anti-money laundering guidelines and monitor fund transfers to ensure that such transfers are in compliance with anti-money laundering regulations; and
- (10) act as the central bank of the PRC to conduct relevant international financial activities.

### Other Regulatory Authorities

In addition to the CBRC and the PBOC, commercial banks in the PRC are also subject to the supervision and regulation by other regulatory authorities including, among others, the State Administration of Foreign Exchange (“SAFE”), the China Securities Regulatory Commission (“CSRC”) and China Insurance Regulatory Commission the (“CIRC”). For example, in conducting foreign exchange business, banks are subject to the regulation of the SAFE; in dealing with securities-related matters such as distributing securities investment funds or acting as the custodians of investment assets of securities institutional investors, banks are subject to the regulation of the CSRC; and in conducting bancassurance business, banks are subject to the regulation of the CIRC.

### Licensing Requirements for a foreign bank to incorporate in PRC

#### Basic Requirements

Under the Regulations, for a foreign bank to offer a full range of banking services, including Renminbi retail business, it has to be incorporated in PRC. To incorporate a banking subsidiary in the PRC, foreign banks must at least satisfy the following main criteria:

- (1) provide proof of international track record;
- (2) provide evidence of continual profit-making ability;
- (3) show effective internal policies and procedures, including anti-money laundering measures;
- (4) have approvals from home country regulators;
- (5) the registered capital of the proposed subsidiary must meet the minimum requirement of Renminbi 1.0 billion;
- (6) the principal persons-in-charge of the proposed subsidiary must possess the requisite qualifications;
- (7) execution of the power of attorney to the proposed principal persons-in-charge of the bank;
- (8) guarantee letter issued by the foreign bank establishing a subsidiary, stating that it shall be responsible for all the taxes and other indebtedness that the subsidiary may incur; and
- (9) the foreign banks’ (as the controlling or major shareholders of their PRC subsidiaries) total assets at the end of the most recent year prior to the application for establishment of their PRC subsidiaries must meet the minimum requirement of U.S.\$10 billion.

#### Branches

A wholly-owned foreign bank intending to set up branches in the PRC should allocate a working capital of no less than Renminbi 100 million per branch. The total capital used for setting up these branches should not exceed 60% of the wholly-owned foreign bank registered capital.

### Regulations Regarding Capital Adequacy

#### Capital Adequacy Guidelines

In March 2004, the CBRC implemented capital adequacy guidelines applicable to all commercial banks in the PRC. The guidelines, the Capital Adequacy Measures, provided for a phase-in period whereby all domestic banks must have met minimum capital adequacy ratios by 1 January 2007. On 3 July 2007, the CBRC amended the Capital Adequacy Measures issued in March 2004 to set forth new and more stringent capital adequacy guidelines which must be complied with from 3 July 2007.

## Regulation and Supervision

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While the 2004 guidelines did not change the previous requirements of an 8% capital adequacy ratio and a 4% core capital adequacy ratio, they amended the risk weighting for a variety of assets and required deductions from core capital for certain kinds of assets. In addition, the 2004 guidelines required commercial banks to make adequate allowances for various impairment losses, including for loans, before calculating their capital adequacy ratios. For Wholly Foreign Funded Banks, the capital adequacy ratios are calculated at head office level, as opposed to at branch level. The capital adequacy ratios and core capital adequacy ratio are calculated in accordance with the PRC GAAP as follows:

$$\text{Capital Adequacy Ratio} = \frac{\text{capital} - \text{deductions from capital}}{\text{risk-weighted assets} + (12.5 \times \text{capital charge for market risk})} \times 100\%$$

$$\text{Core Capital Adequacy Ratio} = \frac{\text{core capital} - \text{deductions from core capital}}{\text{risk-weighted assets} + (12.5 \times \text{capital charge for market risk})} \times 100\%$$

The Capital Adequacy Measures and the 2007 amendment to Measures together further raise the requirement on the capital adequacy ratios banks must reach and require that banks in the PRC more efficiently monitor risk and improve their operational safety and stability.

### ***Liquidity Ratios requirements***

The Regulations provides that Wholly Foreign Funded Banks must have a liquidity ratio of its current assets to its current liabilities of no less than 25%.

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## Description of the Units

*The following is a description of the Units. Capitalised terms used herein and not defined have the meanings given to them in “Terms and Conditions of the Notes”, “Preference Share Terms” and “Description of the Guarantee”, as applicable.*

The Units are issued in an aggregate principal amount of U.S.\$500,000,000. Each Unit comprises one Note issued by the Bank and one Preference Share issued by Innovate, a wholly-owned, direct subsidiary of the Bank. The payment obligations of Innovate under the Preference Shares are guaranteed by the Bank pursuant to the Deed of Guarantee.

The Notes will be represented by beneficial interests in the Global Note Certificate in registered form, without coupons attached that will be registered in the name of a nominee of, and shall be deposited on or about the Issue Date with a common depositary for, Euroclear and Clearstream. The Preference Shares will be represented by beneficial interests in the Global Preference Share Certificate in registered form that will be registered in the name of the same nominee of, and shall be deposited on or about the Issue Date with the same common depositary for, Euroclear and Clearstream. Holders of the Units will be entitled to the rights of holders of interests in the Notes and the rights of holders of interests in the Preference Shares. For a description of the rights attaching to the Notes and the Preference Shares see “*Terms and Conditions of the Notes*” and “*Preference Share Terms*”, respectively. For a description of the rights of holders of interests in the Preference Shares in respect of the Guarantee see “*Description of the Guarantee*”.

No global or definitive certificate will be issued in respect of the Units. Interests in the Units will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear and Clearstream. Units will be traded in denominations of U.S.\$1,000.

The Bank, Innovate, the Trustee and Deutsche Bank Luxembourg SA in its capacities as Registrar for the Notes, Registrar for the Preference Shares and as registrar for the Units (the “**Unit Registrar**”) will enter into the Stapling Deed on or about the Issue Date, pursuant to which and to the Conditions and the Memorandum and Articles, the Notes and the Preference Shares are effectively stapled prior to the Assignment Date such that each Note may only be traded together with the corresponding Preference Share in the form of a Unit and any purported transfer otherwise will be void.

On the occurrence of an Assignment Event, the Bank shall instruct Euroclear and Clearstream (or any Alternative Clearing System) not to accept the Notes for clearance in their respective systems with effect from the Assignment Date. On and with effect from the Assignment Date the Registrar for the Notes shall transfer the Notes represented by the Global Note Certificate to the Company by entry in the Note Register without the need for any further formality.

Also, on and with effect from the Assignment Date, the Units will be cancelled and participants in Euroclear and Clearstream having an interest in such Units will be credited with an interest in a corresponding aggregate liquidation preference of Preference Shares.

The Units have been accepted for clearance through Euroclear and Clearstream with the Common Code of 046288360 and the ISIN for the Units is XS0462883603. The Preference Shares have been accepted for clearance through Euroclear and Clearstream with the Common Code of 046288505 and the ISIN for the Preference Shares is XS0462885053. The Notes have been accepted for clearance through Euroclear and Clearstream as a component part of the Units only. Consequently, the Notes have not been assigned a separate Common Code or ISIN. Prior to the Assignment Date, the Notes and the Preference Shares may only be transferred through Euroclear and Clearstream as constituent parts of a Unit by reference to the Common Code and ISIN allocated to the Units. Therefore, interests in the Preference Shares may only be transferred separately through Euroclear and Clearstream by reference to the Common Code and ISIN allocated to the Preference Shares after the Assignment Date.

In connection with the issuance of the Units, the Bank and Innovate will enter into the Preference Share Agency Agreement.

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## Terms and Conditions of the Notes

*The following (subject to completion and amendment) other than the words in italics is the text of the Terms and Conditions of the Notes which will appear on the reverse of each of the definitive certificates evidencing the Notes:*

The U.S.\$500,000,000 Step-Up Subordinated Notes due 2059 (the “Notes”) of The Bank of East Asia, Limited (the “Bank”) are constituted by a trust deed dated 5 November 2009 (as amended or supplemented from time to time, the “Trust Deed”) between the Bank and DB Trustees (Hong Kong) Limited as trustee (the “Trustee”, which expression includes all persons for the time being trustee or trustees appointed under the Trust Deed) and are the subject of a note agency agreement dated 5 November 2009 (as amended or supplemented from time to time, the “Note Agency Agreement”) between the Bank, Deutsche Bank AG, Hong Kong Branch as principal agent (the “Principal Agent”, which expression includes any successor principal agent appointed from time to time in connection with the Notes), Deutsche Bank Luxembourg S.A. as registrar (the “Note Registrar”, which expression includes any successor registrar appointed from time to time in connection with the Notes), Deutsche Bank AG, Hong Kong Branch as calculation agent (the “Calculation Agent”, which expression includes any successor calculation agent appointed from time to time in connection with the Notes), the paying agents named therein (together with the Principal Agent, the Calculation Agent and the Note Registrar, the “Agents”, which expression includes any successor or additional agents appointed from time to time in connection with the Notes) and the Trustee. The Notes are subject to (i) the stapling deed dated 5 November 2009 (as amended or supplemented from time to time, the “Stapling Deed”) between the Bank, the Company, the Trustee, the Note Registrar, Deutsche Bank Luxembourg S.A. as the registrar of the Preference Shares and the Units and (ii) the assignment deed dated 5 November 2009 (as amended or supplemented from time to time, the “Assignment Deed”) between the Bank, Innovate Holdings Limited (the “Company”), the Trustee, the Note Registrar and UBS Limited (the “Initial Purchaser”). Copies of the Trust Deed and the Note Agency Agreement are available for inspection by Noteholders during normal business hours at the office for the time being of the Trustee, being at the date hereof 48/F Cheung Kong Center, 2 Queen’s Road Central, Hong Kong and at the specified offices (as defined in the Note Agency Agreement) of each of the Agents, the initial specified offices of which are set out below.

Certain provisions of these Conditions are summaries of the Trust Deed and the Note Agency Agreement and subject to their detailed provisions. The holders of the Notes are bound by the Trust Deed, and are deemed to have notice of all the provisions of the Trust Deed and the Note Agency Agreement applicable to them.

### 1 DEFINITIONS

“Additional Amounts” has the meaning given in Condition 11;

“Arrears of Interest” has the meaning given in Condition 7(g)(3);

“Assets” means the unconsolidated gross assets of the Bank, as shown in the latest published audited balance sheet of the Bank, but adjusted for subsequent events in such manner as the Directors, or if the Bank is in a Winding-Up, its liquidator may determine;

“Assignee” means the Company or its permitted successors or assigns in accordance with the Assignment Deed;

“Assignment” means the assignment right in respect of all and any outstanding Notes granted by the Initial Purchaser to the Assignee under the terms of the Assignment Deed to be automatically exercised on an Assignment Date;

“Assignment Date” means, in respect of an Assignment Event that is a date, that date and, in respect of an Assignment Event that is the occurrence of an event, the date on which that event first occurs;

“Assignment Event” means the occurrence of any of the following:

- (i) the deferral of payment of any interest on any Note in accordance with Condition 7(g);
- (ii) a Substitution Event;

## Terms and Conditions of the Notes

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- (iii) an Enforcement Event;
- (iv) following the giving of a valid redemption notice in respect of the Preference Shares, the date scheduled for redemption in such notice;
- (v) the Business Day (as defined for the purposes of Condition 3) prior to the Maturity Date;
- (vi) an Optional Assignment Date; or
- (vii) an HKMA Assignment Date;

The Assignment Events set out in paragraphs (i), (iv), (v) and (vi) shall be referred to as “**Scheduled Assignment Events**” and those set out in paragraphs (ii), (iii) and (vii) shall be referred to as “**Non-Scheduled Assignment Events**”;

“**Assignment Notice**” has the meaning given in Condition 6(a);

“**Assignment Transfer Date**” means:

- (i) in the case of a Scheduled Assignment Event, the Assignment Date; and
- (ii) in the case of a Non-Scheduled Assignment Event, the date of delivery of the relevant Assignment Notice pursuant to Condition 6;

“**Business Day**” means:

- (i) for the purposes of Condition 3, a day other than a Saturday or Sunday on which commercial banks are open for business in the city in which the specified office of the Note Registrar (if a Certificate is deposited with it in connection with a transfer or conversion) or the Agent with whom a Certificate is deposited in connection with a transfer or conversion, is located;
- (ii) for the purposes of Condition 7(a), a day other than a Saturday or Sunday on which commercial banks are open for business in New York and London;
- (iii) for the purposes of Condition 9, a day other than a Saturday or Sunday on which commercial banks are open for business in New York and Hong Kong and the city in which the specified office of the Principal Agent is located and, in the case of the surrender of a Certificate, in the place where the Certificate is surrendered;
- (iv) for the purposes of the definition of Interest Determination Date, a day other than a Saturday or Sunday on which commercial banks are open for business in London; and
- (v) in all other cases, a day other than a Saturday or Sunday on which commercial banks are open for business in London and Hong Kong;

“**Calculation Amount**” has the meaning given in Condition 7(b);

“**Capital Adequacy Ratio**” has the meaning given to it from time to time by the HKMA Supervisory Policy Manual CA-S-6 as amended, supplemented or replaced from time to time;

“**Category I Core Capital**” has the meaning given to it from time to time in the HKMA Supervisory Policy Manual CA-S-6 as amended, supplemented or replaced from time to time;

“**Category II Supplementary Capital**” has the meaning given to it from time to time in the HKMA Supervisory Policy Manual CA-S-8, as amended, supplemented or replaced from time to time;

“**Certificate**” has the meaning given in Condition 2(a);

“**Companies Ordinance**” means the Companies Ordinance (Cap. 32) of Hong Kong, as amended from time to time;

## Terms and Conditions of the Notes

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“Company” has the meaning given in Condition 3(g);

“Consolidated Subsidiary” means any Subsidiary of the Bank or any other entity, in each case the financial statements of which are required by HKFRS to be consolidated with the financial statements of the Bank;

“Directors” means the directors of the Bank;

“Distributable Profits” means:

- (i) the aggregate of the consolidated net profits after tax of the Bank and its Consolidated Subsidiaries (determined before any payments of interest, dividends or other distributions by the Bank or any of its Consolidated Subsidiaries on any Category I Core Capital or Category II Supplementary Capital or other securities ranking *pari passu* with such capital but after the deduction of amounts (if any) required by the HKMA to be transferred to the reserves of the Bank on a consolidated basis) for the immediately preceding two six-month financial periods for which results have been announced publicly; less
- (ii) the aggregate amount of interest, dividends, distributions or other amounts paid, determined to be paid or liable to be paid by the Bank or any of its Consolidated Subsidiaries in the twelve-month period ending on and including the applicable Interest Payment Date on:
  - (a) any class of share capital of the Bank;
  - (b) the Notes, the Preference Shares or the Substitute Preference Shares; and
  - (c) any other Category I Core Capital or Category II Supplementary Capital of the Bank or any of its Consolidated Subsidiaries or securities ranking *pari passu* with such capital,

but excluding interest payable on the Notes on the relevant Interest Payment Date;

“Enforcement Event” has the meaning given in Condition 12;

“Group” means the Bank and its Subsidiaries;

“HKFRS” means Hong Kong Financial Reporting Standards, from time to time;

“HKMA” means the Hong Kong Monetary Authority or such other governmental authority in Hong Kong (or if the Bank becomes domiciled in a jurisdiction other than Hong Kong, in such jurisdiction) having primary supervisory authority with respect to the Bank;

“HKMA Assignment Date” means any date designated by the HKMA in its absolute discretion as the Assignment Date;

“Hong Kong Business Day” means a day other than a Saturday or Sunday on which commercial banks are open for business in Hong Kong;

“Interest Determination Date” means, in relation to each Interest Period from and including the Interest Period beginning on 5 November 2019, the day falling two Business Days prior to the first day of the relevant Interest Period;

“Interest Payment Date” has the meaning given in Condition 7(a);

“Interest Period” has the meaning given to it in Condition 7(a);

“Interest Record Date” has the meaning given in Condition 9(a);

“Issue Date” has the meaning given in Condition 7(a);

“Liabilities” means the unconsolidated gross liabilities of the Bank, as shown in the latest published audited balance sheet of the Bank, but adjusted for contingent liabilities and for subsequent events in such manner as the Directors or, if the Bank is in a Winding-Up, its liquidator may determine;

## Terms and Conditions of the Notes

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“LIBOR” shall mean:

- (i) the rate for three-month U.S. dollar deposits which appears on the display designated as page “LIBOR01” on the Reuter Monitor Money Rates Service (or such other page or service as may replace it, or such other service as may be nominated as the information vendor, for the purpose of displaying comparable rates) as at 11.00 a.m. (London time) on the Interest Determination Date;
- (ii) if such rate does not appear on that page, or if the relevant page is unavailable, the Calculation Agent will:
  - (a) request the principal London office of each of four major banks in the U.S. dollar interbank market in London as selected by the Calculation Agent to provide the Calculation Agent with its offered quotation to leading banks in the London interbank market for three-month U.S. dollar deposits as at 11.00 a.m. (London time) on the Interest Determination Date in question; and
  - (b) determine the arithmetic mean (rounded, if necessary, to the nearest one hundred-thousandth of a percentage point, 0.000005% being rounded upwards) of such offered quotations; and
- (iii) if fewer than two such quotations are provided as requested, the Calculation Agent will determine the arithmetic mean (rounded, if necessary, as aforesaid) of the U.S. dollar lending rates which leading banks in London selected by the Calculation Agent are quoting, on the relevant Interest Determination Date, to leading banks in Europe for a period of three months as at 11.00 a.m. (London time),

provided, however, that if the Calculation Agent is unable to determine a rate or (as the case may be) an arithmetic mean in accordance with the above provisions in relation to any Interest Period, the rate of LIBOR applicable to the Notes during such Interest Period shall either be the rate or (as the case may be) arithmetic mean last determined in relation to the Notes in respect of a preceding Interest Period;

“Mandatory Deferral Date” has the meaning given in Condition 7(g);

“Maturity Date” has the meaning given in Condition 8(a);

“Noteholders” has the meaning given in Condition 2(b);

“Optional Assignment Date” means any date designated by the Assignee in its absolute discretion as the Assignment Date;

“Optional Interest Payment Date” has the meaning given in Condition 7(g);

“Parity Securities” means the most senior ranking class or classes of preference shares in the capital of the Bank from time to time and any other securities of the Bank or any other member of the Group ranking or expressed to rank *pari passu* with the Notes and/or such preference shares either issued directly by the Bank or, where issued by a member of the Group, where the terms of the securities benefit from a guarantee or support agreement entered into by the Bank which ranks or is expressed to rank *pari passu* with the Notes and/or such preference shares;

“Preference Shareholders” means the holders of Preference Shares from time to time;

“Preference Shares” has the meaning given in Condition 3(g);

“Rate of Interest” has the meaning given in Condition 7(c);

“Register” has the meaning given in Condition 2(a);

“Senior Creditors” means (a) creditors of the Bank that are unsubordinated creditors of the Bank; (b) creditors of the Bank whose claims are or are expressed to be subordinated to the claims of other creditors of the Bank (other than those whose claims are in respect of the Bank’s outstanding securities or obligations that constitute, or would but for any applicable limitation on the amount of such capital, constitute, Category I Core Capital or whose claims rank or are expressed to rank *pari passu* with, or junior to, the claims of Noteholders); and (c)

creditors of the Bank whose claims are in respect of the Bank's outstanding securities or obligations that constitute Category II Supplementary Capital (and such other securities and obligations outstanding from time to time that rank, or are expressed to rank, *pari passu* with, or senior to, any such Category II Supplementary Capital) but excluding other Parity Securities;

“SGX-ST” means the Singapore Exchange Securities Trading Limited;

“Subsidiary” means each subsidiary as defined in section 2 of the Companies Ordinance for the time being of the Bank;

“Substitute Preference Shares” means the non-cumulative step-up preference shares in an aggregate liquidation preference of U.S.\$500,000,000 proposed to be created and issued by the Bank and conforming to the description thereof set out in the offering circular published by the Bank on 29 October 2009 in respect of the Notes, the Preference Shares and the Substitute Preference Shares;

“Substitution Event” means:

- (i) the HKMA determines in writing that the Bank has a Capital Adequacy Ratio of less than 8% or such other percentage as the HKMA shall stipulate from time to time, as being the minimum required Capital Adequacy Ratio for licensed banks, provided that a Substitution Event will not be deemed to have occurred until the end of any grace period allowed by the HKMA for the Bank to bring its Capital Adequacy Ratio above 8% or such other stipulated percentage;
- (ii) a Winding-Up Proceeding is instituted against the Bank and is not dismissed within 30 Hong Kong Business Days from the initial date of institution; or
- (iii) the HKMA exercises its power to appoint a manager of the Bank under Section 52 of the Banking Ordinance (Cap.155) of Hong Kong;

*Under current policy, the HKMA may allow a grace period of no more than six months to allow a bank (including the Bank) following notice from the HKMA to bring its Capital Adequacy Ratio above 8%. Therefore, if the HKMA were to determine that the Bank's Capital Adequacy Ratio was less than 8% and allow the maximum grace period under current policy, a Substitution Event would not occur until the expiration of a period of six months from the date of the HKMA's written determination.*

“Unit” has the meaning given in Condition 3(g);

“Winding-Up” shall mean, with respect to the Bank, a final and effective order or resolution for the bankruptcy, winding-up, liquidation, receivership or similar proceeding in respect of the Bank; and

“Winding-Up Proceeding” shall mean, with respect to the Bank, proceedings in Hong Kong for the bankruptcy, liquidation, winding-up, receivership, or other similar proceeding of the Bank.

## 2 FORM, DENOMINATION AND TITLE

### (a) Form and Denomination

The Notes are issued in registered form in the denomination of U.S.\$1,000 each and integral multiples in excess thereof without coupons attached. A note certificate (each a “Certificate”) will be issued to each Noteholder (as defined in Condition 2(b)) in respect of its registered holding of Notes. Each Note and each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Noteholders (the “Register”) which the Bank will procure to be kept by the Note Registrar.

*Upon issue, the Notes will be represented by the Global Certificate deposited with a common depositary for, and representing Notes registered in the name of a nominee of, Euroclear and Clearstream, Luxembourg. The Conditions are modified by certain provisions contained in the Global Certificate. See “Summary of Provisions Relating to the Notes while in Global Form”.*

*Any offer or sale of Units in any member state of the European Economic Area that has implemented the Prospectus Directive must be for a minimum purchase price or minimum consideration of at least U.S.\$100,000 or addressed to Qualified Investors (as defined in the Prospectus Directive). To the extent that the Notes are traded on the SGX-ST, the Notes will be traded in a minimum board lot size of U.S.\$200,000 (as long as any of the Notes remain listed on the SGX-ST).*

**(b) Title**

Title to the Notes passes only by transfer and registration in the Register as described in Condition 3. The holder of any Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest in it or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Terms and Conditions, “**Noteholder**” and (in relation to a Note) “**holder**” or “**Holder**” means the person in whose name a Note is registered.

### **3 TRANSFERS OF NOTES; ISSUE OF CERTIFICATES; STAPLING**

**(a) Register**

The Bank will cause the Register to be kept at the specified office of the Note Registrar outside Hong Kong and the United Kingdom and in accordance with the terms of the Note Agency Agreement on which shall be entered the names and addresses of the holders of the Notes and the particulars of the Notes held by them and of all transfers of the Notes.

**(b) Transfer**

Subject to Conditions 3(e), 3(f), 3(g) and 6(a) and the terms of the Note Agency Agreement, a Note may be transferred by delivery of the Certificate issued in respect of that Note, together with the form of transfer on the back duly completed and signed by the holder or his attorney duly authorised in writing and any other evidence as the Note Registrar or such Agent may require, to the specified office of the Note Registrar or any of the other Agents. No transfer of a Note will be valid unless and until entered on the Note Register.

*Transfers of interests in the Notes evidenced by the Global Certificate will be effected as a constituent part of the Units only in accordance with the rules of the relevant clearing systems.*

**(c) Delivery of New Certificates**

Each new Certificate to be issued upon a transfer of Notes will, within five Business Days of receipt by the Note Registrar or, as the case may be, any other relevant Agent of the original Certificate and the form of transfer duly completed and signed (other than as permitted by Condition 6(a)), be made available for collection at the specified office of the Note Registrar or such other relevant Agent or, if so requested in the form of transfer, be mailed by uninsured mail at the risk of the holder entitled to the Notes (but free of charge to the holder and at the Bank’s expense) to the address specified in the form of transfer. The form of transfer is available at the specified office of the Principal Agent.

*Except in the limited circumstances described herein (see “Summary of Provisions Relating to the Notes while in Global Form”), owners of interests in the Notes will not be entitled to receive physical delivery of Certificates.*

Where only part of a principal amount of the Notes (being that of one or more Notes) in respect of which a Certificate is issued is to be transferred, a new Certificate in respect of the Notes not so transferred will, within five Business Days of delivery of the original Certificate to the Note Registrar or other relevant Agent, be made available for collection at the specified office of the Note Registrar or such other relevant Agent or, if so requested in the form of transfer, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred (but free of charge to such holder and at the Bank’s expense) to the address of such holder appearing on the Register.

**(d) Formalities Free of Charge**

Registration of a transfer of Notes and issuance of new Certificates will be effected without charge by or on behalf of the Bank or any of the Agents, but upon payment (or the giving of such indemnity as the Bank or any of the Agents may require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

**(e) Closed Periods**

No Noteholder may require the transfer of a Note to be registered (i) during the period of fifteen days ending on (and including) the dates for payment of any principal pursuant to the Conditions; (ii) during the period of fifteen days ending on (and including) any Interest Record Date (as defined in Condition 9(a)); or (iii) during the period commencing on (and including) the Assignment Date and ending on (and including) the Assignment Transfer Date (if different), other than pursuant to the Assignment (each such period being a “Closed Period”). Any purported transfer made during a Closed Period shall be void.

**(f) Regulations**

All transfers of Notes and entries on the Register will be made subject to the detailed regulations concerning transfer of Notes scheduled to the Note Agency Agreement. The regulations may be changed by the Bank, with the prior written approval of the Trustee and the Note Registrar. A copy of the current regulations will be mailed (free of charge) by the Note Registrar to any Noteholder who asks for one.

**(g) Stapling**

Prior to the Assignment Date, no Noteholder may require the transfer of a Note to be registered by the Bank and the Note Registrar unless it provides evidence satisfactory to the Bank and the Note Registrar that it is simultaneously requesting the transfer to the same transferee to whom it is requiring the transfer of the relevant Note of an equal aggregate amount in liquidation preference of the non-cumulative step-up preference shares of Innovate Holdings Limited (the “Company”) in an aggregate liquidation preference of U.S.\$500,000,000 issued on even date with the Notes (the “Preference Shares”) and that the transfer of such Preference Shares is conditional only upon transfer of the relevant Note as required.

Pursuant to the Stapling Deed, each Note and each Preference Share will together be traded as one unit (each a “Unit”). The Bank and the Company have agreed in the Stapling Deed that, until the Assignment Date, the Bank and the Company will maintain, outside Hong Kong and the United Kingdom, a joint register for the Units to be kept at the specified office of the registrar of the Units.

## 4 STATUS

The Notes constitute direct and unsecured obligations of the Bank, conditional as described below in Condition 5, ranking *pari passu* without any preference among themselves.

## 5 SUBORDINATION

**(a) Conditions to Payment**

Payments in respect of or arising from (including any damages awarded for breach of any obligations under) the Notes are, in addition to the provision as to the payment of interest in Condition 7, conditional upon the Bank being solvent at the time of payment by the Bank and no principal, premium, interest or any other amount shall be due and payable in respect of or arising from the Notes and the Trust Deed except to the extent that the Bank could make such payment and still be solvent immediately thereafter, in each case except where Condition 5(b) applies.

*The obligations of the Bank in respect of the Notes are conditional upon the Bank being solvent for the purpose of this Condition 5 immediately before and after payment by the Bank. If Condition 5 is not satisfied, any amounts which might otherwise have been allocated in or towards payment of principal and interest in respect of the Notes may be used to absorb losses without the Bank being obliged to cease trading.*

In these Conditions, the Bank shall be considered to be solvent if (i) it is able to pay its debts as they fall due and (ii) its Assets exceed its Liabilities. The Trustee may, and upon the request in writing of Noteholders holding in aggregate not less than one-tenth of the principal amount of the outstanding Notes, shall request from the Bank a certificate as to the solvency of the Bank by two Directors (or if there is a Winding-Up of the Bank, the liquidator of the Bank) (“Solvency Certificate”). The Solvency Certificate shall, in the absence of manifest error, be treated and accepted by the Bank, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof.

The Bank shall (except where Condition 5(b) applies) satisfy any Arrears of Interest which arise as a result of this Condition 5(a) in the manner, and at the time, referred to in Condition 7(g).

**(b) Winding-Up**

The rights and claims of the Noteholders are subordinated to the claims of Senior Creditors in that if at any time an order is made, or an effective resolution is passed, for the Winding-Up of the Bank (except, in any such case, a solvent Winding-Up solely for the purposes of a reorganisation, reconstruction or amalgamation or the substitution in place of the Bank of a successor in business of the Bank, the terms of which reorganisation, reconstruction, amalgamation or substitution (x) have previously been approved in writing by the Trustee or by an Extraordinary Resolution (as defined in the Trust Deed) and (y) do not provide that the Notes shall thereby become redeemable or repayable in accordance with these Conditions), the obligation of the Bank to make, and the entitlement of each Noteholder to receive and retain, any payment of the principal of, interest on, Arrears of Interest in relation to, or any other amount with respect to the Notes held by it is subject to the satisfaction in full of the claims of Senior Creditors, and the rights of each such Noteholder against the Bank shall be limited to, and the maximum amount that such Noteholder may recover is, such amount, if any, as would have been payable to the Holder of such Note if, throughout such Winding-Up, such Holder were the holder of one of a class of preference shares in the capital of the Bank (“**Notional Preference Shares**”) having an equal right to a return of assets in the Winding-Up to, and so ranking *pari passu* with, the holders of the most senior class or classes of issued preference shares with non-cumulative dividends (if any) in the capital of the Bank from time to time and which have a preferential right to a return of assets in the Winding-Up over, and so rank ahead of, the holders of all other classes of issued shares for the time being in the capital of the Bank but ranking junior to the claims of Senior Creditors and junior to any notional class of preference shares in the capital of the Bank by reference to which the amount payable in respect of any Category II Supplementary Capital of the Bank in a Winding-Up of the Bank is determined, on the assumption that the amount that such Holder was entitled to receive in respect of each Notional Preference Share on a return of assets in such Winding-Up was an amount equal to the principal amount of, and any applicable premium on, the relevant Note together with accrued interest to the date of payment and any Arrears of Interest thereon together with, to the extent not otherwise included within the foregoing, any other amounts attributable to the Note, including any damages awarded for breach of any obligations, whether or not the conditions referred to in Condition 5(a) are satisfied on the date upon which the same would otherwise be due and payable.

**(c) No Set-off**

Each Noteholder by virtue of being the holder of any Note irrevocably agrees and acknowledges that:

- (i) it may not exercise or claim any right of set-off in respect of any amount owed to it by the Bank arising under or in connection with the Notes; and
- (ii) it shall, to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off.

**(d) No winding-up**

Neither the Trustee nor any Noteholder may take any action to enforce the obligations of the Bank. In particular, neither the Trustee nor any Noteholder may:

- (i) issue any demand under Section 178(1)(a) of the Companies Ordinance (or any analogous provision under any other applicable law) against the Bank;
- (ii) institute a Winding-Up Proceeding against the Bank; or
- (iii) levy or enforce any distress or other execution to, on, or against any assets of the Bank.

## 6 ASSIGNMENT

**(a) Notes subject to Assignment**

Each Noteholder by virtue of becoming or being the Holder of any Note irrevocably agrees and acknowledges that it holds each Note subject to the Assignment. The Bank shall:

- (i) no more than 30 and no less than seven days prior to the Assignment Date in respect of any Scheduled Assignment Event; and

- (ii) as soon as reasonably practicable and in any event no later than 10 days following a Non-Scheduled Assignment Event,

deliver to the Trustee, the Principal Agent and the Note Registrar and to the Noteholders in accordance with Condition 19 a notice (an “Assignment Notice”) stating in reasonable detail the events constituting the Assignment Event and notifying them of the Assignment Date and (if different) the Assignment Transfer Date. With effect from the Assignment Date, the Notes shall cease to be traded with the Preference Shares as a Unit, the provisions of Condition 3(g) shall cease to have effect and the Note Registrar shall, immediately on the Assignment Transfer Date, in accordance with the provisions of the Note Agency Agreement, forthwith without the necessity of a form of transfer from the Holders of the Notes at such time register all Notes then outstanding in the name of the Assignee.

Neither the Trustee, the Principal Agent nor the Note Registrar shall be under any duty to monitor whether any Assignment Event has occurred and will not be responsible to Holders or any other person for any loss arising from any failure by it to do so. Unless and until it has received an Assignment Notice in relation to an Assignment Event, each of the Trustee, the Principal Agent and the Note Registrar shall be entitled to assume that no Assignment Event has occurred.

**(b) Payments on an Assignment**

Noteholders shall not be entitled to any payment in respect of any assignment or transfer of Notes in accordance with Condition 6(a) and the Assignment Deed, and with effect from the Assignment Date all amounts payable to Noteholders under the Notes or the Trust Deed and falling due on or after the Assignment Date (including accrued and unpaid interest for the then current Interest Period to, but excluding, the Assignment Date and any Arrears of Interest outstanding in respect of any period ending on or prior to the Assignment Date) shall be paid solely to the Assignee as Holder of the Notes.

**(c) Claims on a Winding-Up**

With effect from the Assignment Date no person (including any Noteholder by virtue of holding Notes prior to the Assignment Date), other than the Trustee on behalf of the Assignee in accordance with the Trust Deed, will have any claim in a Winding-Up of the Bank in respect of the Notes or the Trust Deed and no such person shall have any right to institute Winding-Up Proceedings with effect from such Assignment Date.

**(d) Turnover**

Any payments (whether intentional, by mistake or otherwise) paid to a Noteholder in respect of its holding of Notes at any time after the Interest Payment Date on or immediately preceding the Assignment Date are to be held by the relevant Noteholder on trust for the Assignee in accordance with the Trust Deed.

*Interest will, subject to deferral pursuant to these Conditions, be paid to Noteholders on each Interest Payment Date. Noteholders are not entitled to any payments on the Notes on or after the Assignment Date (including accrued and unpaid interest for the then current Interest Period to, but excluding, the Assignment Date and any Arrears of Interest outstanding in respect of any period ending on or prior to the Assignment Date). The dividend payable on the Preference Shares on the first Dividend Payment Date will, subject to the limitations, discretions and qualifications under the Memorandum and Articles, include an amount equal to the accrued and unpaid interest for the then current Interest Period and any Arrears of Interest which have accumulated up to and including the Assignment Date. As the payment on the first Dividend Payment Date is subject to the limitations, discretions and qualifications under the Memorandum and Articles, such payment may not be made. If and to the extent that dividends are not paid on the Preference Shares, the relevant Preference Shareholder will have no claim in respect thereof, whether or not the Company subsequently makes payments of any dividends on the Preference Shares.*

*As an Assignment Event will, in any case, occur on the Business Day prior to the Maturity Date, holders of the Notes (other than the Company as the Assignee) will never be entitled to receive repayment of the principal amount of the Notes. On the Assignment Date, however, non-cumulative dividends (to the extent payable under the Memorandum and Articles) will start to accrue on the Preference Shares. To the extent that persons that held Notes prior to the Assignment as part of Units continue to hold the corresponding Preference Shares, such persons will be entitled as Preference Shareholders to receive dividends on the Preference Shares or the redemption proceeds of a redemption of the Preference Shares to the extent such dividends or redemption proceeds become due and payable under the Preference Shares.*

**7 INTEREST**

**(a) Accrual of Interest**

The Notes bear interest from and including 5 November 2009 (the “**Issue Date**”) to but excluding 5 November 2019 at the Rate of Interest payable semi-annually in arrear on 5 May and 5 November in each year (each, an “**Interest Payment Date**”) and thereafter at the Rate of Interest payable quarterly in arrear on 5 February, 5 May, 5 August and 5 November in each year (each, an “**Interest Payment Date**”), subject as provided in Condition 5, Condition 7(g) and Condition 9 and provided however that, commencing on 5 November 2019, if any Interest Payment Date would otherwise fall on a day which is not a Business Day, it will be postponed to the next Business Day unless it would thereby fall into the next calendar month, in which case it will be brought forward to the preceding Business Day.

Each Note will cease to bear interest on the Maturity Date unless, upon due presentation, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at the prevailing Rate of Interest (both before and after judgment) until whichever is the earlier of (1) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (2) the day which is seven days after the Principal Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

The period beginning on (and including) the Issue Date and ending on (but excluding) the first Interest Payment Date and each successive period beginning on an Interest Payment Date and ending on (but excluding) the next Interest Payment Date is called an “**Interest Period**”.

**(b) Calculation of Interest**

Interest in respect of any Note shall be calculated per U.S.\$1,000 in principal amount of the Notes (the “**Calculation Amount**”). The amount of interest payable per Calculation Amount for any Interest Period:

- (i) prior to 5 November 2019 shall be calculated by applying the Rate of Interest to the Calculation Amount and multiplying such product by the Day-Count Fraction for the relevant period, rounding the resulting figure to the nearest cent (half a cent being rounded upwards); and
- (ii) commencing on or after 5 November 2019 shall be calculated by applying the Rate of Interest to the Calculation Amount and multiplying such product by the actual number of days in the Interest Period concerned divided by 360 and rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

The Day-Count Fraction referred to in Condition 7(b)(i) above shall be calculated on the basis of a 360 day year of twelve 30 day months.

**(c) Rate of Interest**

The rate of interest (“**Rate of Interest**”) applicable to the Notes shall be:

- (1) at a fixed interest rate (“**Fixed Interest Rate**”) for the period from, and including, the Issue Date to, but excluding, 5 November 2019 of 8.50% per annum; and
- (2) at a floating interest rate (“**Floating Interest Rate**”) for the period from, and including, 5 November 2019 of LIBOR plus 7.3605% per annum.

**(d) Determination of Floating Interest Rate and Floating Interest Amount**

If the Notes are not to be redeemed in accordance with Condition 8, the Calculation Agent will, as soon as practicable after 11.00 a.m. (London time) on each Interest Determination Date, determine the Floating Interest Rate in respect of the Interest Period commencing immediately following that Interest Determination Date and calculate the amount of interest payable per Calculation Amount on the Interest Payment Date for that Interest Period (the “**Floating Interest Amount**”). Absent manifest error, the Calculation Agent’s determination of the Floating Interest Rate for any Interest Period will be final and binding.

**(e) Publication of Floating Interest Rate and Floating Interest Amount**

The Bank shall cause notice of the Floating Interest Rate in respect of each relevant Interest Period, the Floating Interest Amount in respect of each relevant Interest Period and the relevant date scheduled for payment to be given to the Trustee, the Agents, any stock exchange or other relevant authority on which the Notes are for the time being listed or admitted to trading and, in accordance with Condition 19, the Noteholders, in each case as soon as practicable after its determination but in any event not later than the fourth Hong Kong Business Day thereafter. The Floating Interest Amount, the Floating Interest Rate and the date scheduled for payment so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notice in the event of any extension or shortening of the relevant period in accordance with these Conditions or in the event of manifest error.

**(f) Calculation Agent**

The Bank will procure that, so long as any Note is outstanding, there shall at all times be a Calculation Agent for the purposes of the Notes. If any such Calculation Agent (acting through its relevant office) is unable or unwilling to continue to act as the Calculation Agent, or if the Calculation Agent fails duly to determine the Floating Interest Rate for any Interest Period or to calculate the Floating Interest Amount, the Bank shall (with the prior approval of the Trustee) appoint a leading bank engaged in the London interbank market (acting through its principal London office) to act as such in its place or, as the case may be, to make such determination or calculation. The Calculation Agent may not resign its duties without a successor having been so appointed.

**(g) Deferral of Interest**

- (1) If, as at any Interest Record Date, the Bank does not have Distributable Profits equal to or greater than the aggregate of (i) the interest payment scheduled for such Interest Payment Date and (ii) all other payments to be made on the same date in respect of any obligation ranking or expressed to rank *pari passu* with the Notes (in each case translated into U.S. dollars at the then current exchange rate) (the “*Pari Passu Payments*”), such Interest Payment Date shall be referred to as a “**Mandatory Deferral Date**”. The Bank must, unless otherwise allowed by the HKMA, reduce the amount of interest payable on a Mandatory Deferral Date to an amount that may be paid on a *pro rata* basis with all other *Pari Passu Payments* without exceeding the relevant amount of Distributable Profits, subject to the minimum amount of interest payable on any Interest Payment Date being zero. Any failure by the Bank to pay an amount exceeding the *pro rata* amount of the Bank’s Distributable Profits attributable to the Notes on a Mandatory Deferral Date shall not constitute a default by the Bank for any purpose.
- (2) To the extent that Condition 7(g)(1) does not apply, if, during the 12 months preceding any Interest Payment Date, no dividend has been declared or paid on any class of share capital of the Bank, such due date shall be referred to as an “**Optional Interest Payment Date**”. The Bank may if it so elects, but shall not be obliged to, pay on any Optional Interest Payment Date the interest that is due to be paid on such date in respect of the Notes and any failure to pay shall not constitute a default by the Bank for any purpose.
- (3) Any interest not paid on a Mandatory Deferral Date or an Optional Interest Payment Date shall (except to the extent such interest shall subsequently have been paid) constitute “**Arrears of Interest**”. Arrears of Interest shall themselves bear interest at the then prevailing Rate of Interest.
- (4) Arrears of Interest shall, prior to the commencement of the Winding-Up of the Bank and subject to the foregoing provisions of this Condition 7(g), be paid in whole or in part upon the next following Interest Payment Date on which a payment is made, but payment in respect of Interest Periods during which Arrears of Interest have accrued shall be made taking the earliest Interest Period first. Arrears of Interest shall otherwise only become payable on (i) the due date for repayment of the Notes to which such Arrears of Interest relate, (ii) the date on which any declaration or payment of any dividend on any class of share capital of the Bank is made or (iii) the commencement of the Winding-Up of the Bank (except for the purposes of a reconstruction, amalgamation or otherwise the terms of which have previously been approved in writing by the Trustee or by an Extraordinary Resolution of Noteholders or which is permitted under Condition 16(c) or Condition 17).

- (5) The Bank shall give notice in writing to the Trustee and the Principal Agent and to Noteholders in accordance with Condition 19:
- (i) not more than 15 Hong Kong Business Days prior to any Mandatory Deferral Date that such Interest Payment Date is a Mandatory Deferral Date and the amount of interest, if any, to be paid on such Mandatory Deferral Date in respect of each U.S.\$1,000 principal amount of Notes; and
  - (ii) not more than 30 days nor less than seven days prior to any Optional Interest Payment Date in respect of which it will elect not to make any payment of interest in accordance with the above provisions, of such election.

## 8 REDEMPTION ON MATURITY AND PURCHASE

- (a) **Maturity:** Unless previously purchased and cancelled as provided herein, the Bank will redeem each Note at its principal amount together with accrued interest thereon and any Arrears of Interest in respect thereof on 5 November 2059 (the “**Maturity Date**”). Other than as set out in Condition 8(b), the Bank may not otherwise redeem the Notes prior to the Maturity Date.

*As an Assignment Event will occur on the Business Day prior to the Maturity Date, holders of the Notes (other than the Company as the Assignee) will never be entitled to receive repayment of the principal amount of the Notes. On the Assignment Date, however, non-cumulative dividends (to the extent payable under the Memorandum and Articles) will start to accrue on the Preference Shares. To the extent that persons that held Notes prior to the Assignment as part of Units continue to hold the corresponding Preference Shares, such persons will be entitled as Preference Shareholders to receive dividends on the Preference Shares or the redemption proceeds of a redemption of the Preference Shares to the extent such dividends or redemption proceeds become due and payable under the Memorandum and Articles.*

- (b) **Redemption on Substitution:** Subject to Condition 8(e), the Bank shall redeem the Notes, in whole but not in part, on the occurrence of a Substitution Event and following the Assignment Transfer Date in respect thereof, in exchange for the Bank issuing and allotting to the Preference Shareholders the Substitute Preference Shares. The Bank shall forthwith on the occurrence of a Substitution Event give notice to the Trustee, the Principal Agent, the Note Registrar and the Noteholders in accordance with Condition 19 stating that a Substitution Event has occurred and the date on which the Notes are to be redeemed.
- (c) **Purchase:** Subject to Condition 8(e), the Bank or any of the Bank’s Subsidiaries may at any time purchase Notes in the open market or otherwise and at any price provided that, prior to the Assignment Date, each Note may only be purchased as part of a Unit together with the corresponding Preference Share.
- (d) **Cancellation:** All Notes so redeemed or purchased by the Bank or any of the Bank’s Subsidiaries (excluding the Company with respect to the Assignment) shall be cancelled and may not be reissued or resold. Nothing in these Conditions shall prevent the Bank or any of its Subsidiaries from acquiring or holding Notes on behalf of clients in a nominee capacity provided that, prior to the Assignment Date, each such Note is acquired and held together with a corresponding Preference Share as a Unit.
- (e) **Conditions:** Notwithstanding any other provision in these Conditions, the Notes (subject as provided below) may not be purchased and cancelled without the prior written consent of the HKMA. Accordingly, neither the Bank nor its Subsidiaries shall purchase the Notes (as principal or, in the case of Subsidiaries, on behalf of the Bank) unless the prior written consent of the HKMA thereto shall have been obtained provided, however, that if from time to time such written consent of the HKMA is not a requirement for any such Notes to constitute Category I Core Capital of the Bank, then the condition to the purchase and cancellation of the relevant Notes set out in this Condition 8(e) shall not apply for so long as such written consent is not so required. Neither the Bank nor any of its Subsidiaries shall require the consent of the HKMA to acquire or hold Notes together with corresponding Preference Shares as Units on behalf of clients in a nominee capacity.

*Holders of the Notes should note that it is intended that the Notes should constitute Category I Core Capital of the Bank and accordingly, under statutory requirements prevailing at the date hereof relating to Category I Core Capital, and by virtue of the above provisions, any purchase and cancellation of the Notes is subject to the prior written consent of the HKMA at the relevant time.*

### 9 PAYMENTS

#### (a) Method of Payment

Payment of principal and interest (including Arrears of Interest) due other than on an Interest Payment Date will be made by transfer to the registered account of the Noteholder or by U.S. dollar cheque mailed to the registered address of the Noteholder if it does not have a registered account. Payment of principal will only be made after surrender of the relevant Certificate at the specified office of any of the Agents.

Interest (including Arrears of Interest) on Notes due on an Interest Payment Date will be paid on the due date for the payment of interest to the holder shown on the Register at the close of business on the fifteenth day before the due date for the payment of interest (the “**Interest Record Date**”). Payments of interest on each Note will be made by transfer to the registered account of the Noteholder or by U.S. dollar cheque mailed to the registered address of the Noteholder if it does not have a registered account.

If an amount which is due on the Notes is not paid in full, the Note Registrar will annotate the Register with a record of the amount (if any) in fact paid.

#### (b) Registered Accounts

For the purposes of this Condition 9, a Noteholder’s registered account means the U.S. dollar account, details of which appear on the Register at the close of business on the Business Day before the relevant Interest Record Date, and a Noteholder’s registered address means its address appearing on the Register at that time.

#### (c) Fiscal Laws

All payments are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 11. No commissions or expenses shall be charged to the Noteholders in respect of such payments.

#### (d) Payment Initiation

Where payment is to be made by transfer to a registered account, payment instructions (for value on the due date or, if that is not a Business Day, for value on the first following day which is a Business Day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed (at the risk and, if mailed at the request of the holder otherwise than by ordinary mail, expense of the holder) on the due date for payment (or, if it is not a Business Day, the immediately following Business Day) or, in the case of a payment of principal, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of an Agent.

#### (e) Delay In Payment

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Noteholder is late in surrendering its Certificate (if required to do so) or if a cheque mailed in accordance with this Condition arrives after the due date for payment.

### 10 LISTING

The Bank will use all reasonable endeavours to maintain a listing of the Notes on the SGX-ST including obtaining all approvals and consents and promptly making all notifications, registrations and filings as may from time to time be required and paying all fees and supplying any and all documents, instruments, information and undertakings and publishing all advertisements or other material that may be necessary for that purpose. Neither the Trustee nor the Note Registrar shall have any responsibility for the maintenance of the listing of the Notes on the SGX-ST or any other stock exchange.

## 11 TAXATION

All payments of principal and interest (including Arrears of Interest) in respect of the Notes by or on behalf of the Bank shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by Hong Kong or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In that event, the Bank shall pay such additional amounts (“**Additional Amounts**”) as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, except that no such Additional Amounts shall be payable in relation to any payment in respect of any Note:

- (a) to or on behalf of a holder which is liable to such taxes, duties, assessments or governmental charges in respect of such Note by reason of its having some connection with Hong Kong other than the mere holding of such Note; or
- (b) where 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 the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (c) to or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Agent in a member state of the European Union; or
- (d) more than 30 days after the Relevant Date except to the extent that the relevant holder would have been entitled to such Additional Amounts if it had presented such Note on the last day of such period of 30 days.

In these Conditions, “**Relevant Date**” means whichever is the later of (1) the date on which the payment in question first becomes due and (2) if the full amount payable has not been received by the Principal Agent or the Trustee on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders.

Any reference in these Conditions to principal or interest (including Arrears of Interest) shall be deemed to include any Additional Amounts in respect of principal or interest (as the case may be) which may be payable under this Condition 11 or any undertaking given in addition to or in substitution of this Condition 11 pursuant to the Trust Deed.

If the Bank becomes subject at any time to any taxing jurisdiction other than Hong Kong, references in these Conditions to Hong Kong shall be construed as references to Hong Kong and/or such other jurisdiction.

## 12 ENFORCEMENT EVENTS

Any default made in the payment of any amount of principal in respect of the Notes on the due date for payment thereof or of any amount of interest in respect of the Notes within seven days after the date upon which the payment of interest is compulsory (unless such payment is to be deferred pursuant to Condition 7(g)) shall be referred to in these Conditions as an “**Enforcement Event**”.

*An Enforcement Event will constitute an Assignment Event and the date of notification of any Enforcement Event will constitute the Assignment Date. Therefore, with effect from the Assignment Date, the Notes will be automatically assigned to the Company as the Assignee under Condition 6 and the provisions of the Assignment Deed. Persons that are Noteholders immediately prior to the Assignment Date to the extent that they retain the Preference Shares that correspond to the Notes assigned to the Company will have the rights of a holder of such Preference Shares effective from the Assignment Date.*

If an order is made or an effective resolution is passed for the Winding-Up of the Bank (whether or not an Enforcement Event has occurred and is continuing) then the Trustee at its sole discretion may and, if so requested in writing by holders holding in aggregate at least one-quarter in principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or provided with security to its satisfaction) give written notice to the Bank declaring the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their principal amount together with accrued interest and all Arrears of Interest without further action or formality.

The Trustee at its sole discretion may and, if so requested in writing by holders of at least one quarter in principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or provided with security to its satisfaction) institute such proceedings against the Bank as it may think fit to enforce any obligation, condition or provision binding on the Bank in respect of the Notes provided that neither the Trustee nor the Noteholders shall have any right to institute any Winding-Up Proceedings against the Bank to enforce any obligation, condition or provision in respect of the Notes and neither the Trustee nor the Noteholders shall be entitled to enforce any award of monetary damages or other restitution made by a court against the Bank in respect of any breach of such obligation, condition or provision until after the commencement of Winding-Up Proceedings of the Bank and the payment of such money, damages or other restitution shall be subject to the provisions of Condition 5. Nothing herein shall limit the right of the Trustee from taking any action to enforce any claims for amounts payable to the Trustee for its own account pursuant to the Trust Deed.

Except as provided herein and in the Trust Deed, the Trustee and the Noteholders shall otherwise have no right to accelerate payment of any Note in the case of an Enforcement Event.

### **13 PRESCRIPTION**

Claims for principal shall become prescribed unless the relevant Notes are presented for payment within ten years of the appropriate Relevant Date. Claims for interest shall become prescribed unless made within five years of the appropriate Relevant Date.

### **14 REPLACEMENT OF NOTES**

If any Certificate is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Principal Agent or such other place of which notice shall be given in accordance with Condition 19, subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Bank may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued. In addition, the Bank may require the person requesting delivery of a replacement Certificate to pay, prior to delivery of such replacement Certificate, any stamp or other tax or governmental charges required to be paid in connection with such replacement.

### **15 TRUSTEE AND AGENTS**

Under the Trust Deed, the Trustee is entitled to be indemnified and/or to be provided with security and to be relieved from responsibility in certain circumstances and to be paid its costs and expenses in priority to the claims of the Noteholders. The Trust Deed includes (without limitation) provisions relieving the Trustee from any obligation to act unless indemnified and/or secured to its satisfaction against any liabilities and expenses which may be incurred by it in the execution of its duties, trusts, powers, authorities, rights or discretions under the Notes, the Trust Deed, the Note Agency Agreement or otherwise. In addition, the Trustee is entitled to enter into business transactions with the Bank and any entity relating to the Bank without accounting for any profit.

The Trustee is entitled to rely on information and certificates provided by the Bank, the independent certified accountants for the time being of the Bank and other parties without investigating or verifying such information or the content of such certificates and the Trustee will not be liable to any person for so relying.

Any certificate or report of any expert or the Bank or any other person called for, by or provided to the Trustee (whether or not addressed to the Trustee) in accordance with or for the purposes of these Conditions or the Trust Deed may be relied upon by the Trustee as sufficient evidence of the facts therein (and shall, in the absence of manifest error, be conclusive and binding on all parties (including, without limitation, the Noteholders)) notwithstanding that such certificate or report and/or engagement letter or other document entered into by the Trustee or the Bank or any other person in connection therewith contains a monetary or other limit on the liability of the relevant expert or person in respect thereof.

In connection with the exercise by it of any of its trusts, powers, authorities, or discretions (including, but without limitation, any modification, waiver, authorisation, determination or substitution), the Trustee shall have regard to the general interests of the Noteholders as a class and shall not have regard to any interests arising from

circumstances particular to individual Noteholders (whatever their number) and, in particular, but without limitation, shall not have regard to the consequences of such exercise for individual Noteholders resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Bank, the Trustee or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders except to the extent already provided for in Condition 11 and/or any undertaking given in addition to, or in substitution for, Condition 11 pursuant to the Trust Deed. In acting under the Note Agency Agreement and in connection with the Notes, the Agents act solely as agents of the Bank and (to the extent provided therein) the Trustee and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders.

The initial Agents and their initial specified offices are listed below. The Bank reserves the right (with the prior written approval of the Trustee) at any time to vary or terminate the appointment of any Agent and to appoint a successor principal agent or registrar and additional or successor agents; provided, however, that the Bank shall at all times maintain (a) a registrar that will maintain the register of Noteholders and the register of holders of Units, in each case outside Hong Kong and the United Kingdom, (b) a principal agent, (c) a paying agent having a specified office in Europe, (d) a calculation agent, and (e) an Agent having a specified office in a European Union member state that will not be obliged to withhold or deduct tax pursuant to any law implementing European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000.

Notice of any change in any of the Agents or in their specified offices shall promptly be given by the Bank to the Noteholders in accordance with Condition 19.

For so long as the Notes are listed on the SGX-ST and the rules of the SGX-ST so require, in the event that the Global Note Certificate (as defined in the Trust Deed) is exchanged for definitive Certificates, the Bank will appoint and maintain a paying agent in Singapore, where the Notes may be presented or surrendered for payment or redemption. In addition, in the event that the Global Note Certificate is exchanged for definitive Certificates, an announcement of such exchange shall be made by or on behalf of the Bank through the SGX-ST and such announcement will include all material information with respect to the delivery of the definitive Certificates, including details of the paying agent in Singapore.

## 16 MEETINGS OF NOTEHOLDERS; MODIFICATION AND WAIVER

- (a) *Meetings of Noteholders:* The Trust Deed contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions or the Trust Deed, and to enable the Trustee to obtain directions or instructions from Noteholders. Any such modification may be made if sanctioned by an Extraordinary Resolution. Such a meeting may be convened by the Bank or by the Trustee and shall be convened by the Trustee upon the request in writing of Noteholders holding in aggregate not less than one-tenth of the principal amount of the outstanding Notes. The quorum at any meeting convened to vote on an Extraordinary Resolution will be two or more persons holding or representing in aggregate more than half of the principal amount of the outstanding Notes or, at any adjourned meeting, one or more persons being or representing Noteholders whatever the principal amount of the Notes held or represented; provided, however, that certain proposals (including any proposal to change any date fixed for payment of principal or interest in respect of the Notes, to reduce or cancel the amount of principal or interest payable on any date in respect of the Notes, to alter the method of calculating the amount of any payment in respect of the Notes (including the Rate of Interest) or the date for any such payment, to change the currency of payments under the Notes or to change the quorum requirements relating to meetings or the majority required to pass an Extraordinary Resolution (each, a “Reserved Matter”) (and for the avoidance of doubt, the matters contemplated in Condition 16(c) and Condition 17 shall not be a Reserved Matter)) may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more persons holding or representing not less than three-quarters or, at any adjourned meeting, one quarter of the aggregate principal amount of the outstanding Notes form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not.

In addition, a resolution in writing signed by or on behalf of not less than 90 per cent. in principal amount of the Notes who for the time being are entitled to receive notice of a meeting of Noteholders under the Trust Deed will take effect as it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

- (b) *Modification and waiver:* The Trustee may, without the consent of the Noteholders, agree (i) to any modification of these Conditions or the Trust Deed (other than in respect of a Reserved Matter) which is, in the opinion of the Trustee, proper to make if, in the opinion of the Trustee, such modification will not be materially prejudicial to the interests of Noteholders and (ii) to any modification of the Notes or the Trust Deed which is in its opinion of a formal, minor or technical nature or is to correct a manifest error. No modification to these Conditions or any other provisions of the Trust Deed shall become effective unless the Trustee shall have received from the Bank a copy of the written approval to such modification from the HKMA.

In addition, the Trustee may, without the consent of the Noteholders, authorise or waive any proposed breach or breach of the Notes or the Trust Deed (other than a proposed breach or breach relating to the subject of a Reserved Matter) if, in the opinion of the Trustee, the interests of the Noteholders will not be materially prejudiced thereby.

Unless the Trustee agrees otherwise, any such authorisation, waiver or modification shall be notified to the Noteholders by the Bank in accordance with Condition 19 as soon as practicable thereafter.

- (c) *Consolidation, Merger and Sale of Assets:* Except as provided in Condition 17 below, the Bank shall not consolidate with or merge into any other company or entity, and the Bank may not, directly or indirectly, sell, convey, transfer or lease all or substantially all of its properties and assets to any company or other entity unless:
- (1) the company or other entity formed by or surviving such consolidation or merger or the person, company or other entity which acquires by conveyance or transfer, or which leases, all or substantially all of the properties and assets of the Bank shall expressly assume by way of supplemental trust deed the due and punctual payment of the principal of, and interest (including any Arrears of Interest) on, the Notes and the performance of the Notes, the Trust Deed and the Note Agency Agreement on the part of the Bank to be performed or observed;
  - (2) immediately after giving effect to such transaction, no Enforcement Event or Assignment Event with respect to the Notes, and no event, which after notice or lapse of time, or both, would become an Enforcement Event or an Assignment Event with respect to the Notes, shall have happened and be continuing;
  - (3) the Bank has delivered to the Trustee (in each case in form and substance satisfactory to the Trustee) (i) a certificate signed by two Directors and (ii) an opinion of independent legal advisers of recognised standing (acceptable to the Trustee) each stating that such consolidation, merger, conveyance, transfer or lease and any such supplemental trust deed comply with this paragraph and that all conditions precedent relating to such transaction have been complied with; and
  - (4) immediately after giving effect to such consolidation, amalgamation or merger of the Bank, no internationally recognised 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.

## **17 SUBSTITUTION**

The Trustee may, without the consent of the Noteholders, agree with the Bank to the substitution in place of the Bank (or of any previous substitute under this Condition) as the principal debtor under the Notes and the Trust Deed (on a subordinated basis equivalent to that set out in Condition 5) of a subsidiary of the Bank, or a holding company of the Bank or any other subsidiary of any such holding company (in each case, the “**Substitute Issuer**”), subject to (a) the Trustee being satisfied that the interests of the Noteholders will not be materially prejudiced by the substitution, (b) the obligations of the Substitute Issuer in these Conditions shall be guaranteed by the Bank on equivalent terms to Condition 5, (c) the Substitute Issuer shall enter into deeds supplemental to the Stapling Deed and the Assignment Deed agreeing to be bound by such documents on the same terms as the Bank and (d) certain other conditions set out in the Trust Deed being complied with. In the case of a substitution pursuant to this Condition the Trustee may in its absolute discretion agree, without the consent of the Noteholders, to a change of the law governing the Notes and/or the Trust Deed and/or the Note Agency Agreement provided that such change would not in the opinion of the Trustee be materially prejudicial to the interests of the Noteholders.

## **18 ENFORCEMENT**

The Trustee may at any time, at its discretion and without further notice, institute such proceedings as it thinks fit in accordance with Condition 12 to enforce its rights under the Trust Deed in respect of the Notes, but it shall not be bound to do so unless:

- (a) it has been so requested in writing by the holders of at least one quarter of the aggregate principal amount of the outstanding Notes or has been so directed by an Extraordinary Resolution; and
- (b) it has been indemnified and/or provided with security to its satisfaction.

No Noteholder may proceed directly against the Bank unless the Trustee, having become bound to do so, fails to do so within a reasonable time and such failure is continuing.

## **19 NOTICES**

All notices to Noteholders shall be validly given if mailed to them at their respective addresses in the Note Register maintained by the Note Registrar or published in (i) a leading daily newspaper in the United Kingdom (which is expected to be the *Financial Times*) and (ii) a leading newspaper having general circulation in Hong Kong or, if such publication is not practicable, in an English language newspaper having general circulation in Asia (which is expected to be the *Asian Wall Street Journal*) and so long as the Notes are listed on SGX-ST and if the rules of SGX-ST so require, published in a leading newspaper having general circulation in Singapore (which is expected to be *The Business Times*). Any such notice shall be deemed to have been given on the later of the first date of publication referred to in (i) and (ii) above and the seventh day after being so mailed, as the case may be.

*So long as the Notes are represented by a Global Note and the Global Certificate is held on behalf of Euroclear or Clearstream or an alternative Clearing System, notices required to be given to Noteholders may be given by their being delivered to the relevant clearing system for communication by it to accountholders entitled to an interest in the respective Units in substitution for notification, as required by these Conditions.*

## **20 GOVERNING LAW AND JURISDICTION**

- (a) *Governing law:* The Trust Deed and the Notes, and any non-contractual obligations arising out of or in connection with them, are governed by, and shall be construed in accordance with, English law except that the subordination provisions set out in Condition 5 hereof and Clause 5 of the Trust Deed, and any non-contractual obligations arising out of or in connection with them, shall be governed by, and construed in accordance with the laws of the Special Administrative Region of Hong Kong.

## Terms and Conditions of the Notes

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- (b) *Jurisdiction:* The courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Trust Deed or the Notes (other than any dispute in relation to Condition 5 or Clause 5 of the Trust Deed in respect of which the Courts of the Special Administrative Region of Hong Kong are to have jurisdiction) and accordingly any legal action or proceedings arising out of or in connection with the Trust Deed or the Notes (“**Proceedings**”) may be brought in such courts.
- (c) *Agent for Service of Process:* The Bank has irrevocably appointed the Bank’s London Branch at its registered office for the time being in England, currently at 75 Shaftesbury Avenue, London W1D 5BB (Attention: General Manager) to receive service of process in any Proceedings in England based on any of the Notes.
- (d) *Rights of Third Parties:* No person shall have any right to enforce any term or condition of this Note under the Contracts (Rights of Third Parties) Act 1999.

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## Preference Share Terms

*The following (subject to completion and amendment) other than the words in italics is the text of the relevant provisions of the Memorandum and Articles of Association of Innovate Holdings Limited (the “Company”).*

### GENERAL

The Preference Shares are created and issued pursuant to a resolution of the Board of Directors of the Company dated 29 October 2009 and are issued fully paid at an issue price equal to U.S.\$1,000 per Preference Share. The Preference Shares rank *pari passu* without any preference among themselves and in priority to the Ordinary Shares.

### DIVIDENDS

#### Entitlement to dividend

Prior to an Assignment Date, the Preference Shares shall not entitle the holders thereof to receive any dividend. With effect from the Assignment Date and subject to the limitations, discretions and qualifications set out in these Memorandum and Articles, each Preference Share shall entitle the holder thereof to receive out of the profits of the Company available for distribution and permitted by law to be distributed, in priority to the payment of any dividend to holders of Ordinary Shares (other than the Ordinary Share Dividend) but *pari passu* among themselves, a non-cumulative preferential dividend from, and including, the Interest Payment Date immediately prior to the Assignment Date to, but excluding, the Step-up Date at the Dividend Rate payable semi-annually in arrear on the Dividend Payment Dates in each year and thereafter at the Dividend Rate payable quarterly in arrear on the Dividend Payment Dates in each year, provided however that, commencing on the Step-up Date, if any Dividend Payment Date would otherwise fall on a day which is not a Business Day, it will be postponed to the next Business Day unless it would thereby fall into the next calendar month, in which case it will be brought forward to the preceding Business Day.

Subject to the limitations, discretions and qualifications set out in these Memorandum and Articles, each Preference Share shall entitle the holder thereof to receive out of the profits of the Company available for distribution and permitted by law to be distributed, in priority to the payment of any dividend to holders of Ordinary Shares but *pari passu* among themselves, an Initial Dividend. The Initial Dividend will be payable on the first Dividend Payment Date occurring on or immediately after the Assignment Date. If, as a result of the limitations, discretions and qualifications set out in these Memorandum and Articles, the Initial Dividend is not paid on the first Dividend Payment Date occurring immediately after an Assignment Date such Initial Dividend will be cancelled and no holder shall have any claim in respect thereof, whether on a Winding-Up or otherwise.

Each Preference Share will cease to bear a dividend from the date fixed for redemption unless, upon the date fixed for redemption, payment of the liquidation preference is improperly withheld or refused, in which case it will continue to bear a dividend at the prevailing Dividend Rate (both before and after judgment) until whichever is the earlier of (1) the day on which all sums due in respect of such Preference Share up to that day are received by or on behalf of the relevant holder and (2) the day which is seven days after the Principal Agent has notified the holders that it has received all sums due in respect of the Preference Shares up to such seventh day (except to the extent that there is any subsequent default in payment).

The period beginning on (and including) the Interest Payment Date immediately prior to the Assignment Date (or, if none, the Issue Date) and ending on (but excluding) the first Dividend Payment Date and each successive period beginning on a Dividend Payment Date and ending on (but excluding) the next Dividend Payment Date is called a “Dividend Period”.

#### Calculation of dividend

The dividend in respect of any Preference Share shall be calculated per U.S.\$1,000 of liquidation preference of the Preference Shares (the “Calculation Amount”). The amount of dividend payable per Calculation Amount for any Dividend Period:

- (i) prior to the Step-up Date shall be calculated by applying the Dividend Rate to the Calculation Amount and multiplying such product by the Day-Count Fraction for the relevant period, rounding the resulting figure to the nearest cent (half a cent being rounded upwards); and

## Preference Share Terms

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- (ii) commencing on or after the Step-up Date shall be calculated by applying the Dividend Rate to the Calculation Amount and multiplying such product by the actual number of days in the Dividend Period concerned divided by 360 and rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

The Day-Count Fraction referred to above shall be calculated on the basis of a 360 day year of twelve 30 day months.

### Rate of dividend

The dividend rate (“**Dividend Rate**”) applicable to the Preference Shares shall be:

- (i) at a fixed rate (“**Fixed Dividend Rate**”) for the period from, and including, the Issue Date, to but excluding, the Step-up Date equal to the Fixed Interest Rate (as defined in Condition 7(c)(1) of the Conditions); and
- (ii) at a floating rate (“**Floating Dividend Rate**”) for the period from, and including, the Step-up Date equal to the Floating Interest Rate (as defined in Condition 7(c)(2) of the Conditions).

### Determination of Floating Dividend Rate and Floating Dividend Amount

If the Preference Shares are not to be redeemed, the Calculation Agent will, as soon as practicable after 11.00 a.m. (London time) on each Dividend Determination Date, determine the Floating Dividend Rate in respect of the Dividend Period commencing immediately following that Dividend Determination Date and calculate the amount of dividend payable per Calculation Amount on the Dividend Payment Date for that Dividend Period (the “**Floating Dividend Amount**”). Absent manifest error, the Calculation Agent’s determination of the Floating Dividend Rate for any Dividend Period will be final and binding.

### Publication of Floating Dividend Rate and Floating Dividend Amount

The Company shall cause notice of the Floating Dividend Rate in respect of each relevant Dividend Period, the Floating Dividend Amount in respect of each relevant Dividend Period and the relevant date scheduled for payment to be given to the Principal Agent and the holders, in each case as soon as practicable after its determination but in any event not later than the fourth Hong Kong Business Day thereafter. The Floating Dividend Amount, the Floating Dividend Rate and the date scheduled for payment so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notice in the event of any extension or shortening of the relevant period in accordance with these Memorandum and Articles or in the event of manifest error.

### Limitation on payment of dividends

- (1) If, as at any Dividend Record Date (as defined in “Payments” below), the Bank does not have Distributable Profits equal to or greater than the aggregate of (i) the dividend scheduled for such Dividend Payment Date and (ii) all other payments to be made in respect of any obligation ranking or expressed to rank *pari passu* with the Guarantee (in each case translated into U.S. dollars at the then current exchange rate) (the “**Pari Passu Payments**”), such Dividend Payment Date shall be referred to as a “**Mandatory Limitation Date**”. The Company must, unless otherwise allowed by the HKMA, reduce the amount of dividend payable on a Mandatory Limitation Date to an amount that may be paid on a *pro rata* basis with all other *Pari Passu* Payments without exceeding the relevant amount of Distributable Profits, subject to the minimum amount of dividend payable on any Dividend Payment Date being zero. Any failure by the Company to pay an amount exceeding the *pro rata* amount of the Bank’s Distributable Profits attributable to the Preference Shares on a Mandatory Deferral Date shall not constitute a default by the Company for any purpose.
- (2) To the extent that clause (1) above does not apply, if, during the 12 months preceding a date on which a dividend is due to be paid in respect of the Preference Shares, no dividend has been declared or paid on any class of share capital of the Bank, such due date shall be referred to as an “**Optional Dividend Payment Date**”. The Company may if it so elects, but shall not be obliged to, pay on any Optional Dividend Payment Date the dividend that is due to be paid on such date in respect of the Preference Shares and any failure to pay shall not constitute a default by the Company for any purpose.

## Preference Share Terms

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- (3) The Company shall give notice to the holders of Preference Shares:
- (i) not more than 15 Hong Kong Business Days prior to any Mandatory Limitation Date that such Dividend Payment Date is a Mandatory Limitation Date and the dividend amount, if any, to be paid on such Mandatory Limitation Date in respect of each U.S.\$1,000 liquidation preference of Preference Shares; and
  - (ii) not more than 30 days nor less than seven days prior to any Optional Dividend Payment Date in respect of which it will elect not to make any dividend payment in accordance with the above provisions, of such election.

## SOLVENCY CONDITION ON PAYMENTS

All payments in respect of the Preference Shares are, in the case of payments of dividends in addition to the provision as to the limitations on payment of dividends above, conditional upon the Bank being solvent at the time of payment by the Company and no dividend or any other amount shall be due and payable in respect of or arising from the Preference Shares except to the extent that the Company could make such payment and the Bank still be solvent immediately thereafter.

In these Memorandum and Articles, the Bank shall be considered to be solvent if (i) it is able to pay its debts as they fall due and (ii) Bank Assets exceed Bank Liabilities. Any Preference Shareholder holding in aggregate not less than one-tenth of the outstanding aggregate liquidation preference of the Preference Shares may request from the Bank a certificate as to the solvency of the Bank by two Bank Directors (or if there is a Winding-Up of the Bank, the liquidator of the Bank) (“Solvency Certificate”). The Solvency Certificate shall, in the absence of manifest error, be treated and accepted by the Bank, the Company, the Preference Shareholders and all other interested parties as correct and sufficient evidence thereof.

## CAPITAL

On a Winding-Up of the Company or other return of capital (other than a redemption, reduction or purchase by the Company of any of its issued shares) the assets of the Company available to the shareholders shall be applied, in priority to any payment to the holders of Ordinary Shares, *pari passu* among themselves, in payment to the holders of the Preference Shares of a sum equal to the aggregate of:

- (i) the liquidation preference of such Preference Shares;
- (ii) an amount equal to dividends accrued thereon for the then current Dividend Period to the date of the commencement of the Winding-Up of the Company or other return of capital (which may include the Initial Dividend), but only to the extent that any such amount was, or would have been payable as a cash dividend; and
- (iii) an amount equal to any dividend thereon which has been resolved to be paid on or after the date of commencement of the Winding-Up of the Company or other return of capital (other than a redemption, reduction or purchase by the Company of its issued shares) but which is payable in respect of a Dividend Period ending on or before such date.

If, upon any return of capital or distribution of assets, the amounts available for payment are insufficient to cover the amounts payable in full on the Preference Shares, the holders of the Preference Shares will share rateably in the distribution of surplus assets (if any) of the Company in proportion to the full amounts to which they are respectively entitled. The Preference Shares confer no rights to participate in the surplus assets of the Company other than as described above.

## REDEMPTION

### Redemption at the option of the Company

Subject to the Act, prior written approval of the HKMA, all other applicable law and regulation and the provisions of these Memorandum and Articles, the Preference Shares may be redeemed at the option of the Company in whole, but not in part, on the Dividend Payment Date falling on the Step-up Date or thereafter on

## Preference Share Terms

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every Dividend Payment Date (the “**Optional Redemption Date**”) at a redemption price equal to 100% of their liquidation preference together with accrued and unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period to the date fixed for redemption on the Company giving not less than 30 nor more than 60 days’ notice to the holders (which notice shall be irrevocable and shall oblige the Company to redeem the Preference Shares on the Optional Redemption Date at such amount).

### **Redemption for tax reasons**

Subject to the Act, all other applicable law and regulation and the provisions of these Memorandum and Articles, the Preference Shares may be redeemed at the option of the Company in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days’ notice to the holders (which notice shall be irrevocable) at a redemption price equal to 100% of their liquidation preference together with accrued and unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period to the date fixed for redemption, if:

- (i) (1) the Company has or will become obliged to pay Additional Amounts (as defined in “Taxation” below) as provided or referred to in these Memorandum and Articles as a result of any change in, or amendment to, the laws or regulations of the British Virgin Islands or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations (including a holding by a court of competent jurisdiction), which change or amendment becomes effective on or after the Pricing Date; and (2) such obligation cannot be avoided by the Company taking reasonable measures available to it; provided, however, that (i) no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Company would be obliged to pay such Additional Amounts; and (ii) prior to such notice of redemption, the written approval of the HKMA for such redemption shall have been obtained;
- (ii) (1) the Bank has or will become obliged to pay Bank Additional Amounts as a result of any change in, or amendment to, the laws or regulations of Hong Kong or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations (including a holding by a court of competent jurisdiction), which change or amendment becomes effective on or after the Pricing Date; and (2) such obligation cannot be avoided by the Bank taking reasonable measures available to it; provided, however, that (i) no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Bank would be obliged to pay such Bank Additional Amounts; and (ii) prior to such notice of redemption, the written approval of the HKMA for such redemption shall have been obtained; or
- (iii) as a result of any change in, or amendment to, the laws or regulations of Hong Kong or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations (including a holding by a court of competent jurisdiction), which change or amendment becomes effective on or after the Pricing Date, (1) the Bank would not be entitled to claim a deduction in respect of computing its taxation liabilities in Hong Kong, or such entitlement is materially reduced; or (2) the Bank would not to any material extent be entitled to have such deduction set against the profits of companies with which it is grouped for applicable Hong Kong tax purposes (under any group relief or similar system or systems having like effect as may from time to time exist), provided in each case, however, that prior to such notice of redemption, the written approval of the HKMA for such redemption shall have been obtained.

### **Regulatory Redemption**

Subject to the Act, prior written approval of the HKMA, all other applicable law and regulations and the provisions of these Memorandum and Articles, the Preference Shares may be redeemed at the option of the Company in whole, but not in part, at any time at a redemption price equal to the Regulatory Event Redemption Price together with accrued but unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period to the date fixed for redemption on the Company giving not less than 30 nor more than 60 days’ notice to holders (which notice shall be irrevocable and shall oblige the Company to redeem the Preference Shares on the date fixed for redemption at such amount), following the occurrence of a Regulatory Redemption Event.

## Preference Share Terms

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For the purposes of this clause a “**Regulatory Redemption Event**” occurs if:

- (i) the Preference Shares no longer qualify as solo Category I Core Capital of the Bank (other than solely by virtue of the Bank already having on issue securities with an aggregate principal amount or liquidation preference up to or in excess of the limit of innovative Category I Core Capital permitted from time to time by the HKMA); or
- (ii) any or all consents or approvals required for the creation and issue of the Substitute Preference Shares are not obtained by the Bank within 180 days of the Issue Date (a “**Substitute Preference Share Regulatory Event**”).

### Purchase

Subject to the Act, all other applicable law and regulation and the provisions of these Memorandum and Articles, the Bank or any of its Subsidiaries (including the Company) may at any time purchase Preference Shares in the open market or otherwise and at any price. Provided that if such purchase occurs prior to the Assignment Date such Preference Shares may only be purchased as part of a Unit (as defined in “Restrictions on Transfer” below) together with the corresponding Note.

### Conditions of Redemption

Notwithstanding any other provision in these Memorandum and Articles, the Preference Shares (subject as provided below) may not be redeemed or purchased and cancelled without the prior written consent of the HKMA. Accordingly (i) the Company shall not redeem any of such Preference Shares and (ii) neither the Bank nor its Subsidiaries (including the Company) shall purchase the Preference Shares unless the prior written consent of the HKMA thereto shall have been obtained provided, however, that if from time to time such consent of the HKMA is not a requirement of any such Preference Shares to constitute Category I Core Capital of the Bank, then the condition to the redemption or purchase and cancellation of the relevant Preference Shares set out herein shall not apply for so long as such consent is not so required.

*Holders of the Preference Shares should note that it is intended that the Preference Shares should constitute Category I Core Capital of the Bank and accordingly, under statutory requirements prevailing at the date hereof relating to Category I Core Capital, and by virtue of the above provisions, any redemption of such Preference Shares or purchase of such Preference Shares by the Bank or its Subsidiaries (including the Company) is subject to the prior consent of the HKMA at the relevant time.*

## PAYMENTS

### Method of Payment

Payment of any amount payable by way of dividend or on redemption of a Preference Share will be made by transfer to the registered account of the holder or by U.S. dollar cheque mailed to the registered address of the holder if it does not have a registered account.

Payments of dividends due on a Dividend Payment Date will be paid on the due date for the payment of the relevant dividend to the holder shown on the Register at the close of business on the fifteenth day before the due date for the payment of the dividend (the “**Dividend Record Date**”).

### Registered Accounts

For the purposes of these Memorandum and Articles, a holder’s registered account means the U.S. dollar account, details of which appear on the Register at the close of business on the Business Day before the relevant Dividend Record Date, and a holder’s registered address means its address appearing on the Register at that time.

### Fiscal Laws

All payments are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of these Memorandum and Articles. No commissions or expenses shall be charged to the holders in respect of such payments.

## Preference Share Terms

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### Payment Initiation

Where payment is to be made by transfer to a registered account, payment instructions (for value on the due date or, if that is not a Business Day, for value on the first following day which is a Business Day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed (at the risk and, if mailed at the request of the holder otherwise than by ordinary mail, expense of the holder) on the due date for payment (or, if it is not a Business Day, the immediately following Business Day).

### Delay In Payment

Holders of Preference Shares will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day or if a cheque mailed in accordance with these Memorandum and Articles arrives after the due date for payment. If an amount which is due on the Preference Shares is not paid in full, the Preference Share Registrar will annotate the Register with a record of the amount (if any) in fact paid.

## TAXATION

All payments in respect of the Preference Shares by or on behalf of the Company shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by the British Virgin Islands or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In that event, the Company shall pay such additional amounts (“**Additional Amounts**”) as will result in the receipt by the holders of such amounts as would have been received by them if no such withholding or deduction had been required, except that no such Additional Amounts shall be payable in respect of any Preference Share presented for payment:

- (i) by or on behalf of a holder which is liable to such taxes, duties, assessments or governmental charges in respect of such Preference Share by reason of its having some connection with the British Virgin Islands other than the mere holding of such Preference Share; or
- (ii) where 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 the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive.

Any reference in these Memorandum and Articles to liquidation preference or dividends shall be deemed to include any Additional Amounts in respect of liquidation preference or dividends (as the case may be) which may be payable under these Memorandum and Articles or any undertaking given in addition to or in substitution of this provision.

If the Company becomes subject at any time to any taxing jurisdiction other than the British Virgin Islands, references in these Memorandum and Articles to the British Virgin Islands shall be construed as references to the British Virgin Islands and/or such other jurisdiction.

## SUBSTITUTION

Subject to the Act, all applicable laws and regulations and the provisions of these Memorandum and Articles, on the occurrence of a Substitution Event, the Company and the Bank pursuant to the Substitution Deed, shall substitute the Preference Shares in whole, but not in part, for Substitute Preference Shares without any requirement for consent or approval of the holders of the Preference Shares. The Company shall, forthwith after the occurrence of a Substitution Event, give notice to the Principal Agent and the Preference Shareholders of the substitution of the Substitute Preference Shares for the Preference Shares.

For the purposes of effecting the substitution, the Company shall, in exchange for the issue to the Preference Shareholders of Substitute Preference Shares in an equal liquidation preference, cancel the Preference Shares in whole, but not in part as soon as reasonably practicable and in any event no later than 10 Business Days after the occurrence of the relevant Substitution Event as notified to the holders (the “**Substitution Date**”) (without the

## Preference Share Terms

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need for any further action on the part of the holders of the Preference Shares). Pursuant to the Substitution Deed, the Bank shall issue and allot to each Preference Shareholder an amount of Substitute Preference Shares in an equal liquidation preference to those Preference Shares that such Preference Shareholder held on the Substitution Date immediately prior to the redemption referred to above.

The Company will pay (or procure that the Bank shall pay) any costs and expenses associated with such substitution and the issuance of the Substitute Preference Shares, including, without limitation, the fees of the Preference Share Registrar and the Principal Agent or other third party involved in the issuance thereof and the fees and expenses relating to the listing and clearing of the Substitute Preference Shares. The Company will also pay (or procure that the Bank shall pay) any stamp duty reserve taxes, capital duties, stamp duties or similar taxes payable in Hong Kong arising on the allotment and issue of the Substitute Preference Shares and the cancellation of the Preference Shares.

### VOTING

The holders of the Preference Shares shall not be entitled to convene, attend or vote at any general meeting of the Company except:

- (i) where a dividend that is payable on such Preference Shares shall have become due or payable and shall not have been paid in full;
- (ii) where a resolution is to be proposed at the meeting varying or abrogating any of the rights, preferences, privileges, limitations or restrictions attached to any class of shares of which the Preference Shares form a part (and then only to attend, speak and vote on any such resolution);
- (iii) where a resolution is proposed to consider the manner in which and terms on which the Bank may exercise or enforce any right to be indemnified, benefit from or enforce any security or exercise any guarantee or indemnity by or against the Company at any time when the Guarantee is outstanding;
- (iv) where a resolution is proposed to consider approving any re-organisation, reconstruction, amalgamation or substitution of the Bank at any time when the Guarantee is outstanding; or
- (v) after the Assignment Date, where a resolution is proposed to consider a Winding-Up Proceeding in relation to the Company.

Whenever holders of Preference Shares are entitled to vote on a resolution, on a show of hands every such holder present in person shall have one vote and every proxy holder present that has been duly appointed by a holder shall have one vote and on a poll every such holder that is present in person or by proxy shall have one vote in respect of each Preference Share held by him.

Subject to the above conditions, all other provisions of these Memorandum and Articles relating to voting rights and procedures also apply to the Preference Shares.

### RESTRICTIONS ON TRANSFER

Prior to the Assignment Date, no holder may require the transfer of a Preference Share to be registered by the Company and the Preference Share Registrar unless it provides evidence satisfactory to the Company and the Preference Share Registrar that it is simultaneously requesting the transfer to the same transferee to whom it is requiring the transfer of the relevant Preference Share of an equal aggregate principal amount of Notes and that the transfer of such Notes is conditional only upon transfer of the relevant Preference Share as required.

Pursuant to the Stapling Deed, each Preference Share and each Note will together be traded as one unit (each a “Unit”). The Bank and the Company have agreed in the Stapling Deed that, until the Assignment Date, the Company and the Bank will maintain, outside Hong Kong and the United Kingdom, a joint register for the Units to be kept at the specified office of Deutsche Bank Luxembourg S.A., or any successor registrar from time to time, appointed under the Stapling Deed (the “Unit Registrar”).

**RESTRICTIONS ON ACTIVITIES**

The Company shall not:

- (i) engage in any business other than (1) issuing and allotting the Preference Shares, (2) applying the proceeds of the issue of the Preference Shares to acquire the Assignment, (3) issuing and allotting the Ordinary Shares to the Bank; (4) redeeming the Preference Shares as required or permitted in these Memorandum and Articles (5) paying dividends as permitted by these Memorandum and Articles and (6) entering into related agreements and transactions and performing any act incidental to or necessary in connection with any of the foregoing;
- (ii) create any mortgage, charge or other security interest or right of recourse in respect of any of its assets, present or future;
- (iii) have any Company Subsidiaries;
- (iv) consolidate or merge with any other person or convey or transfer its properties or assets substantially as an entirety to any person;
- (v) have any employees;
- (vi) issue any shares other than the Ordinary Shares and the Preference Shares;
- (vii) open or have any interest in any account with any bank or financial institution, other than any account opened and operated by the Company for the purposes of receiving and funding payments under or in respect of the Preference Shares or the Notes;
- (viii) declare any dividends on the Ordinary Shares other than the Ordinary Share Dividend;
- (ix) incur any indebtedness; or
- (x) purchase, own, lease or otherwise acquire any real property.

**NO SET-OFF**

Each Preference Shareholder by virtue of being the holder of any Preference Share irrevocably agrees and acknowledges that:

- (i) it may not exercise or claim any right of set-off in respect of any amount owed to it by the Bank arising under or in connection with the Preference Shares; and
- (ii) it shall, to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off.

**NO WINDING-UP**

Prior to the Assignment Date, no Preference Shareholder may take any action to enforce the obligations of the Company. In particular, no Preference Shareholder may:

- (i) issue any demand for the payment of debts under applicable law against the Company;
- (ii) institute a Winding-Up Proceeding against the Company; or
- (iii) levy or enforce any distress or other execution to, on, or against any assets of the Company.

**AMENDMENT**

The provisions of these Memorandum and Articles concerning the Preference Shares may not be amended without the prior written approval of the HKMA. Subject to this requirement, the other provisions of these Memorandum and Articles relating to amendment of these Memorandum and Articles also apply to the foregoing provisions.

### FORM

The Preference Shares will be issued in registered form. Upon issue, the Preference Shares will be represented by a global preference share certificate (“**Global Preference Share Certificate**”) deposited with a common depository for, and representing Preference Shares registered in the name of a nominee of, Euroclear Bank S.A/N.V. (“**Euroclear**”) and Clearstream Banking, société anonyme, Luxembourg (“**Clearstream**”). For so long as the Preference Shares are deposited and registered as described above, book-entry interests in the Preference Shares will be shown on, and transfers thereof will be effected through, records maintained by Euroclear or Clearstream. The Preference Shares will be issued in definitive certificated form only in limited circumstances and these Memorandum and Articles are modified by certain provisions contained in the Global Preference Share Certificate.

### DEFINITIONS

The following terms have the following meanings when used in these Memorandum and Articles:

“**Act**” means the BVI Companies Act 2004, as amended;

“**Arrears of Interest**” means any interest not paid on an Optional Interest Payment Date or a Mandatory Deferral Date (except to the extent such interest shall subsequently have been paid);

“**Assignee**” means the Company or its permitted successors or assigns in accordance with the Assignment Deed;

“**Assignment**” means the assignment right in respect of all and any outstanding Notes granted by the Initial Purchaser to the Assignee under the terms of the Assignment Deed to be automatically exercised on an Assignment Date;

“**Assignment Date**” means, in respect of an Assignment Event that is a date, that date and, in respect of an Assignment Event that is the occurrence of an event, the date on which that event first occurs;

“**Assignment Deed**” means the deed entered into between, among others, the Company, the Bank and the initial holders of the Notes dated the Issue Date, pursuant to which the Notes shall, on the happening of certain specified events, be assigned to the Company;

“**Assignment Event**” means the occurrence of any of the following:

- (i) the deferral of payment of any interest on any Note in accordance with Condition 7(g) of the Conditions;
- (ii) a Substitution Event;
- (iii) an Enforcement Event;
- (iv) following the giving of a valid redemption notice in respect of the Preference Shares, the date scheduled for redemption in such notice;
- (v) the Business Day (as defined for the purposes of Condition 3 of the Conditions) prior to the Maturity Date;
- (vi) an Optional Assignment Date; or
- (vii) an HKMA Assignment Date;

The Assignment Events set out in paragraphs (i), (iv), (v) and (vi) shall be referred to as “**Scheduled Assignment Events**” and those set out in paragraphs (ii), (iii) and (vii) shall be referred to as “**Non-Scheduled Assignment Events**”;

“**Assignment Notice**” means a notice of an Assignment pursuant to the Conditions;

“**Bank**” means The Bank of East Asia, Limited or its successor in business from time to time;

## Preference Share Terms

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“**Bank Additional Amounts**” means, in relation to all payments of principal and interest in respect of the Notes by or on behalf of the Bank, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by Hong Kong or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law;

“**Bank Assets**” means the unconsolidated gross assets of the Bank, as shown in the latest published audited balance sheet of the Bank, but adjusted for subsequent events in such manner as the Bank Directors, or if the Bank is in a Winding-Up, its liquidator may determine;

“**Bank Directors**” means the directors of the Bank;

“**Bank Liabilities**” means the unconsolidated gross liabilities of the Bank, as shown in the latest published audited balance sheet of the Bank, but adjusted for contingent liabilities and for subsequent events in such manner as the Bank Directors or, if the Bank is in a Winding-Up, its liquidator may determine;

“**Board of Directors**” means the board of directors of the Company as constituted from time to time;

“**Business Day**” means:

- (i) for the purposes of the “Dividends” clause, a day other than a Saturday or Sunday on which commercial banks are open for business in New York and London;
- (ii) for the purposes of the “Payments” clause, a day other than a Saturday or Sunday on which commercial banks are open for business in New York and Hong Kong and the city in which the specified office of the Principal Agent is located;
- (iii) for the purposes of the definition of “Dividend Determination Date”, a day other than a Saturday or Sunday on which commercial banks are open for business in London; and
- (iv) in all other cases, a day other than a Saturday or Sunday on which commercial banks are open for business in London and Hong Kong;

“**Calculation Agent**” means Deutsche Bank AG, Hong Kong Branch, or any successor calculation agent from time to time, appointed under the Preference Share Agency Agreement;

“**Capital Adequacy Ratio**” has the meaning given to it from time to time by the HKMA Supervisory Policy Manual CA-S-6 as amended, supplemented or replaced from time to time;

“**Category I Core Capital**” has the meaning given to it from time to time in the HKMA Supervisory Policy Manual CA-S-6 as amended, supplemented or replaced from time to time;

“**Companies Ordinance**” means the Companies Ordinance (Cap. 32) of Hong Kong, as amended from time to time;

“**Company Subsidiary**” has the meaning given to “subsidiary” under the Act;

“**Comparable Treasury Issue**” means the U.S. Treasury selected by the Calculation Agent as having a maturity comparable to the remaining term of the Preference Shares from the relevant date fixed for redemption to the Step-up Date, that would be utilised, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of a maturity most nearly equal to the Step-up Date;

“**Comparable Treasury Price**” means, with respect to any redemption date, the average of three Reference Treasury Dealer Quotations (or such lesser number as is obtained by the Calculation Agent) for the relevant date fixed for redemption of the Preference Shares;

“**Conditions**” means the terms and conditions of the Notes;

“**Consolidated Subsidiary**” means any Subsidiary of the Bank or any other entity, in each case the financial statements of which are required by HKFRS to be consolidated with the financial statements of the Bank;

## Preference Share Terms

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“Distributable Profits” means:

- (i) the aggregate of the consolidated net profits after tax of the Bank and its Consolidated Subsidiaries (determined before any payments of interest, dividends or other distributions by the Bank or any of its Subsidiaries on any Category I Core Capital or Category II Supplementary Capital or other securities ranking *pari passu* with such capital but after the deduction of amounts (if any) required by the HKMA to be transferred to the reserves of the Bank on a consolidated basis) for the immediately preceding two six month financial periods for which results have been announced publicly; less
- (ii) the aggregate amount of interest, dividends, distributions or other amounts paid, determined to be paid or liable to be paid by the Bank or any of its Consolidated Subsidiaries in the twelve month period to and including the applicable Dividend Payment Date on:
  - (a) any class of share capital of the Bank;
  - (b) the Notes, the Preference Shares or the Substitute Preference Shares; and
  - (c) any other Category I Core Capital or Category II Supplementary Capital of the Bank or any of its Consolidated Subsidiaries or securities ranking *pari passu* with such capital,

but excluding dividends payable on the Preference Shares on the relevant Dividend Payment Date;

“Dividend Determination Date” means, in relation to each Dividend Period from and including the Dividend Period beginning on the Step-up Date, the day falling two Business Days prior to the first day of the relevant Dividend Period;

“Dividend Payment Date” means each date defined as an “Interest Payment Date” in the Conditions;

“Enforcement Event” means any default made in the payment of any amount of principal in respect of the Notes on the due date for payment thereof or of any amount of interest in respect of the Notes within seven days after the date upon which the payment of interest is compulsory (pursuant to Condition 7(g) of the Conditions);

“Guarantee” means the subordinated guarantee of certain payments under the Preference Shares made by the Bank under a Deed of Guarantee dated the Issue Date;

“HKFRS” means Hong Kong Financial Reporting Standards, from time to time;

“HKMA” means the Hong Kong Monetary Authority or such other governmental authority in Hong Kong (or if the Bank becomes domiciled in a jurisdiction other than Hong Kong, in such jurisdiction) having primary supervisory authority with respect to the Bank;

“HKMA Assignment Date” means any date designated by the HKMA in its absolute discretion as the Assignment Date;

“Hong Kong Business Day” means a day other than a Saturday or Sunday on which commercial banks are open for business in Hong Kong;

“Initial Dividend” means an amount equal to the Arrears of Interest which have accumulated up to and including the Assignment Date;

“Initial Purchaser” means UBS Limited;

“Interest Payment Date” has the meaning given to it in the Conditions;

“Issue Date” has the meaning given to it in the Conditions;

## Preference Share Terms

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“LIBOR” shall mean:

- (i) the rate for three-month U.S. dollar deposits which appears on the display designated as page “LIBOR01” on the Reuter Monitor Money Rates Service (or such other page or service as may replace it, or such other service as may be nominated as the information vendor, for the purpose of displaying comparable rates) as at 11.00 a.m. (London time) on the Dividend Determination Date;
- (ii) if such rate does not appear on that page, or if the relevant page is unavailable, the Calculation Agent will:
  - (a) request the principal London office of each of four major banks in the U.S. dollar interbank market in London as selected by the Calculation Agent to provide the Calculation Agent with its offered quotation to leading banks in the London interbank market for three-month U.S. dollar deposits as at 11.00 a.m. (London time) on the Dividend Determination Date in question; and
  - (b) determine the arithmetic mean (rounded, if necessary, to the nearest one hundred-thousandth of a percentage point, 0.000005% being rounded upwards) of such offered quotations; and
- (iii) if fewer than two such quotations are provided as requested, the Calculation Agent will determine the arithmetic mean (rounded, if necessary, as aforesaid) of the U.S. dollar lending rates which leading banks in London selected by the Calculation Agent are quoting, on the relevant Dividend Determination Date, to leading banks in Europe for a period of three months as at 11.00 a.m. (London time),

provided, however, that if the Calculation Agent is unable to determine a rate or (as the case may be) an arithmetic mean in accordance with the above provisions in relation to any Dividend Period, the rate of LIBOR applicable to the Preference Shares during such Dividend Period shall either be (i) the rate or (as the case may be) arithmetic mean last determined in relation to the Preference Shares in respect of a preceding Dividend Period;

“**Makewhole Amount**” means in respect of each Preference Share, (a) the liquidation preference of such Preference Share or, if this is higher (b) the amount equal to the sum of the present value of the liquidation preference of such Preference Share, together with the present values of the scheduled dividend payments (assuming for this purpose the relevant dividend payments become due pursuant to these Memorandum and Articles) from the relevant date fixed for redemption to, but excluding, the Step-up Date, in each case, discounted to such redemption date on a semi-annual compounded basis at the adjusted U.S. Treasury Rate plus 0.50 per cent., all as determined by the Calculation Agent;

“**Mandatory Deferral Date**” means any Interest Payment Date, whereas at the relevant Interest Record Date, the Bank does not have Distributable Profits equal to or greater than the interest payment scheduled for that Interest Payment Date and all other payments to be made on such date in respect of any obligation ranking or expressed to rank *pari passu* with the Notes;

“**Maturity Date**” has the meaning given to it in the Conditions;

“**Memorandum and Articles**” means the Memorandum of Association and Articles of Association of the Company as amended from time to time;

“**Note Agency Agreement**” means the note agency agreement dated on or about the Issue Date between the Bank, the principal agent for the Notes, the calculation agent for the Notes and the Note Registrar;

“**Note Registrar**” means Deutsche Bank Luxembourg S.A., or any successor registrar from time to time appointed under the Note Agency Agreement;

“**Notes**” means the Step-Up Subordinated Notes due 2059 issued by the Bank on the Issue Date;

“**Optional Assignment Date**” means any date designated by the Assignee in its absolute discretion as the Assignment Date;

“**Optional Interest Payment Date**” means any Interest Payment Date where during the 12 calendar months preceding such Interest Payment Date no dividend has been declared or paid on any class of share capital of the Bank;

## Preference Share Terms

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“**Ordinary Share Dividend**” means a dividend that, subject to all applicable law and regulation, shall become payable on the Ordinary Shares in any circumstances where the Company holds cash other than for the purposes of the payment of dividends on, or a redemption or repurchase of, Preference Shares, in preference to any payment on the Preference Shares equal to the amount of such cash;

“**Ordinary Shares**” means the ordinary shares of the Company of no par value having a right to participate in a Winding-Up of the Company in the surplus assets on a *pro rata* basis;

“**Preference Share Agency Agreement**” means the preference share agency agreement dated on or about the Issue Date between the Bank, the Company, the Principal Agent, the Calculation Agent and the Preference Share Registrar;

“**Preference Shareholders**” means the holders of Preference Shares;

“**Preference Share Registrar**” means Deutsche Bank Luxembourg S.A., or any successor registrar from time to time, appointed under the Preference Share Agency Agreement;

“**Preference Shares**” means the perpetual non-cumulative step-up preference shares of the Company of no par value issued on the Issue Date;

“**Pricing Date**” means the date of the Subscription Agreement;

“**Principal Agent**” means Deutsche Bank AG, Hong Kong Branch, or any successor principal agent from time to time, appointed under the Preference Share Agency Agreement;

“**Reference Treasury Dealer**” means each of the three nationally recognised investment banking firms selected by the Calculation Agent that are primary U.S. Government securities dealers;

“**Reference Treasury Dealer Quotations**” means with respect to each Reference Treasury Dealer and any date fixed for redemption of the Preference Shares, the average, as determined by the Calculation Agent, of the bid and asked prices for the Comparable Treasury Issue, expressed in each case as a percentage of its principal amount, quoted in writing to the Calculation Agent by such Reference Treasury Dealer at 5:00 p.m., New York City time on the third Business Day immediately preceding such due date for redemption;

“**Register**” means the register of holders of Preference Shares that the Company shall procure is kept by the Preference Share Registrar outside Hong Kong and the United Kingdom;

“**Regulatory Event Redemption Price**” means in respect of each Preference Share:

- (i) in respect of a Substitute Preference Share Regulatory Event, an amount equal to 101% of the liquidation preference of such Preference Share;
- (ii) in respect of a redemption following the occurrence of a Regulatory Redemption Event (other than a Substitute Preference Shares Regulatory Event) scheduled to take place on a date that falls prior to the Step-up Date, an amount equal to the Makewhole Amount; and
- (iii) in respect of a redemption following the occurrence of a Regulatory Redemption Event scheduled to take place on a date that falls on or after the Step-up Date, an amount equal to 100% of the liquidation preference of the relevant Preference Shares;

“**Stapling Deed**” means the stapling deed between the Bank, the Company, the Preference Share Registrar, the Note Registrar, the Unit Registrar and DB Trustees (Hong Kong) Limited dated the Issue Date;

“**Step-up Date**” means the date falling in 2019 from, and including, which the Notes accrue interest at the Floating Interest Rate (as defined in the Conditions) pursuant to the Conditions;

“**Subscription Agreement**” means the subscription agreement between the Bank, the Company, UBS Limited, UBS AG and Deutsche Bank AG, Singapore Branch relating to the initial purchase of the Notes and the Preference Shares;

## Preference Share Terms

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“**Subsidiary**” means each subsidiary, as defined in section 2 of the Companies Ordinance, for the time being of the Bank;

“**Substitute Preference Shares**” means the non-cumulative step-up preference shares proposed to be created by the Bank and conforming to the description thereof set out in the Offering Circular published by the Bank on or about 29 October 2009 in respect of the Notes, the Preference Shares and the Substitute Preference Shares;

“**Substitution Deed**” means the deed entered into between the Company, the Bank, the Preference Share Registrar and the Principal Agent dated the Issue Date, pursuant to which the Preference Shares shall, on the happening of certain specified events, be substituted for the Substitute Preference Shares;

“**Substitution Event**” means:

- (i) the HKMA determines in writing that the Bank has a Capital Adequacy Ratio of less than 8% or such other percentage as the HKMA shall stipulate from time to time as being the minimum required Capital Adequacy Ratio for licensed banks, provided that a Substitution Event will not be deemed to have occurred until the end of any grace period allowed by the HKMA for the Bank to bring its Capital Adequacy Ratio above 8% or such other stipulated percentage;
- (ii) a Winding-Up Proceeding is instituted against the Bank and is not dismissed within 30 Hong Kong Business Days from the initial date of institution; or
- (iii) the HKMA exercises its power to appoint a manager of the Bank under Section 52 of the Banking Ordinance (Cap. 155) of Hong Kong;

“**U.S. dollars**” and “**U.S.\$**” refer to the lawful currency for the time being of the United States of America;

“**U.S. Treasury Rate**” means either (i) the rate per annum equal to the yield, under the heading that represents the average for the week immediately preceding the third Business Day prior to the relevant redemption date, appearing in the most recently published statistical release designated “H.15(519)” or any successor publication that is published weekly by the Board of Governors of the Federal Reserve System and that establishes yields on actively traded U.S. Treasury securities adjusted to constant maturity under the caption “Treasury Constant Maturities — Nominal” for the maturity corresponding to the Comparable Treasury Issue (if no maturity is within three months before or after the Step-up Date, yields for the two published maturities most closely corresponding to the Comparable Treasury Issue shall be determined and the U.S. Treasury Rate shall be interpolated or extrapolated from such yields on a straight line basis, rounding to the nearest month) or (ii) if such release (or any successor release) is not published during the week preceding the third Business Day prior to the relevant date or does not contain such yields, the rate per annum equal to the semi-annual equivalent yield to maturity of the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for the relevant date fixed for redemption, in each case calculated on the third Business Day immediately preceding the relevant date fixed for redemption;

“**Winding-Up**” shall mean a final and effective order or resolution for the bankruptcy, winding-up, liquidation, receivership or similar proceeding in respect of the Bank or the Company (as applicable); and

“**Winding-Up Proceeding**” means:

- (i) with respect to the Bank, proceedings in Hong Kong for the bankruptcy, liquidation, winding-up, receivership, or other similar proceedings of the Bank; and
- (ii) with respect to the Company, proceedings in the British Virgin Islands or Hong Kong for the bankruptcy, liquidation, winding-up, receivership, or other similar proceedings of the Company.

## GOVERNING LAW

The creation and issue of the Preference Shares and the rights attached to them are governed by, and shall be construed in accordance with, British Virgin Islands law.

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## Description of the Guarantee

*The following is a summary of the material provisions of the Guarantee. A copy of the Deed of Guarantee may be inspected at the specified office of the Principal Agent. Capitalised terms used herein have the meanings given to them in “Terms and Conditions of the Notes” and “Preference Share Terms”.*

### **GUARANTEE BY THE BANK**

Pursuant to the Deed of Guarantee, the Bank has unconditionally and irrevocably guaranteed that if the Company does not pay, as and when due and payable, any Guaranteed Payment by the time and on the date specified for such payment, the Bank will pay that sum to or to the order of the Preference Shareholders, in the manner provided in the Memorandum and Articles.

### **GUARANTEE PAYMENTS**

Guaranteed Payments include (i) all dividends due on the Preference Shares to which the Preference Shareholders are entitled and which have become due and payable (or that would have become due and payable but for mandatory provisions of British Virgin Islands law applicable to the Company), including any related Additional Amounts; and/or (ii) any liquidation preference, and any cash amounts due in respect of redemption of the Preference Shares, to which the Preference Shareholders are entitled and which have become due and payable.

### **CONTINUING OBLIGATION**

The Bank’s obligations under the Deed of Guarantee are and will remain in full force and effect by way of continuing security until all the Preference Shares have been redeemed in accordance with the Memorandum and Articles.

### **SUBORDINATION**

The rights and claims of the Preference Shareholders under the Guarantee are subordinated to the claims of Senior Creditors in that if at any time an order is made, or an effective resolution is passed, for the Winding-Up of the Bank (except, in any such case, a solvent Winding-Up solely for the purposes of a reorganisation, reconstruction or amalgamation or the substitution in place of the Bank of a successor in business of the Bank, the terms of which reorganisation, reconstruction, amalgamation or substitution (x) have previously been approved by the Preference Shareholders in general meeting and (y) do not provide that the Preference Shares shall thereby become redeemable or repayable in accordance with the Memorandum and Articles), the obligation of the Bank to make, and the entitlement of the Preference Shareholders to receive and retain, any payment of an amount equal to the liquidation preference of, dividends on, or any other amount with respect to, the Preference Shares is subject to the satisfaction in full of the claims of Senior Creditors, and the rights of the Preference Shareholders against the Bank shall be limited to, and the maximum amount that the Preference Shareholders may recover is such amount, if any, as represents a preferential right to a return of assets in the Winding-Up over, and so ranks ahead of, the holders of all other classes of issued shares for the time being in the capital of the Bank but ranks junior to the claims of Senior Creditors and junior to any notional class of preference shares in the capital of the Bank by reference to which the amount payable in respect of any Category II Supplementary Capital of the Bank in a Winding-Up of the Bank is determined, on the assumption that the amount that such Preference Shareholder is entitled to receive in respect of each Preference Share on a return of assets in such Winding-Up or administration is an amount equal to the liquidation preference, the relevant Preference Share together with accrued but unpaid dividends for the then current Dividend Period to the date of payment together with, to the extent not otherwise included within the foregoing, any other amounts attributable to the Preference Share, including any damages awarded for breach of any obligations.

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## Substitute Preference Share Terms

*The following (subject to completion and amendment) other than the words in italics is the text of the relevant provisions of the Articles of Association of the Bank that the Bank intends to put to the Extraordinary General Meeting of the Bank for the purposes of considering and, if thought fit, passing a resolution providing for the creation and issue of the Substitute Preference Shares on the Substitution Date. References in this section to the “Company” are to The Bank of East Asia, Limited and to “Innovate” are to Innovate Holdings Limited.*

### GENERAL

The Substitute Preference Shares are created pursuant to a resolution of the Shareholders of the Company dated [relevant date to be inserted at the time of issue] 2009 and a resolution of the Board of Directors of the Company dated 19 October 2009 and, when issued, will be fully paid at their nominal value of U.S.\$1,000 per Substitute Preference Share. The Substitute Preference Shares rank *pari passu* without any preference among themselves and in priority to the Ordinary Shares.

### DIVIDENDS

#### Entitlement to dividend

Subject to the limitations, discretions and qualifications set out in these Articles, each Substitute Preference Share shall entitle the holder thereof to receive out of the profits of the Company available for distribution and permitted by law to be distributed, in priority to the payment of any dividend to holders of Ordinary Shares but *pari passu* among themselves, a non-cumulative preferential dividend from, and including, the Interest Payment Date immediately prior to the Assignment Date to, but excluding, 5 November 2019 at the Dividend Rate payable semi-annually in arrear on 5 May and 5 November in each year (each, a “Dividend Payment Date”) and thereafter at the Dividend Rate payable quarterly in arrear on 5 February, 5 May, 5 August and 5 November in each year (each, a “Dividend Payment Date”), provided however that, commencing on 5 November 2019, if any Dividend Payment Date would otherwise fall on a day which is not a Business Day, it will be postponed to the next Business Day unless it would thereby fall into the next calendar month, in which case it will be brought forward to the preceding Business Day.

Subject to the limitations, discretions and qualifications set out in these Articles, each Substitute Preference Share shall entitle the holder thereof to receive out of the profits of the Company available for distribution and permitted by law to be distributed, in priority to the payment of any dividend to holders of Ordinary Shares but *pari passu* among themselves, an Initial Dividend. The Initial Dividend will be payable on the first Dividend Payment Date occurring on or immediately after the Issue Date. If, as a result of the limitations, discretions and qualifications set out in these Articles, the Initial Dividend is not paid on the first Dividend Payment Date occurring immediately after the Issue Date such Initial Dividend will be cancelled and no holder shall have any claim in respect thereof, whether on a Winding-Up or otherwise.

Each Substitute Preference Share will cease to bear a dividend from the date fixed for redemption unless, upon the date fixed for redemption, payment of the liquidation preference is improperly withheld or refused, in which case it will continue to bear a dividend at the prevailing Dividend Rate (both before and after judgement) until the day on which all sums due in respect of such Substitute Preference Share up to that day are received by or on behalf of the relevant holder.

The period beginning on (and including) the Interest Payment Date immediately prior to the Assignment Date (or, if none, the Issue Date) and ending on (but excluding) the first Dividend Payment Date and each successive period beginning on a Dividend Payment Date and ending on (but excluding) the next Dividend Payment Date is called a “Dividend Period”.

#### Calculation of dividend

The dividend in respect of any Substitute Preference Share shall be calculated per U.S.\$1,000 of liquidation preference of the Substitute Preference Shares (the “Calculation Amount”). The amount of dividend payable per Calculation Amount for any Dividend Period:

- (i) prior to 5 November 2019 shall be calculated by applying the Dividend Rate to the Calculation Amount and multiplying such product by the Day-Count Fraction for the relevant period, rounding the resulting figure to the nearest cent (half a cent being rounded upwards); and

## Substitute Preference Share Terms

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- (ii) commencing on or after 5 November 2019 shall be calculated by applying the Dividend Rate to the Calculation Amount and multiplying such product by the actual number of days in the Dividend Period concerned divided by 360 and rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

The Day-Count Fraction referred to above shall be calculated on the basis of a 360 day year of twelve 30 day months.

### Rate of dividend

The dividend rate (“**Dividend Rate**”) applicable to the Substitute Preference Shares shall be:

- (i) at a fixed rate (“**Fixed Dividend Rate**”) for the period from, and including, the Issue Date to but excluding, 5 November 2019 of 8.50% per annum; and
- (ii) at a floating rate (“**Floating Dividend Rate**”) for the period from, and including, 5 November 2019, of LIBOR plus 7.3605% per annum.

### Determination of Floating Dividend Rate and Floating Dividend Amount

If the Substitute Preference Shares are not to be redeemed, the Calculation Agent will, as soon as practicable after 11.00 a.m. (London time) on each Dividend Determination Date, determine the Floating Dividend Rate in respect of the Dividend Period commencing immediately following that Dividend Determination Date and calculate the amount of dividend payable per Calculation Amount on the Dividend Payment Date for that Dividend Period (the “**Floating Dividend Amount**”). Absent manifest error, the Calculation Agent’s determination of the Floating Dividend Rate for any Dividend Period will be final and binding.

### Publication of Floating Dividend Rate and Floating Dividend Amount

The Company shall cause notice of the Floating Dividend Rate in respect of each relevant Dividend Period, the Floating Dividend Amount in respect of each relevant Dividend Period and the relevant date scheduled for payment to be given to the holders as soon as practicable after its determination but in any event not later than the fourth Hong Kong Business Day thereafter. The Floating Dividend Amount, the Floating Dividend Rate and the date scheduled for payment so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notice in the event of any extension or shortening of the relevant period in accordance with these Articles or in the event of manifest error.

### Limitation on payment of dividends

- (i) If, as at any Dividend Record Date, the Company does not have Distributable Profits equal to or greater than the aggregate of (i) the dividend scheduled for such Dividend Payment Date and (ii) all other payments to be made in respect of any obligation ranking or expressed to rank *pari passu* with the Guarantee (in each case translated into U.S. dollars at the then current exchange rate) (the “**Pari Passu Payments**”), such Dividend Payment Date shall be referred to as a “**Mandatory Limitation Date**”. The Company must, unless otherwise allowed by the HKMA, reduce the amount of dividend payable on a Mandatory Limitation Date to an amount that may be paid on a *pro rata* basis with all other *Pari Passu* Payments without exceeding the relevant amount of Distributable Profits, subject to the minimum amount of dividend payable on any Dividend Payment Date being zero. Any failure by the Company to pay an amount exceeding the *pro rata* amount of the Company’s Distributable Profits attributable to the Substitute Preference Shares on a Mandatory Deferral Date shall not constitute a default by the Company for any purpose.
- (ii) To the extent that clause (i) above does not apply, if, during the 12 months preceding a date on which a dividend is due to be paid in respect of the Substitute Preference Shares no dividend has been declared or paid on any class of share capital of the Company, such due date shall be referred to as an “**Optional Dividend Payment Date**”. The Company may if it so elects, but shall not be obliged to, pay on any Optional Dividend Payment Date the dividend that is due to be paid on such date in respect of the Substitute Preference Shares and any failure to pay shall not constitute a default by the Company for any purpose.

## **Substitute Preference Share Terms**

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- (iii) The Company shall give notice to the holders of Substitute Preference Shares:
- (a) not more than 15 Hong Kong Business Days prior to any Mandatory Limitation Date that such Dividend Payment Date is a Mandatory Limitation Date and the dividend amount, if any, to be paid on such Mandatory Limitation Date in respect of each U.S.\$1,000 liquidation preference of Substitute Preference Shares; and
  - (b) not more than 30 days nor less than seven days prior to any Optional Dividend Payment Date in respect of which it will elect not to make any dividend payment in accordance with the above provisions, of such election.

## **SOLVENCY CONDITION ON PAYMENTS**

All payments in respect of the Substitute Preference Shares are, in the case of payment of dividends in addition to the provision as to the limitations on payment of dividends above, conditional upon the Company being solvent at the time of payment and no dividend or any other amount shall be due and payable in respect of or arising from the Substitute Preference Shares except to the extent that the Company could make such payment and still be solvent immediately thereafter.

In these Articles, the Company shall be considered to be solvent if (i) it is able to pay its debts as they fall due and (ii) Assets exceed Liabilities. Any Substitute Preference Shareholder holding in aggregate not less than one-tenth of the outstanding aggregate liquidation preference of the Substitute Preference Shares may request from the Company a certificate as to the solvency of the Company by two Directors (or if there is a Winding-Up of the Company, the liquidator of the Company) (“**Solvency Certificate**”). The Solvency Certificate shall, in the absence of manifest error, be treated and accepted by the Company, the Substitute Preference Shareholders and all other interested parties as correct and sufficient evidence thereof.

## **CAPITAL**

The rights and claims of the Substitute Preference Shareholders are subordinated to the claims of Senior Creditors in that if at any time an order is made, or an effective resolution is passed, for the Winding-Up of the Company (except, in any such case, a solvent Winding-Up solely for the purposes of a reorganisation, reconstruction or amalgamation or the substitution in place of the Company of a successor in business of the Company, the terms of which reorganisation, reconstruction, amalgamation or substitution (x) have previously been approved by the Substitute Preference Shareholders in general meeting and (y) do not provide that the Substitute Preference Shares shall thereby become redeemable or repayable in accordance with these Articles), the obligation of the Company to make, and the entitlement of each Substitute Preference Shareholder to receive and retain, any payment of an amount equal to the liquidation preference of, dividends on, or any other amount with respect to, the Substitute Preference Shares held by it is subject to the satisfaction in full of the claims of Senior Creditors, and the rights of each such Substitute Preference Shareholder against the Company shall be limited to, and the maximum amount that each Substitute Preference Shareholder may recover is such amount, if any, as represents a preferential right to a return of assets in the Winding-Up over, and so ranks ahead of, the holders of all other classes of issued shares for the time being in the capital of the Company but ranks junior to the claims of Senior Creditors and junior to any notional class of preference shares in the capital of the Company by reference to which the amount payable in respect of any Category II Supplementary Capital of the Company in a Winding-Up of the Company is determined, on the assumption that the amount that such Substitute Preference Shareholder is entitled to receive in respect of each Substitute Preference Share on a return of assets in such Winding-Up is an amount equal to the liquidation preference of the relevant Substitute Preference Share together with accrued but unpaid dividends for the then current Dividend Period to the date of payment (which may include the Initial Dividend) together with, to the extent not otherwise included within the foregoing, any other amounts attributable to the Substitute Preference Share, including any damages awarded for breach of any obligations.

## **REDEMPTION**

### **Redemption at the option of the Company**

Subject to the Companies Ordinance, prior written approval of the HKMA, all other applicable law and regulation and the provisions of these Articles, the Substitute Preference Shares may be redeemed at the option of the Company in whole, but not in part, on the Dividend Payment Date falling on 5 November 2019 or

## **Substitute Preference Share Terms**

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thereafter on every Dividend Payment Date (the “**Optional Redemption Date**”) at a redemption price equal to 100% of their liquidation preference together with accrued and unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period to the date fixed for redemption on the Company giving not less than 30 nor more than 60 days’ notice to the holders (which notice shall be irrevocable and shall oblige the Company to redeem the Substitute Preference Shares on the Optional Redemption Date at such amount).

### **Redemption for tax reasons**

Subject to the Companies Ordinance, all other applicable law and regulation and the provisions of these Articles, the Substitute Preference Shares may be redeemed at the option of the Company in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days’ notice to the holders (which notice shall be irrevocable) at a redemption price equal to 100% of their liquidation preference together with accrued and unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period to the date fixed for redemption, if (1) the Company has or will become obliged to pay Additional Amounts as a result of any change in, or amendment to, the laws or regulations of Hong Kong or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations (including a holding by a court of competent jurisdiction), which change or amendment becomes effective on or after 29 October 2009; and (2) such obligation cannot be avoided by the Company taking reasonable measures available to it; provided, however, that (i) no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Company would be obliged to pay such Additional Amounts; and (ii) prior to such notice of redemption, the written approval of the HKMA for such redemption shall have been obtained.

### **Regulatory Redemption**

Subject to the Companies Ordinance, prior written approval of the HKMA, all other applicable law and regulations and the provisions of these Articles, the Substitute Preference Shares may be redeemed at the option of the Company in whole, but not in part, at any time at a redemption price equal to the Regulatory Event Redemption Price together with accrued but unpaid dividends (which may include the Initial Dividend) for the then current Dividend Period to the date fixed for redemption on the Company giving not less than 30 nor more than 60 days’ notice to holders (which notice shall be irrevocable and shall oblige the Company to redeem the Substitute Preference Shares on the date fixed for redemption at such amount), following the occurrence of a Regulatory Redemption Event.

For the purposes of this clause a “**Regulatory Redemption Event**” occurs if the Substitute Preference Shares no longer qualify as solo Category I Core Capital of the Company (other than solely by virtue of the Company already having on issue securities with an aggregate principal amount or liquidation preference up to or in excess of the limit of innovative Category I Core Capital permitted from time to time by the HKMA).

### **Purchase**

Subject to the Companies Ordinance, all other applicable law and regulation and the provisions of these Articles, the Company or any of its Subsidiaries (including Innovate) may at any time purchase Substitute Preference Shares in the open market or otherwise and at any price.

### **Conditions of Redemption**

Notwithstanding any other provision in these Articles, the Substitute Preference Shares (subject as provided below) may not be redeemed or purchased and cancelled without the prior written consent of the HKMA. Accordingly (i) the Company shall not redeem any of such Substitute Preference Shares and (ii) neither the Company nor its Subsidiaries shall purchase the Substitute Preference Shares, unless the prior written consent of the HKMA thereto shall have been obtained provided, however, that if from time to time such consent of the HKMA is not a requirement of any such Substitute Preference Shares to constitute Category I Core Capital of the Company, then the condition to the redemption or purchase and cancellation of the relevant Substitute Preference Shares set out herein shall not apply for so long as such consent is not so required.

*Holders of the Substitute Preference Shares should note that it is intended that the Substitute Preference Shares should constitute Category I Core Capital of the Company and accordingly, under statutory requirements prevailing at the date hereof relating to Category I Core Capital, and by virtue of the above provisions, any redemption of such Substitute Preference Shares or purchase of such Substitute Preference Shares by the Company or its Subsidiaries is subject to the prior consent of the HKMA at the relevant time.*

### PAYMENTS

#### Method of Payment

Payment of any amount payable by way of dividend or on redemption of a Substitute Preference Share will be made by transfer to the registered account of the holder or by U.S. dollar cheque mailed to the registered address of the holder if it does not have a registered account.

Payments of dividends due on a Dividend Payment Date will be paid on the due date for the payment of the relevant dividend to the holder shown on the Register at the close of business on the fifteenth day before the due date for the payment of the dividend (the “**Dividend Record Date**”).

#### Registered Accounts

For the purposes of these Articles, a holder’s registered account means the U.S. dollar account, details of which appear on the Register at the close of business on the Business Day before the relevant Dividend Record Date, and a holder’s registered address means its address appearing on the Register at that time.

#### Fiscal Laws

All payments are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of these Articles. No commissions or expenses shall be charged to the holders in respect of such payments.

#### Payment Initiation

Where payment is to be made by transfer to a registered account, payment instructions (for value on the due date or, if that is not a Business Day, for value on the first following day which is a Business Day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed (at the risk and, if mailed at the request of the holder otherwise than by ordinary mail, expense of the holder) on the due date for payment (or, if it is not a Business Day, the immediately following Business Day).

#### Delay In Payment

Holders of Substitute Preference Shares will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day or if a cheque mailed in accordance with these Articles arrives after the due date for payment. If an amount which is due on the Substitute Preference Shares is not paid in full, the Registrar will annotate the Register with a record of the amount (if any) in fact paid.

### TAXATION

All payments in respect of the Substitute Preference Shares by or on behalf of the Company shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by Hong Kong or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In that event, the Company shall pay such additional amounts (“**Additional Amounts**”) as will result in the receipt by the holders of such amounts as would have been received by them if no such withholding or deduction had been required, except that no such Additional Amounts shall be payable in respect of any Substitute Preference Share presented for payment:

- (i) by or on behalf of a holder which is liable to such taxes, duties, assessments or governmental charges in respect of such Substitute Preference Share by reason of its having some connection with Hong Kong other than the mere holding of such Substitute Preference Share; or
- (ii) where 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 the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive.

Any reference in these Articles to liquidation preference or dividends shall be deemed to include any Additional Amounts in respect of liquidation preference or dividends (as the case may be) which may be payable under these Articles or any undertaking given in addition to or in substitution of this provision.

## Substitute Preference Share Terms

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If the Company becomes subject at any time to any taxing jurisdiction other than Hong Kong, references in these Articles to Hong Kong shall be construed as references to Hong Kong and/or such other jurisdiction.

### VOTING

The holders of the Substitute Preference Shares shall not be entitled to convene, attend or vote at any general meeting of the Company except:

- (i) where a dividend that is payable on such Substitute Preference Shares shall have become due or payable and shall not have been paid in full;
- (ii) where a resolution is to be proposed at the meeting varying or abrogating any of the rights, preferences, privileges, limitations or restrictions attached to any class of shares of which the Substitute Preference Shares form a part (and then only to attend, speak and vote on any such resolution); or
- (iii) where a resolution is proposed to consider a Winding-Up Proceeding in relation to the Company.

Whenever holders of Substitute Preference Shares are entitled to vote on a resolution, on a show of hands every such holder present in person shall have one vote and every proxy holder present that has been duly appointed by a holder shall have one vote and on a poll every such holder that is present in person or by proxy shall have one vote in respect of each Substitute Preference Share held by him.

Subject to the above conditions, all other provisions of these Articles relating to voting rights and procedures also apply to the Substitute Preference Shares.

### AMENDMENT

The foregoing provisions of these Articles may not be amended without the prior written approval of the HKMA. Subject to this requirement, the other provisions of these Articles relating to amendment of these Articles also apply to the foregoing provisions.

### DEFINITIONS

The following terms have the following meanings when used in these Articles:

“**Arrears of Interest**” means any interest not paid on an Optional Interest Payment Date or a Mandatory Deferral Date (except to the extent such interest shall subsequently have been paid);

“**Articles**” means the Articles of Association of the Company as amended from time to time;

“**Assets**” means the unconsolidated gross assets of the Company, as shown in the latest published audited balance sheet of the Company, but adjusted for subsequent events in such manner as the Directors, or if the Company is in a Winding-Up, its liquidator may determine;

“**Assignee**” means Innovate or its permitted successors or assigns in accordance with the Assignment Deed;

“**Assignment**” means the assignment right in respect of all and any outstanding Notes granted by the Initial Purchaser to the Assignee under the terms of the Assignment Deed to be automatically exercised on an Assignment Date;

“**Assignment Date**” means, in respect of an Assignment Event that is a date, that date and, in respect of an Assignment Event that is the occurrence of an event, the date on which that event first occurs;

“**Assignment Deed**” means the deed entered into between, among others, Innovate, the Company and the initial holders of the Notes dated the Notes Issue Date, pursuant to which the Notes shall, on the happening of certain specified events, be assigned to Innovate;

## Substitute Preference Share Terms

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“**Assignment Event**” means the occurrence of any of the following:

- (i) the deferral of payment of any interest on any Note in accordance with Condition 7(g) of the Conditions;
- (ii) a Substitution Event;
- (iii) an Enforcement Event;
- (iv) following the giving of a valid redemption notice in respect of the Substitute Preference Shares, the date scheduled for redemption in such notice;
- (v) the Business Day (as defined for the purposes of Condition 3 of the Conditions) prior to the Maturity Date;
- (vi) an Optional Assignment Date; or
- (vii) an HKMA Assignment Date;

The Assignment Events set out in paragraphs (i), (iv), (v) and (vi) shall be referred to as “**Scheduled Assignment Events**” and those set out in paragraphs (ii), (iii) and (vii) shall be referred to as “**Non-Scheduled Assignment Events**”;

“**Assignment Notice**” means a notice of an Assignment pursuant to the Conditions;

“**Board of Directors**” means the board of directors of the Company as constituted from time to time;

“**Business Day**” means:

- (i) for the purposes of the “Dividends” clause, a day other than a Saturday or Sunday on which commercial banks are open for business in New York and London;
- (ii) for the purposes of the “Payments” clause, a day other than a Saturday or Sunday on which commercial banks are open for business in New York and Hong Kong;
- (iii) for the purposes of the definition of “Dividend Determination Date”, a day other than a Saturday or Sunday on which commercial banks are open for business in London; and
- (iv) in all other cases, a day other than a Saturday or Sunday on which commercial banks are open for business in London and Hong Kong;

“**Calculation Agent**” means Deutsche Bank AG, Hong Kong Branch or any successor calculation agent from time to time;

“**Capital Adequacy Ratio**” has the meaning given to it from time to time by the HKMA Supervisory Policy Manual CA-S-6 as amended, supplemented or replaced from time to time;

“**Category I Core Capital**” has the meaning given to it from time to time in the HKMA Supervisory Policy Manual CA-S-6 as amended, supplemented or replaced from time to time;

“**Category II Supplementary Capital**” has the meaning given to it from time to time in the HKMA Supervisory Policy Manual CA-S-8, as amended, supplemented or replaced from time to time;

“**Companies Ordinance**” means the Companies Ordinance (Cap. 32) of Hong Kong, as amended from time to time;

“**Company**” means The Bank of East Asia, Limited or its successor in business from time to time;

“**Comparable Treasury Issue**” means the U.S. Treasury selected by the Calculation Agent as having a maturity comparable to the remaining term of the Substitute Preference Shares from the relevant date fixed for redemption to 5 November 2019, that would be utilised, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of a maturity most nearly equal to 5 November 2019;

## Substitute Preference Share Terms

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“Comparable Treasury Price” means, with respect to any redemption date, the average of three Reference Treasury Dealer Quotations (or such lesser number as is obtained by the Calculation Agent) for the relevant date fixed for redemption of the Substitute Preference Shares;

“Conditions” means the terms and conditions of the Notes;

“Consolidated Subsidiary” means any Subsidiary of the Company or any other entity, in each case the financial statements of which are required by HKFRS to be consolidated with the financial statements of the Company;

“Directors” means the directors of the Company;

“Distributable Profits” means:

- (i) the aggregate of the consolidated net profits after tax of the Company and its Consolidated Subsidiaries (determined before any payments of interest, dividends or other distributions by the Company or any of its Consolidated Subsidiaries on any Category I Core Capital or Category II Supplementary Capital or other securities ranking *pari passu* with such capital but after the deduction of amounts (if any) required by the HKMA to be transferred to the reserves of the Company on a consolidated basis) for the immediately preceding two six-month financial periods for which results have been announced publicly; less
- (ii) the aggregate amount of interest, dividends, distributions or other amounts paid, determined to be paid or liable to be paid by the Company or any of its Consolidated Subsidiaries in the twelve-month period ending on and including the applicable Interest Payment Date on:
  - (a) any class of share capital of the Company;
  - (b) the Notes, the Substitute Preference Shares or the Innovate Preference Shares; and
  - (c) any other Category I Core Capital or Category II Supplementary Capital of the Company or any of its Consolidated Subsidiaries or securities ranking *pari passu* with such capital,

but excluding dividends payable on the Substitute Preference Shares on the relevant Dividend Payment Date;

“Dividend Determination Date” means, in relation to each Dividend Period from and including the Dividend Period beginning on 5 November 2019, the day falling two Business Days prior to the first day of the relevant Dividend Period;

“Enforcement Event” means any default made in the payment of any amount of principal in respect of the Notes on the due date for payment thereof or of any amount of interest in respect of the Notes within seven days after the date upon which the payment of interest is compulsory (pursuant to Condition 7(g) of the Conditions);

“Group” means the Company and its Subsidiaries;

“Guarantee” means the subordinated guarantee of certain payments under the Innovate Preference Shares made by the Company under a Deed of Guarantee dated the Notes Issue Date;

“HKFRS” means Hong Kong Financial Reporting Standards, from time to time;

“HKMA” means the Hong Kong Monetary Authority or such other governmental authority in Hong Kong (or if the Company becomes domiciled in a jurisdiction other than Hong Kong, in such jurisdiction) having primary supervisory authority with respect to the Company;

“HKMA Assignment Date” means any date designated by the HKMA in its absolute discretion as the Assignment Date;

“Hong Kong Business Day” means a day other than a Saturday or Sunday on which commercial banks are open for business in Hong Kong;

## Substitute Preference Share Terms

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“**Initial Dividend**” means an amount equal to the Arrears of Interest which have accumulated up to and including the Assignment Date;

“**Initial Purchaser**” means UBS Limited;

“**Innovate**” means Innovate Holdings Limited;

“**Innovate Preference Shares**” means the perpetual non-cumulative step-up preference shares of Innovate of no par value in an aggregate liquidation preference of U.S.\$500,000,000 issued on the Notes Issue Date;

“**Interest Payment Date**” means, in relation to the Notes:

- (i) up to 5 November 2019, 5 May and 5 November in each year; and
- (ii) thereafter, 5 February, 5 May, 5 August and 5 November in each year.

“**Issue Date**” means the date of issue of the Substitute Preference Shares;

“**Liabilities**” means the unconsolidated gross liabilities of the Company, as shown in the latest published audited balance sheet of the Company, but adjusted for contingent liabilities and for subsequent events in such manner as the Directors or, if the Company is in a Winding-Up, its liquidator may determine;

“**LIBOR**” shall mean:

- (i) the rate for three-month U.S. dollar deposits which appears on the display designated as page “LIBOR01” on the Reuter Monitor Money Rates Service (or such other page or service as may replace it, or such other service as may be nominated as the information vendor, for the purpose of displaying comparable rates) as at 11.00 a.m. (London time) on the Dividend Determination Date;
- (ii) if such rate does not appear on that page, or if the relevant page is unavailable, the Calculation Agent will:
  - (a) request the principal London office of each of four major banks in the U.S. dollar interbank market in London as selected by the Calculation Agent to provide the Calculation Agent with its offered quotation to leading banks in the London interbank market for three-month U.S. dollar deposits as at 11.00 a.m. (London time) on the Dividend Determination Date in question; and
  - (b) determine the arithmetic mean (rounded, if necessary, to the nearest one hundred-thousandth of a percentage point, 0.000005% being rounded upwards) of such offered quotations; and
- (iii) if fewer than two such quotations are provided as requested, the Calculation Agent will determine the arithmetic mean (rounded, if necessary, as aforesaid) of the U.S. dollar lending rates which leading banks in London selected by the Calculation Agent are quoting, on the relevant Dividend Determination Date, to leading banks in Europe for a period of three months as at 11.00 a.m. (London time),

provided, however, that if the Calculation Agent is unable to determine a rate or (as the case may be) an arithmetic mean in accordance with the above provisions in relation to any Dividend Period, the rate of LIBOR applicable to the Substitute Preference Shares during such Dividend Period shall either be (i) the rate or (as the case may be) arithmetic mean last determined in relation to the Substitute Preference Shares in respect of a preceding Dividend Period;

“**Makewhole Amount**” means in respect of each Substitute Preference Share, (a) the liquidation preference of such Substitute Preference Share or, if this is higher (b) the amount equal to the sum of the present value of the liquidation preference of such Substitute Preference Share, together with the present values of the scheduled dividend payments (assuming for this purpose the relevant dividend payments become due pursuant to these Articles) from the relevant date fixed for redemption to, but excluding, 5 November 2019, in each case, discounted to such redemption date on a semi-annual compounded basis at the adjusted U.S. Treasury Rate plus 0.50 per cent., all as determined by the Calculation Agent;

## Substitute Preference Share Terms

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“**Mandatory Deferral Date**” means any Interest Payment Date, whereas at the relevant Interest Record Date, the Company does not have Distributable Profits equal to or greater than the interest payment scheduled for that Interest Payment Date and all other payments to be made on such date in respect of any obligation ranking or expressed to rank *pari passu* with the Notes;

“**Maturity Date**” means 5 November 2059;

“**Notes**” means the Step-Up Subordinated Notes due 2059 in an aggregate principal amount of U.S.\$500,000,000 issued by the Company on the Notes Issue Date;

“**Notes Issue Date**” means 5 November 2009;

“**Optional Assignment Date**” means any date designated by the Assignee in its absolute discretion as the Assignment Date;

“**Optional Interest Payment Date**” means any Interest Payment Date where during the 12 calendar months preceding such Interest Payment Date no dividend has been declared or paid on any class of share capital of the Company;

“**Ordinary Shares**” means the ordinary shares in the capital of the Company having a par value of HK\$2.50 and having a right to participate in a Winding-Up of the Company in the surplus assets on a *pro rata* basis;

“**Parity Securities**” means the most senior ranking class or classes of preference shares in the capital of the Company from time to time and any other securities of the Company or any other member of the Group ranking or expressed to rank *pari passu* with the Notes, the Substitute Preference Shares and/or such preference shares either issued directly by the Company or, where issued by a member of the Group, where the terms of the securities benefit from a guarantee or support agreement entered into by the Company which ranks or is expressed to rank *pari passu* with the Notes, the Substitute Preference Shares and/or such preference shares;

“**Reference Treasury Dealer**” means each of the three nationally recognised investment banking firms selected by the Calculation Agent that are primary U.S. Government securities dealers;

“**Reference Treasury Dealer Quotations**” means with respect to each Reference Treasury Dealer and any date fixed for redemption of the Substitute Preference Shares, the average, as determined by the Calculation Agent, of the bid and asked prices for the Comparable Treasury Issue, expressed in each case as a percentage of its principal amount, quoted in writing to the Calculation Agent by such Reference Treasury Dealer at 5:00 p.m., New York City time on the third Business Day immediately preceding such due date for redemption;

“**Register**” means the register of holders of Substitute Preference Shares that the Company shall procure is kept by the Registrar outside Hong Kong and the United Kingdom;

“**Registrar**” means the share registrar appointed by the Company from time to time;

“**Regulatory Event Redemption Price**” means in respect of each Substitute Preference Share:

- (i) in respect of a redemption following the occurrence of a Regulatory Event scheduled to take place on a date that falls prior to 5 November 2019, an amount equal to the Makewhole Amount; and
- (ii) in respect of a redemption following the occurrence of a Regulatory Event scheduled to take place on a date that falls on or after 5 November 2019, an amount equal to 100% of the liquidation preference of the relevant Substitute Preference Shares;

“**Senior Creditors**” means (a) creditors of the Company that are unsubordinated creditors of the Company; (b) creditors of the Company whose claims are or are expressed to be subordinated to the claims of other creditors of the Company (other than those whose claims are in respect of the Company’s outstanding securities or obligations that constitute, or would but for any applicable limitation on the amount of such capital, constitute, Category I Core Capital or whose claims rank or are expressed to rank *pari passu* with, or junior to, the claims

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of Noteholders); and (c) creditors of the Company whose claims are in respect of the Company's outstanding securities or obligations that constitute Category II Supplementary Capital (and such other securities and obligations outstanding from time to time that rank, or are expressed to rank, *pari passu* with, or senior to, any such Category II Supplementary Capital) but excluding other Parity Securities;

“**Subsidiary**” means each subsidiary, as defined in section 2 of the Companies Ordinance, for the time being of the Company;

“**Substitute Preference Shares**” means the perpetual non-cumulative step-up preference shares of the Company having a par value of U.S.\$1,000 each and an aggregate liquidation preference of U.S.\$500,000,000 issued on the Issue Date;

“**Substitution Event**” means:

- (i) the HKMA determines in writing that the Company has a Capital Adequacy Ratio of less than 8% or such other percentage as the HKMA shall stipulate from time to time as being the minimum required Capital Adequacy Ratio for licensed banks, provided that a Substitution Event will not be deemed to have occurred until the end of any grace period allowed by the HKMA for the Company to bring its Capital Adequacy Ratio above 8% or such other stipulated percentage;
- (ii) a Winding-Up Proceeding is instituted against the Company and is not dismissed within 30 Hong Kong Business Days from the initial date of institution; or
- (iii) the HKMA exercises its power to appoint a manager of the Company under Section 52 of the Banking Ordinance (Cap. 155) of Hong Kong;

“**U.S. dollars**” and “**U.S.\$**” refer to the lawful currency for the time being of the United States of America;

“**U.S. Treasury Rate**” means either (i) the rate per annum equal to the yield, under the heading that represents the average for the week immediately preceding the third Business Day prior to the relevant redemption date, appearing in the most recently published statistical release designated “H.15(519)” or any successor publication that is published weekly by the Board of Governors of the Federal Reserve System and that establishes yields on actively traded U.S. Treasury securities adjusted to constant maturity under the caption “Treasury Constant Maturities — Nominal” for the maturity corresponding to the Comparable Treasury Issue (if no maturity is within three months before or after 5 November 2019, yields for the two published maturities most closely corresponding to the Comparable Treasury Issue shall be determined and the U.S. Treasury Rate shall be interpolated or extrapolated from such yields on a straight line basis, rounding to the nearest month) or (ii) if such release (or any successor release) is not published during the week preceding the third Business Day prior to the relevant date or does not contain such yields, the rate per annum equal to the semi-annual equivalent yield to maturity of the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for the relevant date fixed for redemption, in each case calculated on the third Business Day immediately preceding the relevant date fixed for redemption;

“**Winding-Up**” shall mean a final and effective order or resolution for the bankruptcy, winding-up, liquidation, receivership or similar proceeding in respect of the Company; and

“**Winding-Up Proceeding**” means with respect to the Company, proceedings in Hong Kong for the bankruptcy, liquidation, winding-up, receivership, or other similar proceeding of the Company.

## GOVERNING LAW

The creation and issue of the Substitute Preference Shares and the rights attached to them are governed by, and shall be construed in accordance with, Hong Kong law.

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## Summary of Provisions Relating to the Notes while in Global Form

*The Global Note Certificate contains provisions, which apply to the Notes in respect of which the Global Note Certificate is issued, some of which modify the effect of the Terms and Conditions of the Notes set out in this Offering Circular. The following is a summary of those provisions. Terms defined in the Terms and Conditions of the Notes have the same meanings in the paragraphs below:*

### **MEETING**

The registered holder of the Global Note Certificate, at any meeting of Noteholders, will be treated as being two persons for the purposes of any quorum requirements of a meeting of Noteholders and, at any such meeting, as having one vote in respect of each U.S.\$1,000 in principal amount of Notes for which such Global Note Certificate is issued. The Trustee may allow a person with an interest in Notes in respect of which the Global Note Certificate has been issued to attend and speak at a meeting of Noteholders on appropriate proof of his identity and interest.

### **CANCELLATION**

Cancellation of any Note by the Bank following its redemption or purchase by the Bank will be effected by a reduction in the principal amount of the Global Note Certificate and in the Register of Noteholders.

### **TRUSTEE'S POWERS**

In considering the interests of Noteholders while the Global Note Certificate is registered in the name of a nominee for a clearing system, the Trustee may, to the extent it considers it appropriate to do so in the circumstances, but without being obliged to do so, (a) have regard to any information as may have been made available to it by or on behalf of the relevant clearing system or its operator as to the identity of its accountholders (either individually or by way of category) with entitlements in respect of the respective Units and (b) consider such interests on the basis that such accountholders were the holders of the Notes in respect of which the Global Note Certificate is issued.

### **PAYMENT**

Payments of principal and interest in respect of Notes represented by the Global Note Certificate will be made without presentation or, if no further payment falls to be made in respect of the Notes, against presentation and surrender of such Global Note Certificate to or to the order of the Principal Agent or such other Agent as shall have been notified to the Noteholders for such purpose.

### **NOTICES**

So long as Notes are represented by the Global Note Certificate and such Global Note Certificate is held on behalf of Euroclear or Clearstream or any alternative clearing system on behalf of which the Notes evidenced by the Global Note Certificate may be held (“**Alternative Clearing System**”), notices to Noteholders may be given by delivery of the relevant notice to Euroclear or Clearstream or such Alternative Clearing System, for communication by it to accountholders entitled to an interest in the respective Units in substitution for notification as required by the Terms and Conditions of the Notes.

### **REGISTRATION OF TITLE**

Certificates in definitive form for individual holdings of Notes will not be issued to holders of Units in exchange for interests in Notes in respect of which the Global Note Certificates are issued, except if either Euroclear or Clearstream or the Alternative Clearing System is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so.

**TRANSFERS**

Prior to the Assignment Date, transfers of interests in the Units, of which the Notes are a constituent part, will be effected through the records of Euroclear and Clearstream (or any Alternative Clearing System) and their respective participants in accordance with the rules and procedures of Euroclear and Clearstream (or any Alternative Clearing System) and their respective direct and indirect participants. The Notes have been accepted for clearance through Euroclear or Clearstream as a constituent part of the Units only and will not be allocated a separate Common Code or ISIN.

**ENFORCEMENT**

For all purposes, each person who is for the time being shown in the records of Euroclear or of Clearstream (or any Alternative Clearing System) as a holder of Units corresponding to a particular principal amount of Notes in respect of which the Global Note Certificate is issued (in which regard any certificate or other document issued by Euroclear or Clearstream (or any Alternative Clearing System) as to the number of Units corresponding to the principal amount of Notes represented by such Global Note Certificate standing to the account of any person shall be conclusive and binding for all purposes) shall be recognised as the holder of such principal amount of Notes.

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## Summary of Provisions Relating to the Preference Shares while in Global Form

*The Global Preference Share Certificate contains provisions, which apply to the Preference Shares in respect of which the Global Preference Share Certificate is issued, some of which modify the effect of the Preference Share Terms set out in this Offering Circular. The following is a summary of those provisions. Terms defined in the Preference Share Terms have the same meanings in the paragraphs below:*

### **MEETING**

The registered holder of a Global Preference Share Certificate will be treated as being two persons for the purposes of any quorum requirements of a meeting of Preference Shareholders and, at any such meeting, as having one vote in respect of each U.S.\$1,000 in liquidation preference of Preference Share for which such Global Preference Share Certificate is issued. A person with an interest in Preference Shares in respect of which the Global Preference Share Certificate has been issued will be allowed to attend and speak at a meeting of Preference Shareholders that a holder of Preference Shares would be allowed to attend and speak at on appropriate proof of his identity and interest.

### **CANCELLATION**

Cancellation of any Preference Share by the Company following its redemption or purchase by the Company will be effected by a reduction in the amount in liquidation preference of the Global Preference Share Certificate and in the Register of Preference Shareholders.

### **PAYMENT**

Payments of the liquidation preference and dividends in respect of Preference Shares represented by a Global Preference Share Certificate will be made without presentation or if no further payment falls to be made in respect of the Preference Shares, against presentation and surrender of such Global Preference Share Certificate to or to the order of the Bank.

### **NOTICES**

So long as Preference Shares are represented by a Global Preference Share Certificate and such Global Preference Share Certificate is held on behalf of Euroclear or Clearstream (or any alternative clearing system on behalf of which the Preference Shares evidenced by the Global Preference Share Certificate may be held) (the “**Alternative Clearing System**”), notices to Preference Shareholders may be given by delivery of the relevant notice to Euroclear or Clearstream or the Alternative Clearing System, for communication by it to entitled accountholders (or, prior to the Assignment Date, accountholders entitled to an interest in the respective Units) in substitution for notification as required by the Preference Share Terms.

### **REGISTRATION OF TITLE**

Certificates in definitive form for individual holdings of Preference Shares will not be issued in exchange for interests in Preference Shares in respect of which the Global Preference Share Certificate is issued, except if either Euroclear or Clearstream or the Alternative Clearing System is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so.

### **TRANSFERS**

Transfers of interests in the Preference Shares (or, prior to the Assignment Date, Units of which the Preference Shares are a constituent part) will be effected through the records of Euroclear and Clearstream (or any Alternative Clearing System) and their respective participants in accordance with the rules and procedures of Euroclear and Clearstream (or any Alternative Clearing System) and their respective direct and indirect participants.

**ENFORCEMENT**

For all purposes, each person who is for the time being shown in the records of Euroclear or of Clearstream (or any Alternative Clearing System) as a holder of a particular amount in liquidation preference of Preference Shares in respect of which the Global Preference Share Certificate is issued (in which regard, any certificate or other document issued by Euroclear or Clearstream (or any Alternative Clearing System) as to the amount in liquidation preference of the Preference Shares (or prior to the Assignment Date, the number of Units corresponding to the amount in liquidation preference of the Preference Shares) represented by such Global Preference Share Certificate standing to the account of any person shall be conclusive and binding for all purposes) shall be recognised as the holder of such amount in liquidation preference of Preference Shares.

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## Taxation

*The statements herein regarding taxation are based on the laws in force as at the date of this Offering Circular and are subject to any changes in law occurring after such date, which changes could be made on a retroactive basis. The following summary does not purport to be a comprehensive description of all of 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 tax consequences applicable to all categories of investors, some of which (such as dealers in securities or commodities) may be subject to special rules. Investors should consult their own tax advisers regarding the tax consequences of an investment in the Securities.*

### HONG KONG

#### Withholding Tax

No withholding tax is payable in Hong Kong in respect of payments of principal or interest on the Notes or payment of dividend on the Preference Shares or Substitute Preference Shares or in respect of any capital gains arising from the sale of the Notes, the Preference Shares or Substitute Preference Shares.

#### Profits Tax

Hong Kong profits tax is chargeable on every person (including an individual, a corporation and other unincorporated bodies such as partnership and trust) carrying on a trade, profession or business in Hong Kong in respect of profits arising in or derived from Hong Kong from such trade, profession or business (excluding profits arising from the sale of capital assets).

Interest on the Notes may be deemed to be profits 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 accrues to a person, other than a financial institution, carrying on a trade, profession or business in Hong Kong and such interest is of a Hong Kong source; or
- (ii) interest on the Notes is received by or accrues to a financial institution (as defined in the Inland Revenue Ordinance (Cap. 112) of Hong Kong) and arises through or from the carrying on by the financial institution of its business in Hong Kong.

Pursuant to the Exemption from Profits Tax (Interest Income) Order, interest income accruing to a person other than a financial institution on deposits (denominated in any currency and whether or not the deposit is evidenced by a certificate of deposit) placed with, *inter alia*, an authorised 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 deposits that are used to secure or guarantee money borrowed in certain circumstances. Provided no prospectus in relation to the issue of the Notes is registered under the Companies Ordinance (Cap. 32) of Hong Kong, the issue of the Notes is expected to constitute a deposit to which the above exemption will apply.

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 Notes will be subject to profits tax.

Sums derived from the sale, disposal or redemption of Notes, Preference Shares or Substitute Preference Shares 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. The source of such sums will generally be determined by having regard to the location where and the manner in which the Notes are acquired and disposed. However, where the sum is considered to be a capital gain in the hands of the investor, such capital gain will not be subject to Hong Kong profits tax.

Any dividends paid on the Preference Share or the Substitute Preference Share will generally not be subject to Hong Kong profits tax in the hands of the investors.

### **Stamp Duty**

No Hong Kong stamp duty will be chargeable upon the issue or subsequent transfer of the Notes or Preference Shares. However, stamp duty will be chargeable on the sale or purchase or transfer of the Substitute Preference Shares.

### **EU Savings Directive**

The European Union has adopted a Directive regarding the taxation of savings income. The Directive requires Member States to provide to the tax authorities of other Member States details of payments of interest or other similar income paid by a person to an individual or to certain other persons resident in another Member State, except that Austria, Belgium and Luxembourg may instead impose a withholding system for a transitional period (subject to a procedure whereby, on meeting certain conditions, the beneficial owner of the interest or other income may request that no tax be withheld) unless during such period they elect otherwise. Belgium will change to the provision of information system (rather than a withholding system) from 1 January 2010.

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# Subscription and Sale

## **SUBSCRIPTION AGREEMENT**

The Managers have, pursuant to a subscription agreement dated 29 October 2009 (the “**Subscription Agreement**”), agreed with the Bank, subject to the satisfaction of certain conditions, to procure subscription for (i) the Notes at 100% of their principal amount (the “**Notes Subscription Price**”); and (ii) the Preference Shares at a price equal to U.S.\$1,000 per Preference Share (the “**Preference Shares Subscription Price**”). UBS Limited, as the initial purchaser (the “**Initial Purchaser**”) has, pursuant to the Subscription Agreement, agreed with the Bank, subject to the satisfaction of certain conditions and to the extent that the Managers have procured subscribers for the Units, to purchase (i) the Notes at the Notes Subscription Price; and (ii) the Preference Shares at the Preference Shares Subscription Price. Each of the Managers has agreed to procure subscribers to subscribe and pay the Initial Purchaser for the Units. In addition, the Bank has agreed to reimburse the Managers and other distributors for certain of their fees, commissions and expenses in connection with the issue of the Notes and the Preference Shares. The Subscription Agreement entitles the Joint Lead Managers (on behalf of the Managers) to terminate it in certain circumstances prior to payment being made to the Bank of the net proceeds of the issue of the Notes and the Preference Shares.

The Initial Purchaser has, pursuant to the Assignment Deed, agreed with the Company and others, that it will agree to assign the Notes on the occurrence of an Assignment Event to the Company in consideration of an assignment payment in an aggregate amount of U.S.\$500,000,000 (the “**Assignment Payment**”).

The Bank, the Company, the Managers and the Initial Purchaser have agreed in the Subscription Agreement that the payment obligations of the relevant parties in respect of the Notes at the Notes Subscription Price, the Preference Shares at the Preference Shares Subscription Price and the Assignment Payment shall be settled and satisfied by a single net payment to the Bank by the Initial Purchaser of monies in U.S. dollars equivalent to the Notes subscribed for by the Initial Purchaser at the Notes Subscription Price, subject to the deductions for such fees, commissions and expenses payable to the Managers and other distributors in connection with the issue of the Notes and the Preference Shares as are permitted under the Subscription Agreement.

## **SELLING RESTRICTIONS**

### **General**

No action has been taken or will be taken in any country or jurisdiction by the Managers or the Bank that would permit a public offering of any of the Securities or the possession or distribution of this Offering Circular or any other offering material relating to any of the Securities in any country or jurisdiction where action for any such purpose may be required. Each of the Managers has severally but not jointly agreed to comply with all applicable laws and regulations in each jurisdiction in which it purchases, offers, sells or delivers any Securities or has in its possession or distributes or causes or permits to be distributed the Offering Circular or any other offering material.

### **United States**

The Securities 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.

Each of the Managers has agreed that, except as permitted by the Subscription Agreement, it will not offer or sell any of the Securities (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, and it will have sent to each dealer to which it sells any Securities during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Securities 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 Securities are being offered and sold outside of the United States to non-U.S. persons in reliance on Regulation S.

## Subscription and Sale

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In addition, until 40 days after the commencement of the offering of the Notes and the Preference Shares, an offer or sale of any Securities within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

### Public Offer Selling Restriction under the Prospectus Directive

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”) each Manager has represented, warranted and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “**Relevant Implementation Date**”) it has not made and will not make an offer of any Securities which are the subject of the offering contemplated by this Offering Circular to the public in that Relevant Member State other than:

- (a) to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;
- (b) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts;
- (c) to fewer than 100 natural or legal persons (other than qualified investors as defined in the Prospectus Directive) subject to obtaining the prior consent of the Joint Lead Managers; or
- (d) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Securities shall require the Bank, the Company or any Manager to publish a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer to the public” in relation to any Securities in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Securities to be offered so as to enable an investor to decide to purchase such Securities, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression “**Prospectus Directive**” means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

### United Kingdom

Each of the Managers has represented, warranted and agreed that:

- (1) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any 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 it in connection with the issue or sale of any Notes and the Preference Shares in circumstances in which section 21(1) of the FSMA does not apply to either of the Bank or Innovate; and
- (2) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Securities in, from or otherwise involving the United Kingdom.

### Hong Kong

Each of the Managers has represented, warranted and agreed that:

- (1) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Securities other than (a) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong (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; and

## Subscription and Sale

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- (2) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to any Securities, 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 Securities 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.

### Singapore

Each of the Managers has acknowledged that this Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, each of the Managers has represented, warranted and agreed that it has not offered or sold any Securities or caused the Securities to be made the subject of an invitation for subscription or purchase and will not offer or sell any Securities or cause the Securities to be made the subject of an invitation for subscription or purchase, and has not circulated or distributed, nor will it circulate or distribute, this Offering Circular or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Securities, 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 Securities 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,

securities (as defined in Section 239(1) of the SFA) 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 Securities 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 securities 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.

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## General Information

1. **Clearing Systems:** The Units, the Notes and the Preference Shares have been accepted for clearance through Euroclear and Clearstream. The Common Codes for the Units and the Preference Shares are 046288360 and 046288505, respectively. The International Securities Identification Number (ISIN) for the Units is XS0462883603 and for the Preference Shares is XS0462885053. As interests in the Notes may only be transferred prior to the Assignment Date as a constituent part of the Units, the Notes will not be allocated a separate Common Code or ISIN. As approval for the creation and issue of the Substitute Preference Shares has yet to be obtained, the Substitute Preference Shares have not been accepted for clearance through Euroclear and Clearstream and, consequently, have not been allocated a Common Code or an ISIN.
2. **Listing:** Approval in-principle has been received for the listing of the Notes and the Preference Shares on the SGX-ST. The Notes will be traded on the SGX-ST in a minimum board lot size of U.S.\$200,000 for so long as the Notes are listed on the SGX-ST. The Preference Shares will be traded on the SGX-ST in a minimum board lot size of U.S.\$200,000 for so long as the Preference Shares are listed on the SGX-ST. No application has been or will be made, for the listing of the Units. In the case that Substitute Preference Shares are issued, the Bank will undertake to use all reasonable endeavours to obtain and maintain a listing of the Substitute Preference Shares on either the SGX-ST or The Stock Exchange of Hong Kong Limited and acceptance for clearance of the Substitute Preference Shares through Euroclear and Clearstream.
3. **Litigation:** Neither the Bank nor any of its subsidiaries (including Innovate) is involved in any litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the Notes and the Preference Shares, nor is the Bank or any of its subsidiaries (including Innovate) aware that any such proceedings are pending or threatened.
4. **Authorisations:** Save for the approval of the shareholders of the Bank to create and issue the Substitute Preference Shares, the Bank has obtained all necessary consents, approvals and authorisations as may be required in connection with the issue and performance of the Securities, including, but not limited to, approval by the HKMA. The issue of the Notes, the giving of the Guarantee and the issue of the Substitute Preference Shares was authorised by resolutions of the Board of Directors of the Bank, passed on 19 October 2009 and by the authorised resolutions of the Committee of the Board of Directors of the Bank, passed on 21 October 2009. The issue of the Preference Shares was authorised by resolutions of the Board of Directors of the Company, passed on 29 October 2009. The Bank has, in the Subscription Agreement, undertaken to convene an extraordinary general meeting to be held within 180 days of the Issue Date to consider proposals and, if the shareholders of the Bank see fit, to resolve to create and issue the Substitute Preference Shares.
5. **No Material Adverse Change:** There has been no significant change in the financial or trading position of the Bank or the Group since 30 June 2009 and no material adverse change in the financial position or prospects of the Bank or the Group since 31 December 2008.
6. **Available Documents:** Copies of the following documents may be inspected at the specified office of the Principal Agent at 48/F Cheung Kong Center, 2 Queen's Road Central, Hong Kong:
  - (a) the Memorandum and Articles of Association of the Bank;
  - (b) the Memorandum and Articles of Association of Innovate;
  - (b) a copy of the auditors' reports of KPMG, the Bank's external auditors, the audited consolidated financial statements of the Bank as at and for the years ended 31 December 2006, 2007 and 2008;
  - (c) copies of the most recent annual and interim reports (including the financial statements) published by the Bank; and
  - (d) the Trust Deed, the Note Agency Agreement, the Preference Share Agency Agreement, the Assignment Deed, the Deed of Guarantee, the Stapling Deed, the Substitution Deed and the Payment Direction Deed each to be dated on or about 5 November 2009.

Copies of the auditors' reports and the audited consolidated financial statements referred to above and the most recent annual audited consolidated financial statements (and audited unconsolidated balance sheet) of the Bank and interim unaudited consolidated financial statements published by the Bank, will be made available free of charge at a specified office of the Principal Agent at 48/F Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

7. **Auditors:** The consolidated financial statements of the Bank as at and for the years ended 31 December 2006, 2007 and 2008 included in this Offering Circular have been audited by KPMG, Certified Public Accountants, as stated in the auditors' reports appearing in this Offering Circular in relation to such consolidated financial statements.

KPMG has given and not withdrawn its written consent to the issue of this Offering Circular with references to its auditors' reports on the published annual consolidated financial statements of the Bank for the years ended 31 December 2006, 2007 and 2008 in the form and context in which they appear.

KPMG has audited and rendered unqualified audit reports on the financial statements of the Bank for the years ended 31 December 2006, 2007 and 2008.

8. **Appointment of paying agent in Singapore:** For so long as the Notes are listed on the SGX-ST and the rules of the SGX-ST so require, in the event that the Global Note Certificate is exchanged for definitive Certificates in respect of the Notes, the Bank shall appoint and maintain a paying agent in Singapore, where the Notes may be presented or surrendered for payment or redemption. In addition, in the event that the Global Note Certificate is exchanged for definitive Certificates in respect of the Notes, an announcement of such exchange shall be made by or on behalf of the Bank through the SGX-ST and such announcement will include all material information with respect to the delivery of the definitive Certificates in respect of the Notes, including details of the paying agent in Singapore. For so long as the Preference Shares are listed on the SGX-ST and the rules of the SGX-ST so require, in the event that the Global Preference Share Certificate is exchanged for definitive Certificates in respect of the Preference Shares, Innovate shall appoint and maintain a paying agent in Singapore, where the Preference Shares may be presented or surrendered for payment or redemption. In addition, in the event that the Global Preference Share Certificate is exchanged for definitive Certificates in respect of the Preference Shares, an announcement of such exchange shall be made by or on behalf of Innovate through the SGX-ST and such announcement will include all material information with respect to the delivery of the definitive Certificates in respect of the Preference Shares, including details of the paying agent in Singapore.

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**INDEPENDENT REVIEW REPORT  
TO THE BOARD OF DIRECTORS OF THE BANK OF EAST ASIA, LIMITED**

**INTRODUCTION**

We have reviewed the interim financial report set out on pages F-3 to F-31 which comprises the consolidated statement of financial position of The Bank of East Asia, Limited as of 30th June, 2009 and the related consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the condensed consolidated cash flow statement for the six months period then ended and explanatory notes. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standard 34, "Interim financial reporting" issued by the Hong Kong Institute of Certified Public Accountants. The directors are responsible for the preparation and presentation of the interim financial report in accordance with Hong Kong Accounting Standard 34.

Our responsibility is to form a conclusion, based on our review, on the interim financial report 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 interim financial report consists of making enquires, 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 interim financial report as at 30th June, 2009 is not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34, "Interim financial reporting".

**KPMG**

*Certified Public Accountants*  
8th Floor, Prince's Building  
10 Chater Road  
Central, Hong Kong

Hong Kong, 25th August, 2009

## INTERIM REPORT 2009

### INTERIM RESULTS

The Directors of The Bank of East Asia, Limited (“BEA”) are pleased to announce the unaudited result<sup>a</sup> of the Bank and its subsidiaries (the “Group”) for the six months ended 30th June, 2009. The interim financial report is prepared on a basis consistent with the accounting policies and methods adopted in the 2008 audited accounts. The interim financial report is unaudited, but has been reviewed by KPMG, 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 (“HKICPA”). KPMG’s independent review report to the Board of Directors is included on page F-2.

#### 1. Consolidated Income Statement

	6 months ended 30/6/2009	6 months ended 30/6/2008 Restated	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Interest income.....	6,326	8,832	8,633
Interest expense.....	(3,092)	(5,349)	(5,323)
Net interest income.....	3,234	3,483	3,310
Fee and commission income.....	1,258	1,425	1,193
Fee and commission expense.....	(245)	(238)	(235)
Net fee and commission.....	1,013	1,187	958
Net trading profits/(losses).....	874	(213)	(1,079)
Net result from financial instruments designated at fair value through profit or loss.....	(407)	(1,043)	(569)
Other operating income.....	237	271	152
Non-interest income/(expense).....	1,717	202	(538)
Operating income.....	4,951	3,685	2,772
Operating expenses.....	(3,041)	(2,764)	(3,015)
Operating profit/(loss) before impairment losses.....	1,910	921	(243)
Impairment losses on loans and advances.....	(474)	(89)	(469)
Impairment losses on held-to-maturity investments.....	(9)	(33)	(11)
Impairment losses on available-for-sale financial assets.....	(10)	(198)	(154)
Write back of impairment losses on bank premises.....	—	5	1
Impairment losses.....	(493)	(315)	(633)
Operating profit/(loss) after impairment losses.....	1,417	606	(876)
Net (loss)/profit on sale of held-to-maturity investments.....	(8)	—	25
Net profit on sale of available-for-sale financial assets.....	70	185	12
Net profit on disposal of loans and receivables.....	1	—	1
Net (loss)/profit on sale of subsidiaries/associates.....	—	(9)	1
Net profit/(loss) on sale of fixed assets.....	19	(2)	180
Valuation gains/(losses) on investment properties.....	89	198	(366)
Share of profits less losses of associates.....	79	95	(42)
Profit/(Loss) for the period before taxation.....	1,667	1,073	(1,065)

	6 months ended 30/6/2009	6 months ended 30/6/2008 Restated	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Income tax			
Current tax <sup>b</sup>			
— Hong Kong .....	(33)	18	(82)
— Overseas.....	(224)	(235)	(331)
Deferred tax.....	(205)	(35)	761
Profit/(Loss) for the period after taxation .....	<u>1,205</u>	<u>821</u>	<u>(717)</u>
Attributable to:			
Owners of the parent.....	1,169	785	(746)
Minority interest.....	36	36	29
Profit/(Loss) after taxation.....	<u>1,205</u>	<u>821</u>	<u>(717)</u>
Profit/(Loss) for the Bank .....	<u>373</u>	<u>87</u>	<u>(969)</u>
Proposed dividends <sup>c</sup> .....	<u>516</u>	<u>384</u>	<u>33</u>
	<b>HK\$</b>	<b>HK\$</b>	<b>HK\$</b>
Per share			
— Basic earnings <sup>d</sup> .....	HK\$0.64	HK\$0.43	-HK\$0.41
— Diluted earnings <sup>d</sup> .....	HK\$0.64	HK\$0.43	-HK\$0.41
— Dividends <sup>c</sup> .....	HK\$0.28	HK\$0.21	HK\$0.02

## 2. Consolidated Statement of Comprehensive Income

	6 months ended 30/6/2009	6 months ended 30/6/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Net Profit .....	<u>1,205</u>	<u>821</u>
Other comprehensive income/(expense) for the period (after taxation and reclassification adjustments):		
Exchange differences on translation of financial statements of overseas subsidiaries.....	4	605
Revaluation surplus on bank premises transferred to investment properties .....	98	10
Available-for-sale financial assets: net movement in investment revaluation reserve .....	(288)	(465)
Share of changes in equity of associates .....	(3)	(2)
Other comprehensive (expense)/income .....	(189)	148
Total comprehensive income .....	<u>1,016</u>	<u>969</u>
Total comprehensive income attributable to:		
Owners of the parent.....	980	933
Minority interest .....	36	36
	<u>1,016</u>	<u>969</u>

### 3. Consolidated Statement of Financial Position

	30/6/2009	30/6/2008 Restated	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions.....	19,283	19,209	28,105
Placements with banks and other financial institutions.....	85,667	70,889	96,574
Trade bills.....	973	979	1,164
Trading assets.....	4,401	5,468	3,437
Financial assets designated at fair value through profit or loss .....	6,299	7,461	4,130
Advances to customers and other accounts .....	246,150	254,978	243,725
Available-for-sale financial assets .....	23,872	13,349	18,560
Held-to-maturity investments .....	7,374	10,802	5,006
Investments in associates .....	2,553	2,737	2,486
Fixed assets .....	11,017	7,899	9,146
— Investment properties .....	2,218	2,245	1,839
— Other property and equipment .....	8,799	5,654	7,307
Goodwill and intangible assets .....	4,110	2,756	2,734
Deferred tax assets .....	158	82	187
Total Assets .....	<u>411,857</u>	<u>396,609</u>	<u>415,254</u>
<b>EQUITY AND LIABILITIES</b>			
Deposits and balances of banks and other financial institutions.....	22,158	26,623	27,045
Deposits from customers.....	320,801	300,238	323,802
— Demand deposits and current accounts .....	40,019	26,536	36,332
— Savings deposit.....	68,595	52,832	45,781
— Time, call and notice deposits.....	212,187	220,870	241,689
Trading liabilities.....	2,010	2,811	2,846
Certificates of deposit issued.....	2,867	7,826	5,491
— At fair value through profit or loss.....	2,497	4,521	3,777
— At amortised cost.....	370	3,305	1,714
Current taxation.....	287	196	333
Deferred tax liabilities.....	294	744	77
Other accounts and provisions .....	17,487	10,840	12,139
Loan capital .....	12,035	13,352	11,036
— At fair value through profit or loss.....	7,392	8,682	6,395
— At amortised cost .....	4,643	4,670	4,641
Total Liabilities.....	<u>377,939</u>	<u>362,630</u>	<u>382,769</u>
Share capital.....	4,604	4,177	4,183
Reserves.....	28,957	29,462	27,963
Total equity attributable to owners of the parent.....	33,561	33,639	32,146
Minority interest .....	357	340	339
Total Equity.....	<u>33,918</u>	<u>33,979</u>	<u>32,485</u>
Total Equity and Liabilities.....	<u>411,857</u>	<u>396,609</u>	<u>415,254</u>

#### 4. Consolidated Statement of Changes in Equity

	Share Capital		Capital Reserve- Staff Share	Exchange Revaluation	Investment Revaluation	Revaluation Reserve of Bank Premises	Capital Reserve	General Reserve	Other Reserve	Retained Profits	Total	Minority Interest	Total Equity
	Share Capital	Share Premium	Options Issued	Revaluation Reserve	Revaluation Reserve	Bank Premises	Reserve	Reserve	Reserve	Profits	Total	Interest	Equity
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
As 1st January, 2008.....	3,936	1,118	68	672	475	866	86	14,004	—	8,874	30,099	347	30,446
Changes in equity													
Shares issued in lieu of dividend.....	32	(32)	—	—	—	—	—	520	—	—	520	—	520
Subscription of new shares.....	197	3,745	—	—	—	—	—	—	—	—	3,942	—	3,942
Shares issue under Staff Shares													
Option Schemes.....	12	85	—	—	—	—	—	—	—	—	97	—	97
Equity settled share-based transaction.....	—	—	24	—	—	—	—	—	—	—	24	—	24
Transfer.....	—	8	(8)	—	—	—	—	—	20	(20)	—	—	—
Reversal upon disposal.....	—	—	—	—	(101)	—	—	—	—	—	(101)	—	(101)
Dividends approved in respect of													
previous year.....	—	—	—	—	—	—	—	—	—	(1,956)	(1,956)	(7)	(1,963)
Recognition of deferred tax liabilities.....	—	—	—	—	80	1	—	—	—	—	81	—	81
Purchase of interests in businesses from minority interests investors.....													
	—	—	—	—	—	—	—	—	—	—	—	(36)	(36)
Total comprehensive income for the period...	—	—	—	605	(465)	10	—	—	(2)	785	933	36	969
At 30th June, 2008.....	4,177	4,924	84	1,277	(11)	877	86	14,524	18	7,683	33,639	340	33,979
At 1st January, 2009.....	4,183	4,922	125	1,006	(228)	863	86	14,634	1,216	5,339	32,146	339	32,485
Changes in equity													
Shares issued in lieu of dividend.....	2	(2)	—	—	—	—	—	9	—	—	9	—	9
Capitalisation issue.....	418	(418)	—	—	—	—	—	—	—	—	—	—	—
Shares issue under Staff Shares													
Option Schemes.....	1	7	—	—	—	—	—	—	—	—	8	—	8
Equity settled share-based transaction.....	—	—	39	—	—	—	—	—	—	—	39	—	39
Transfer.....	—	—	(23)	—	—	(6)	—	6	31	(8)	—	—	—
Impairment loss & amortisation.....	—	—	—	—	10	—	—	—	—	—	10	—	10
Reversal upon disposal.....	—	—	—	—	442	—	—	—	—	—	442	—	442
Dividends approved in respect of													
previous year.....	—	—	—	—	—	—	—	—	—	(34)	(34)	(8)	(42)
Recognition of deferred tax liabilities.....	—	—	—	—	(15)	(24)	—	—	—	—	(39)	—	(39)
Purchase of interests in businesses from minority interests investors.....													
	—	—	—	—	—	—	—	—	—	—	—	(10)	(10)
Total comprehensive income for the period...	—	—	—	4	(288)	98	—	—	(3)	1,169	980	36	1,016
At 30th June, 2009.....	4,604	4,509	141	1,010	(79)	931	86	14,649	1,244	6,466	33,561	357	33,918

## 5. Condensed Consolidated Cash Flow Statement

	6 months ended 30/6/2009	6 months ended 30/6/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Cash used in operations .....	(19,984)	(33,211)
Tax paid .....	(304)	(262)
Net cash used in operating activities.....	(20,288)	(33,473)
Net cash used in investing activities.....	(3,454)	(577)
Net cash used in financing activities .....	(3,038)	(2,524)
Net decrease in cash and cash equivalents.....	(26,780)	(36,574)
CASH AND CASH EQUIVALENTS AT 1st JANUARY .....	94,106	103,718
CASH AND CASH EQUIVALENTS AT 30th JUNE.....	<u>67,326</u>	<u>67,144</u>
Cash flows from operating activities included:		
Interest received .....	6,976	8,983
Interest paid .....	3,992	5,572
Dividend received.....	38	42

### Notes:

- (a) The financial information set out in this interim report does not constitute the Group's statutory accounts for the year ended 31st December, 2008 but there is no material change as compared to those accounts, nor for the six months ended 30th June, 2009. The statutory accounts for the year ended 31st December, 2008 are available from the Bank's registered office. The auditors have expressed an unqualified opinion on those accounts in their report dated 17th February, 2009.
- (b) The provision for Hong Kong profits tax is calculated at 16.5% of the estimated assessable profits for the six months ended 30th June, 2009. Taxation for overseas branches and subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.
- (c) Proposed dividends

	6 months ended 30/6/2009	6 months ended 30/6/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Dividends payable to equity owners of the parent attributable to the interim period		
Interim dividend declared and paid after the interim period of HK\$0.28 per share (six months ended 30th June, 2008: HK\$0.23 per share, or HK\$0.21 per share after adjusting for the bonus issue in 2009) .....	<u>516</u>	<u>384</u>

The interim dividend has not been recognised as a liability at the balance sheet date.

- (d) (i) The calculation of basic earnings per share is based on earnings of HK\$1,169 million (six months ended 30th June, 2008: HK\$785 million) and on the weighted average of 1,841 million (six months ended 30th June, 2008: 1,827 million, after adjusting for the bonus issue in 2009) ordinary shares outstanding during the six months ended 30th June, 2009.
- (ii) The calculation of diluted earnings per share is based on earnings of HK\$1,169 million (six months ended 30th June, 2008: HK\$785 million) and on 1,841 million (six months ended 30th June, 2008: 1,834 million, after adjusting for the bonus issue in 2009) ordinary shares, being the weighted average number of ordinary shares outstanding during the six months ended 30th June, 2009, adjusted for the effects of all dilutive potential shares.

## 6. Interest Income

	6 months ended 30/6/2009	6 months ended 30/6/2008	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Listed securities classified as held-to-maturity or available-for-sale .....	125	113	148
Trading assets			
— listed.....	5	—	2
— unlisted.....	8	2	6
Interest rate swaps .....	539	411	506
Financial assets designated at fair value through profit or loss			
— listed.....	81	60	68
— unlisted.....	34	192	118
Loans, deposits with banks and financial institutions, trade bills, and other unlisted securities that are not at fair value through profit or loss .....	5,534	8,054	7,785
Total interest income.....	<u>6,326</u>	<u>8,832</u>	<u>8,633</u>

Included above is interest income accrued on impaired financial assets of HK\$35 million (six months ended 30th June, 2008: HK\$33 million, and six months ended 31st December, 2008: HK\$40 million).

## 7. Interest Expense

	6 months ended 30/6/2009	6 months ended 30/6/2008 Restated	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Customer deposits, deposits of banks and other financial institutions and certificates of deposit issued which are stated at amortised cost .....	2,342	4,319	4,377
Subordinated notes carried at amortised cost.....	45	100	84
Interest rate swaps .....	415	516	546
Financial instruments designated at fair value through profit or loss .....	287	409	316
Other borrowings .....	3	5	—
Total interest expense.....	<u>3,092</u>	<u>5,349</u>	<u>5,323</u>

## 8. Fee and Commission Income

Fee and commission income arises from the following services:

	6 months ended 30/6/2009	6 months ended 30/6/2008	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Corporate services.....	394	416	402
Credit cards.....	247	220	242
Loans, overdrafts and guarantees.....	183	283	99
Securities and brokerage.....	134	146	109
Other retail banking services.....	78	99	88
Trade finance.....	67	68	92
Trust and other fiduciary activities.....	34	59	43
Others.....	121	134	118
Total fee and commission income.....	<u>1,258</u>	<u>1,425</u>	<u>1,193</u>
of which:			
Net fee income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading nor designated at fair value.....	991	1,177	957
Fee income.....	<span style="border: 1px solid black;">1,207</span>	<span style="border: 1px solid black;">1,375</span>	<span style="border: 1px solid black;">1,153</span>
Fee expenses.....	<span style="border: 1px solid black;">(216)</span>	<span style="border: 1px solid black;">(198)</span>	<span style="border: 1px solid black;">(196)</span>

## 9. Net Trading Profits/(Losses)

	6 months ended 30/6/2009	6 months ended 30/6/2008 Restated	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Profit on dealing in foreign currencies.....	36	190	126
Profit/(Loss) on trading securities.....	393	(536)	(82)
Net gain/(loss) on derivatives.....	424	109	(1,141)
Profit/(Loss) on other dealing activities.....	—	1	(2)
Dividend income from listed trading securities.....	21	23	20
Total net trading profits/(losses).....	<u>874</u>	<u>(213)</u>	<u>(1,079)</u>

## 10. Net Result from Financial Instruments Designated at Fair Value Through Profit or Loss

	6 months ended 30/6/2009	6 months ended 30/6/2008 Restated	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Revaluation and disposal loss on Collateralised Debt Obligations.....	—	(1,331)	(2,218)
Revaluation (loss)/gain on debts issued.....	(921)	341	2,283
Net (loss)/profit on sale of other financial assets designated at fair value through profit or loss.....	(20)	4	(1)
Revaluation gain/(loss) on other financial assets designated at fair value through profit or loss.....	534	(57)	(633)
Total net result from financial instruments designated at fair value through profit or loss.....	<u>(407)</u>	<u>(1,043)</u>	<u>(569)</u>

## 11. Other Operating Income

	6 months ended 30/6/2009	6 months ended 30/6/2008	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Dividend income from available-for-sale financial assets			
— listed.....	10	13	7
— unlisted.....	7	6	24
Rental from safe deposit boxes.....	42	44	43
Net revenue from insurance activities.....	91	111	(12)
Rental income on properties.....	50	40	50
Others .....	37	57	40
Total other operating income .....	<u>237</u>	<u>271</u>	<u>152</u>

## 12. Operating Expenses

	6 months ended 30/6/2009	6 months ended 30/6/2008	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Contributions to defined contribution plan.....	100	106	119
Equity-settled share-based payment expenses.....	39	24	42
Salaries and other staff costs .....	1,412	1,333	1,356
Total staff costs.....	<u>1,551</u>	<u>1,463</u>	<u>1,517</u>
Premises and equipment expenses excluding depreciation			
— Rental of premises .....	223	177	201
— Maintenance, repairs and others .....	232	204	241
Total premises and equipment expenses excluding depreciation .....	<u>455</u>	<u>381</u>	<u>442</u>
Depreciation on fixed assets .....	252	197	240
Amortisation of intangible assets.....	4	1	2
Other operating expenses			
— Stamp duty, overseas and PRC* business taxes, and value added taxes .....	157	162	211
— Communications, stationery and printing .....	128	132	142
— Legal and professional fees.....	98	90	103
— Advertising expenses.....	91	140	147
— Business promotions and business travel.....	43	48	49
— Card related expenses .....	43	37	35
— Insurance expenses.....	37	30	13
— Donations .....	12	8	1
— Membership fees.....	4	4	3
— Administration expenses of corporate services.....	3	3	4
— Bank charges.....	3	4	3
— Bank licence .....	2	2	2
— Others .....	158	62	101
Total other operating expenses .....	<u>779</u>	<u>722</u>	<u>814</u>
Total operating expenses.....	<u>3,041</u>	<u>2,764</u>	<u>3,015</u>

\* PRC denotes the People's Republic of China.

### 13. Net Profit on Sale of Available-for-Sale Financial Assets

	6 months ended 30/6/2009	6 months ended 30/6/2008	6 months ended 31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Net revaluation (loss)/gain transferred from reserves.....	(442)	101	14
Profit/(Loss) arising in the period.....	<u>512</u>	<u>84</u>	<u>(2)</u>
	<u>70</u>	<u>185</u>	<u>12</u>

### 14. Placements with Banks and Other Financial Institutions

	30/6/2009	30/6/2008	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Placements with banks and authorised institutions.....	85,667	70,889	96,458
Placements with other financial institutions.....	<u>—</u>	<u>—</u>	<u>116</u>
	<u>85,667</u>	<u>70,889</u>	<u>96,574</u>
Maturing			
— within one month.....	36,629	41,664	46,714
— between one month and one year.....	<u>49,038</u>	<u>29,225</u>	<u>49,860</u>
	<u>85,667</u>	<u>70,889</u>	<u>96,574</u>

### 15. Trading Assets

	30/6/2009	30/6/2008 Restated	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Treasury bills (including Exchange Fund Bills).....	1,210	1,598	400
Debt securities.....	917	12	126
Equity securities.....	1,075	1,845	989
Investment funds.....	<u>191</u>	<u>242</u>	<u>188</u>
Trading securities.....	3,393	3,697	1,703
Positive fair value of derivatives.....	<u>1,008</u>	<u>1,771</u>	<u>1,734</u>
	<u>4,401</u>	<u>5,468</u>	<u>3,437</u>
Issued by:			
Central governments and central banks.....	1,210	1,598	400
Public sector entities.....	9	27	13
Banks and other financial institutions.....	901	625	443
Corporate entities.....	1,262	1,432	840
Other entities.....	<u>11</u>	<u>15</u>	<u>7</u>
	<u>3,393</u>	<u>3,697</u>	<u>1,703</u>
Analysed by place of listing:			
Listed in Hong Kong.....	913	1,634	825
Listed outside Hong Kong.....	<u>546</u>	<u>238</u>	<u>294</u>
	1,459	1,872	1,119
Unlisted.....	<u>1,934</u>	<u>1,825</u>	<u>584</u>
	<u>3,393</u>	<u>3,697</u>	<u>1,703</u>

## 16. Financial Assets Designated at Fair Value through Profit or Loss

	30/6/2009	30/6/2008	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Debt securities .....	6,173	7,461	4,130
Equity securities .....	126	—	—
	<u>6,299</u>	<u>7,461</u>	<u>4,130</u>
Issued by:			
Central governments and central banks .....	228	—	—
Public sector entities .....	142	183	142
Banks and other financial institutions .....	2,053	1,362	1,642
Corporate entities.....	3,876	5,916	2,346
	<u>6,299</u>	<u>7,461</u>	<u>4,130</u>
Analysed by place of listing:			
Listed in Hong Kong .....	2,358	1,807	1,325
Listed outside Hong Kong .....	2,248	933	1,178
	4,606	2,740	2,503
Unlisted .....	1,693	4,721	1,627
	<u>6,299</u>	<u>7,461</u>	<u>4,130</u>

## 17. Advances to Customers and Other Accounts

### (a) Advances to customers and other accounts

	30/6/2009	30/6/2008	31/12/2008
	<i>HK\$ Mn</i>	<i>Restated</i> <i>HK\$ Mn</i>	<i>HK\$ Mn</i>
(i) Advances to customers .....	231,392	245,408	230,339
Less: Impairment allowances			
— Individual.....	(667)	(183)	(523)
— Collective.....	(636)	(447)	(521)
	<u>230,089</u>	<u>244,778</u>	<u>229,295</u>
(ii) Other Accounts			
Advances to banks and other financial institutions .....	997	496	850
Notes and bonds .....	344	270	129
Certificates of deposit held.....	39	39	39
Accrued interest.....	1,213	1,761	1,863
Bankers acceptances .....	7,833	2,309	2,989
Other accounts .....	5,671	5,368	8,592
	16,097	10,243	14,462
Less: Impairment allowances			
— Individual.....	(26)	(33)	(23)
— Collective .....	(10)	(10)	(9)
	<u>16,061</u>	<u>10,200</u>	<u>14,430</u>
	<u>246,150</u>	<u>254,978</u>	<u>243,725</u>

(b) **Advances to customers — by industry sectors**

The analysis of gross advances to customers and the percentage of secured advances by industry sector is based on the categories and definitions used by the Hong Kong Monetary Authority.

	30/6/2009		30/6/2008		31/12/2008	
	Gross advances	% of secured advances	Gross advances	% of secured advances	Gross advances	% of secured advances
	HK\$ Mn	%	HK\$ Mn	%	HK\$ Mn	%
Loans for use in Hong Kong						
Industrial, commercial and financial						
— Property development .....	8,311	65.69	8,240	62.88	8,855	61.25
— Property investment .....	29,447	88.40	27,378	87.23	27,431	86.88
— Financial concerns.....	2,258	68.45	2,621	62.35	2,542	69.94
— Stockbrokers .....	3,493	99.96	633	98.19	550	99.75
— Wholesale and retail trade .....	2,193	62.48	2,590	59.12	2,405	64.60
— Manufacturing .....	2,113	58.05	2,338	46.84	2,055	52.54
— Transport and transport equipment.....	3,303	76.87	4,332	67.84	3,642	74.80
— Recreational activities .....	283	92.54	286	90.82	285	91.11
— Information technology.....	9	54.72	6	40.06	4	49.13
— Others .....	11,960	74.67	10,497	72.19	9,954	71.52
— Sub-total.....	<u>63,370</u>	80.26	<u>58,921</u>	75.90	<u>57,723</u>	76.78
Individuals						
— Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme .....	1,635	100.00	1,158	100.00	1,318	100.00
— Loans for the purchase of other residential properties .....	25,336	99.76	34,641	99.80	24,297	99.74
— Credit card advances.....	2,562	0.00	2,483	0.00	2,997	0.00
— Others .....	7,084	75.88	6,326	75.86	6,553	74.35
— Sub-total.....	<u>36,617</u>	88.17	<u>44,608</u>	90.85	<u>35,165</u>	86.52
Total loans for use in Hong Kong .....	99,987	83.16	103,529	82.34	92,888	80.47
Trade finance .....	2,490	55.13	4,197	55.15	2,905	59.03
Loans for use outside Hong Kong* .....	128,915	76.13	137,682	74.78	134,546	76.56
Total advances to customers .....	<u>231,392</u>	78.94	<u>245,408</u>	77.63	<u>230,339</u>	77.91

\* Loans for use outside Hong Kong includes the following loans for use in the PRC.

	30/6/2009		30/6/2008		31/12/2008	
	Gross advances	% of secured advances	Gross advances	% of secured advances	Gross advances	% of secured advances
	HK\$ Mn	%	HK\$ Mn	%	HK\$ Mn	%
Property development .....	14,310	77.85	13,952	66.83	14,351	78.64
Property investment .....	22,514	86.85	24,677	87.22	24,215	87.95
Wholesale and retail trade .....	14,040	90.89	20,778	90.57	19,021	88.93
Manufacturing .....	6,990	60.59	10,431	65.35	9,547	63.58
Others .....	35,153	71.82	31,187	65.24	31,906	69.99
	<u>93,007</u>	78.42	<u>101,025</u>	76.05	<u>99,040</u>	78.66

Individually impaired loans, as well as relevant information, in respect of industry sectors which constitute 10% or more of total advances to customers are as follows:

	30/6/2009	30/6/2008	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
(i) Property development			
a. Individually impaired loans .....	716	212	207
b. Individual impairment allowance .....	92	7	8
c. Collective impairment allowance .....	40	37	36
d. Provision charged to profit and loss			
— individual impairment loss .....	84	1	2
— collective impairment loss .....	15	5	12
e. Written off.....	—	90	84
(ii) Property investment			
a. Individually impaired loans .....	254	267	145
b. Individual impairment allowance .....	38	—	29
c. Collective impairment allowance .....	112	86	96
d. Provision charged to profit and loss			
— individual impairment loss .....	30	—	29
— collective impairment loss .....	30	10	24
e. Written off.....	19	—	—
(iii) Loans for purchase of residential properties			
a. Individually impaired loans .....	109	143	117
b. Individual impairment allowance .....	1	2	2
c. Collective impairment allowance .....	21	22	30
d. Provision charged to profit and loss			
— individual impairment loss .....	—	1	5
— collective impairment loss .....	3	2	6
e. Written off.....	—	2	3
(iv) Wholesale and retail trade			
a. Individually impaired loans .....	383	139	222
b. Individual impairment allowance .....	170	40	129
c. Collective impairment allowance .....	39	43	48
d. Provision charged to profit and loss			
— individual impairment loss .....	80	18	133
— collective impairment loss .....	6	15	21
e. Written off.....	53	4	4

(c) **Advances to customers — by geographical areas**

The information concerning the breakdown of the gross amount of advances to customers by countries or geographical areas 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.

	<b>30/6/2009</b>				
	<b>Total</b>	<b>Advances</b>	<b>Impaired</b>	<b>Individual</b>	<b>Collective</b>
	<b>advances to</b>	<b>overdue for</b>	<b>advances to</b>	<b>impairment</b>	<b>impairment</b>
	<b>customers</b>	<b>over three</b>	<b>customers</b>	<b>allowance</b>	<b>allowance</b>
	<b>HK\$ Mn</b>	<b>months</b>	<b>customers</b>	<b>allowance</b>	<b>allowance</b>
	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>
Hong Kong .....	118,160	365	624	268	316
People's Republic of China .....	80,169	271	494	90	98
Other Asian Countries .....	10,185	232	353	169	166
Others .....	22,878	118	895	140	56
<b>Total .....</b>	<b>231,392</b>	<b>986</b>	<b>2,366</b>	<b>667</b>	<b>636</b>
% of total advances to customers.....			1.02%		
Market value of security held against impaired advances to customers .....			4,636		

	<b>30/6/2008</b>				
	<b>Total</b>	<b>Advances</b>	<b>Impaired</b>	<b>Individual</b>	<b>Collective</b>
	<b>advances to</b>	<b>overdue for</b>	<b>advances to</b>	<b>impairment</b>	<b>impairment</b>
	<b>customers</b>	<b>over three</b>	<b>customers</b>	<b>allowance</b>	<b>allowance</b>
	<b>HK\$ Mn</b>	<b>months</b>	<b>customers</b>	<b>allowance</b>	<b>allowance</b>
	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>
Hong Kong .....	124,582	184	424	78	226
People's Republic of China .....	85,679	97	500	15	111
Other Asian Countries .....	11,803	310	174	83	81
Others .....	23,344	36	214	7	29
<b>Total .....</b>	<b>245,408</b>	<b>627</b>	<b>1,312</b>	<b>183</b>	<b>447</b>
% of total advances to customers.....			0.53%		
Market value of security held against impaired advances to customers .....			4,015		

	31/12/2008				
	Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Hong Kong .....	112,038	207	642	267	278
People's Republic of China .....	85,741	242	454	78	115
Other Asian Countries .....	10,798	159	246	168	103
Others .....	21,762	25	244	10	25
Total .....	<u>230,339</u>	<u>633</u>	<u>1,586</u>	<u>523</u>	<u>521</u>
% of total advances to customers.....			<u>0.69%</u>		
Market value of security held against impaired advances to customers .....			<u>3,769</u>		

Impaired loans and advances are individually assessed loans with objective evidence of impairment on an individual basis. The above information by countries or geographical areas is derived according to the location of the counterparties after taking into account any transfer of risk.

There were no impaired advances to banks and other financial institutions as at 30th June, 2009, 30th June, 2008 and 31st December, 2008; nor were there any individual impairment allowances made for them on these three respective dates.

## 18. Available-for-Sale Financial Assets

	30/6/2009	30/6/2008	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Treasury bills (including Exchange Fund Bills) .....	11,437	3,115	10,391
Certificates of deposit held .....	594	615	762
Debt securities .....	10,536	8,470	6,398
Equity securities .....	1,198	969	899
Investment funds .....	107	180	110
	<u>23,872</u>	<u>13,349</u>	<u>18,560</u>
Issued by:			
Central governments and central banks.....	11,521	4,026	10,419
Public sector entities.....	5	2,382	231
Banks and other financial institutions .....	10,012	4,641	5,773
Corporate entities.....	2,227	1,855	2,027
Other entities.....	107	445	110
	<u>23,872</u>	<u>13,349</u>	<u>18,560</u>
Analysed by place of listing:			
Listed in Hong Kong .....	515	498	397
Listed outside Hong Kong .....	4,232	4,194	9,329
	4,747	4,692	9,726
Unlisted .....	19,125	8,657	8,834
	<u>23,872</u>	<u>13,349</u>	<u>18,560</u>

## 19. Held-to-Maturity Investments

	30/6/2009	30/6/2008	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Treasury bills (including Exchange Fund Bills) .....	123	88	180
Certificates of deposit held.....	2,709	1,827	1,717
Debt securities .....	4,658	8,983	3,216
	7,490	10,898	5,113
Less: Impairment allowances.....	(116)	(96)	(107)
	<u>7,374</u>	<u>10,802</u>	<u>5,006</u>
Issued by:			
Central governments and central banks.....	673	5,441	243
Public sector entities.....	554	354	318
Banks and other financial institutions .....	5,182	3,745	3,344
Corporate entities.....	965	1,262	1,101
	<u>7,374</u>	<u>10,802</u>	<u>5,006</u>
Analysed by place of listing:			
Listed in Hong Kong .....	360	296	287
Listed outside Hong Kong .....	2,857	2,272	1,863
	3,217	2,568	2,150
Unlisted .....	4,157	8,234	2,856
	7,374	10,802	5,006
Market value:			
Listed securities .....	3,193	2,524	2,028
Unlisted securities.....	4,165	8,275	2,870
	<u>7,358</u>	<u>10,799</u>	<u>4,898</u>

## 20. Fixed Assets

30/6/2009

	Investment Properties	Bank Premises	Furniture, Fixtures and Equipment	Sub-total	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Cost or valuation					
At 1st January, 2009 .....	1,839	6,293	3,507	9,800	11,639
Additions .....	—	1,815	141	1,956	1,956
Additions through acquisition .....	—	—	10	10	10
Revaluation surplus .....	89	—	—	—	89
Revaluation of bank premises transferred to investment properties .....	—	98	—	98	98
Transfer from bank premises to investment properties .....	299	(299)	—	(299)	—
Disposals .....	(14)	(24)	(58)	(82)	(96)
Exchange adjustments .....	5	(3)	9	6	11
At 30th June, 2009 .....	<u>2,218</u>	<u>7,880</u>	<u>3,609</u>	<u>11,489</u>	<u>13,707</u>
Accumulated depreciation and amortisation					
At 1st January, 2009 .....	—	675	1,818	2,493	2,493
Additions through acquisition .....	—	—	3	3	3
Charge for the period .....	—	48	204	252	252
Written back on disposal .....	—	(12)	(55)	(67)	(67)
Exchange adjustments .....	—	—	9	9	9
At 30th June, 2009 .....	<u>—</u>	<u>711</u>	<u>1,979</u>	<u>2,690</u>	<u>2,690</u>
Net book value at 30th June, 2009 .....	<u>2,218</u>	<u>7,169</u>	<u>1,630</u>	<u>8,799</u>	<u>11,017</u>
Net book value at 30th June, 2008 .....	<u>2,245</u>	<u>4,367</u>	<u>1,287</u>	<u>5,654</u>	<u>7,899</u>
Net book value at 31st December, 2008 .....	<u>1,839</u>	<u>5,618</u>	<u>1,689</u>	<u>7,307</u>	<u>9,146</u>
The gross amounts of the above assets are stated:					
At cost .....	—	7,053	3,609	10,662	10,662
At Directors' valuation — 1989 .....	—	827	—	827	827
At professional valuation — 2009 .....	2,218	—	—	—	2,218
	<u>2,218</u>	<u>7,880</u>	<u>3,609</u>	<u>11,489</u>	<u>13,707</u>

## 21. Trading Liabilities

	30/6/2009	30/6/2008 Restated	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Exchange fund bills sold .....	800	1,328	330
Negative fair value of derivatives.....	1,210	1,483	2,516
	<u>2,010</u>	<u>2,811</u>	<u>2,846</u>

## 22. Other Accounts and Provisions

	30/6/2009	30/6/2008	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Accrued interest payable .....	1,037	1,364	1,953
Bankers acceptance.....	7,833	2,309	2,989
Other accounts .....	8,617	7,167	7,197
	<u>17,487</u>	<u>10,840</u>	<u>12,139</u>

## 23. Loan Capital

	30/6/2009	30/6/2008	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
USD550 million 5.625% subordinated notes, measured at fair value through profit or loss.....	4,071	4,303	3,644
GBP300 million 6.125% step-up perpetual subordinated notes, measured at fair value through profit or loss .....	3,321	4,379	2,751
USD600 million floating rate step-up subordinated notes, measured at amortised cost .....	4,643	4,670	4,641
	<u>12,035</u>	<u>13,352</u>	<u>11,036</u>

Loan capital of face value of HK\$4,262 million (US\$550,000,000) and carrying amount of HK\$4,071 million represents 5.625% subordinated notes qualifying as tier 2 capital which were issued on 13th December, 2005 by the Bank. The notes are listed on the Hong Kong Stock Exchange and will mature on 13th December, 2015.

Loan capital of face value of HK\$3,885 million (GBP300,000,000) and carrying amount of HK\$3,321 million represents 6.125% step-up perpetual subordinated notes qualifying as tier 2 capital which were issued on 20th March, 2007 by the Bank. The notes are listed on the Singapore Stock Exchange.

Loan capital of face value of HK\$4,650 million (US\$600,000,000) and carrying amount of HK\$4,643 million represents floating rate step-up subordinated notes qualifying as tier 2 capital which were issued on 21st June, 2007 by the Bank. The notes are listed on the Singapore Stock Exchange and will mature on 22nd June, 2017.

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## **24. Segment Reporting**

The Group manages its businesses by divisions, which are organised by a mixture of both business lines (products and services) and geography. Segment information is presented in a manner consistent with the way in which the information is reported internally to the Group's most senior executive management for the purposes of resource allocation and performance assessment. The Group has identified the following eight reportable segments.

Personal banking includes branch operations, personal Internet banking, consumer finance, property loans and credit card business in Hong Kong.

Corporate banking includes corporate lending and loan syndication, asset based lending, commercial lending and securities lending in Hong Kong.

Treasury markets include treasury operations and securities dealing in Hong Kong.

Wealth management includes private banking business in Hong Kong.

China operations include branches and subsidiaries in China.

Overseas operations include overseas branches and subsidiaries.

Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.

Other businesses include insurance business, property-related business and other subsidiaries in Hong Kong.

Unallocated include supporting units of Hong Kong operation, investment properties, bank premises and investments in associates.

## 6 months ended 30/6/2009

	Hong Kong Operations								Total Reportable Segments	Inter-segment		
	Personal Banking	Corporate Banking	Treasury Markets	Wealth Management	China Operations	Overseas Operations	Corporate Services	Others		Unallocated	Elimination	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn		HK\$ Mn	HK\$ Mn	HK\$ Mn
Net interest income/(expense).....	899	342	260	63	1,450	349	1	30	3,394	(194)	34	3,234
Non-interest income/(expense).....	205	463	(155)	91	184	216	399	317	1,720	264	(267)	1,717
Operating income/(expense).....	1,104	805	105	154	1,634	565	400	347	5,114	70	(233)	4,951
Operating expenses.....	(715)	(52)	(53)	(50)	(932)	(258)	(244)	(225)	(2,529)	(740)	228	(3,041)
Operating profit/(loss) before impairment losses.....	389	753	52	104	702	307	156	122	2,585	(670)	(5)	1,910
(Charge for)/Write back of impairment losses on loans and advances and other accounts.....	(56)	(48)	—	(23)	7	(341)	(4)	(9)	(474)	—	—	(474)
Impairment losses on available-for-sale financial assets and held-to-maturity investments.....	—	—	(9)	—	—	—	—	(10)	(19)	(1)	1	(19)
Operating profit/(loss) after impairment losses.....	333	705	43	81	709	(34)	152	103	2,092	(671)	(4)	1,417
Profit/(Loss) on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments and subsidiaries/associates.....	(2)	—	41	—	22	—	—	21	82	—	—	82
Valuation gains/(losses) on investment properties.....	—	—	—	—	—	(3)	—	14	11	91	(13)	89
Share of profits less losses of associates.....	—	—	—	—	—	—	—	—	—	79	—	79
Profit/(Loss) before taxation.....	331	705	84	81	731	(37)	152	138	2,185	(501)	(17)	1,667
Depreciation for the period.....	(35)	(1)	(1)	(1)	(90)	(13)	(9)	(10)	(160)	(91)	(1)	(252)
Segment assets.....	42,304	63,516	133,816	6,576	132,957	45,672	1,883	5,885	432,609	8,837	(32,142)	409,304
Investments in associates.....	—	—	—	—	—	—	—	—	—	2,553	—	2,553
Total assets.....	42,304	63,516	133,816	6,576	132,957	45,672	1,883	5,885	432,609	11,390	(32,142)	411,857
Total liabilities.....	210,946	536	19,727	12,278	110,628	22,584	145	4,240	381,084	993	(4,138)	377,939

## 6 months ended 30/6/2008 (Restated)

	Hong Kong Operations								Total Reportable Segments	Inter-segment		
	Personal Banking	Corporate Banking	Treasury Markets	Wealth Management	China Operations	Overseas Operations	Corporate Services	Others		Unallocated	Elimination	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn		HK\$ Mn	HK\$ Mn	HK\$ Mn
Net interest income/(expense).....	842	291	676	9	1,410	355	(1)	51	3,633	(183)	33	3,483
Non-interest income/(expense).....	306	64	(1,266)	33	281	99	409	270	196	334	(328)	202
Operating income/(expense).....	1,148	355	(590)	42	1,691	454	408	321	3,829	151	(295)	3,685
Operating expenses.....	(605)	(55)	(36)	(58)	(809)	(277)	(248)	(235)	(2,323)	(635)	194	(2,764)
Operating profit/(loss) before impairment losses.....	543	300	(626)	(16)	882	177	160	86	1,506	(484)	(101)	921
(Charge for)/Write back of impairment losses on loans and advances and other accounts.....	(8)	53	—	—	(40)	(90)	(3)	(1)	(89)	—	—	(89)
Write back of impairment losses on bank premises.....	—	—	—	—	—	—	—	—	—	5	—	5
Impairment losses on available-for-sale financial assets and held-to-maturity investments.....	—	—	(231)	—	—	—	—	—	(231)	—	—	(231)
Operating profit/(loss) after impairment losses.....	535	353	(857)	(16)	842	87	157	85	1,186	(479)	(101)	606
Profit/(Loss) on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments and subsidiaries/associates.....	—	—	163	—	(1)	—	(1)	(2)	159	12	3	174
Valuation gains/(losses) on investment properties.....	—	—	—	—	—	(6)	—	(42)	(48)	274	(28)	198
Share of profits less losses of associates.....	—	—	—	—	—	—	—	—	—	95	—	95
Profit/(Loss) before taxation.....	535	353	(694)	(16)	841	81	156	41	1,297	(98)	(126)	1,073
Depreciation for the period.....	(30)	(1)	(1)	(2)	(55)	(12)	(9)	(10)	(120)	(76)	(1)	(197)
Segment assets.....	52,759	61,426	132,568	7,821	123,887	43,234	1,945	4,704	428,344	6,652	(41,124)	393,872
Investments in associates.....	—	—	—	—	—	—	—	—	—	2,737	—	2,737
Total assets.....	52,759	61,426	132,568	7,821	123,887	43,234	1,945	4,704	428,344	9,389	(41,124)	396,609
Total liabilities.....	217,801	608	26,336	2,985	93,537	22,015	153	3,934	367,369	446	(5,185)	362,630

## 25. Analysis of Assets and Liabilities by Remaining Maturity

	30/6/2009						Total HK\$ Mn
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
<b>Assets</b>							
Cash and balances with banks and other financial institutions .....	10,367	74	—	—	—	8,842	19,283
Placements with banks and other financial institutions .....	—	64,597	21,070	—	—	—	85,667
Trade bills .....	36	870	56	—	—	11	973
Trading assets .....	—	1,034	201	804	88	2,274	4,401
Financial assets designated at fair value through profit or loss.....	—	137	381	4,883	772	126	6,299
Advances to customers and other accounts.....	4,735	48,383	37,398	90,665	59,325	5,644	246,150
Available-for-sale financial assets.	—	7,312	4,816	9,829	610	1,305	23,872
Held-to-maturity investments .....	—	2,018	1,274	3,572	510	—	7,374
Undated assets .....	—	—	—	—	—	17,838	17,838
<b>Total assets .....</b>	<b>15,138</b>	<b>124,425</b>	<b>65,196</b>	<b>109,753</b>	<b>61,305</b>	<b>36,040</b>	<b>411,857</b>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .....	9,426	11,460	1,225	36	—	11	22,158
Deposits from customers .....	112,590	162,308	35,137	10,142	624	—	320,801
- Demand deposits and current accounts .....	40,019	—	—	—	—	—	40,019
- Savings deposit .....	68,595	—	—	—	—	—	68,595
- Time, call and notice deposits.....	3,976	162,308	35,137	10,142	624	—	212,187
Trading liabilities .....	—	800	—	—	—	1,210	2,010
Certificates of deposit issued .....	—	78	1,416	769	604	—	2,867
Current taxation .....	—	—	287	—	—	—	287
Loan capital.....	—	—	—	12,035	—	—	12,035
Other liabilities .....	—	273	—	—	—	—	273
Undated liabilities .....	—	—	—	—	—	17,508	17,508
<b>Total liabilities .....</b>	<b>122,016</b>	<b>174,919</b>	<b>38,065</b>	<b>22,982</b>	<b>1,228</b>	<b>18,729</b>	<b>377,939</b>
<b>Net gap .....</b>	<b>(106,878)</b>	<b>(50,494)</b>	<b>27,131</b>	<b>86,771</b>	<b>60,077</b>		

	31/12/2008						Total
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
<b>Assets</b>							
Cash and balances with banks and other financial institutions .....	19,099	67	—	—	—	8,939	28,105
Placements with banks and other financial institutions .....	—	82,624	13,950	—	—	—	96,574
Trade bills .....	18	991	139	—	—	16	1,164
Trading assets .....	—	400	2	81	43	2,911	3,437
Financial assets designated at fair value through profit or loss.....	—	140	448	3,104	438	—	4,130
Advances to customers and other accounts.....	4,431	43,750	42,249	86,169	55,285	11,841	243,725
Available-for-sale financial assets.	—	5,441	5,651	5,510	949	1,009	18,560
Held-to-maturity investments .....	—	980	1,546	2,160	320	—	5,006
Undated assets .....	—	—	—	—	—	14,553	14,553
<b>Total assets .....</b>	<b>23,548</b>	<b>134,393</b>	<b>63,985</b>	<b>97,024</b>	<b>57,035</b>	<b>39,269</b>	<b>415,254</b>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .....	871	18,150	7,644	362	10	8	27,045
Deposits from customers .....	86,109	192,093	35,341	9,237	1,022	—	323,802
- Demand deposits and current accounts .....	36,332	—	—	—	—	—	36,332
- Savings deposit .....	45,781	—	—	—	—	—	45,781
- Time, call and notice deposits.....	3,996	192,093	35,341	9,237	1,022	—	241,689
Trading liabilities .....	—	130	200	—	—	2,516	2,846
Certificates of deposit issued .....	—	1,941	881	2,028	641	—	5,491
Current taxation .....	—	—	333	—	—	—	333
Loan capital.....	—	—	—	11,036	—	—	11,036
Undated liabilities .....	—	—	—	—	—	12,216	12,216
<b>Total liabilities .....</b>	<b>86,980</b>	<b>212,314</b>	<b>44,399</b>	<b>22,663</b>	<b>1,673</b>	<b>14,740</b>	<b>382,769</b>
<b>Net gap .....</b>	<b>(63,432)</b>	<b>(77,921)</b>	<b>19,586</b>	<b>74,361</b>	<b>55,362</b>		

## 26. Deferred Tax Assets and Liabilities Recognised

The components of deferred tax (assets)/liabilities recognised in the consolidated statement of financial position and the movements during the period are as follows:

Deferred tax arising from :	Depreciation	Revaluation	Impairment	Revaluation	Tax losses	Others	Total
	allowances in excess of related depreciation	of properties	losses on financial assets	of available for-sale securities			
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1st January, 2009.....	361	257	(49)	(4)	(661)	(14)	(110)
Charged/(credited) to consolidated income statement.....	(18)	—	(22)	—	260	(15)	205
Charged to reserves.....	—	24	—	15	—	—	39
Exchange and other adjustments.....	—	—	—	—	—	2	2
At 30th June, 2009.....	<u>343</u>	<u>281</u>	<u>(71)</u>	<u>11</u>	<u>(401)</u>	<u>(27)</u>	<u>136</u>
Balance as at 30th June, 2008.....	<u>346</u>	<u>273</u>	<u>83</u>	<u>14</u>	<u>(68)</u>	<u>14</u>	<u>662</u>
Balance as at 31st December, 2008.....	<u>361</u>	<u>257</u>	<u>(49)</u>	<u>(4)</u>	<u>(661)</u>	<u>(14)</u>	<u>(110)</u>

## 27 Reserves

	30/6/2009	30/6/2008	31/12/2008
	HK\$ Mn	Restated HK\$ Mn	HK\$ Mn
Share premium .....	4,509	4,924	4,922
General reserve .....	14,649	14,524	14,634
Revaluation reserve on bank premises.....	931	877	863
Investment revaluation reserve.....	(79)	(11)	(228)
Exchange revaluation reserve.....	1,010	1,277	1,006
Other reserves .....	1,471	188	1,427
Retained profits* .....	<u>6,466</u>	<u>7,683</u>	<u>5,339</u>
Total .....	<u>28,957</u>	<u>29,462</u>	<u>27,963</u>
Proposed dividends, not provided for.....	<u>516</u>	<u>384</u>	<u>33</u>

\* A regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purposes by earmarking amounts in respect of losses which the Bank will or may incur on loans and advances in addition to impairment losses recognised. Movements in the reserve are earmarked directly through retained earnings and in consultation with the Hong Kong Monetary Authority. As at 30th June, 2009, HK\$1,876 million (31st December, 2008: HK\$1,996 million) was included in the retained profits in this respect which was distributable to equity holders of the Group subject to consultation with the Hong Kong Monetary Authority.

## 28. Consolidated Cash Flow Statement

### (a) Purchase of subsidiaries

	30/6/2009	30/6/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Cash and balances with banks and other financial institutions.....	19	12
Advances and other accounts less provisions .....	19	10
Fixed assets .....	7	4
Goodwill .....	—	25
Other accounts and provisions .....	(2)	(46)
	43	5
Goodwill arising on consolidation.....	—	31
Total purchase price.....	43	36
Less: Cash and cash equivalents acquired.....	(19)	(12)
Cash flow on acquisition net of cash acquired.....	<u>24</u>	<u>24</u>

### (b) Cash and cash equivalents

	30/6/2009	30/6/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
(i) Components of cash and cash equivalents in the consolidated cash flow statement		
Cash and balances with banks and other financial institutions.....	11,487	10,551
Placements with banks and other financial institutions with original maturity within three months.....	51,912	52,576
Treasury bills with original maturity within three months.....	2,817	2,649
Certificates of deposit held with original maturity within three months.....	826	404
Debt securities with original maturity within three months .....	284	964
	<u>67,326</u>	<u>67,144</u>
(ii) Reconciliation with the consolidated statement of financial position		
Cash and balances with banks and other financial institutions.....	19,283	19,209
Placements with banks and other financial institutions.....	85,667	70,889
Treasury bills and certificates of deposit held		
— trading assets.....	2,127	1,610
— designated at fair value through profit or loss.....	6,173	7,461
— advances and other accounts .....	39	39
— available-for sale .....	22,567	12,386
— held-to-maturity .....	7,374	10,802
	<u>38,280</u>	<u>32,298</u>
Amount shown in the consolidated statement of financial position.....	143,230	122,396
Less: amounts with an original maturity of beyond.....	(68,108)	(46,594)
three months cash balance with central bank subject to regulatory restriction .....	(7,796)	(8,658)
Cash and cash equivalents in the consolidated cash flow statement .....	<u>67,326</u>	<u>67,144</u>

## 29. Off-balance Sheet Exposures

(a) The following is a summary of each significant class of off-balance sheet exposures:

	30/6/2009	30/6/2008 Restated	31/12/2008
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Contractual amounts of contingent liabilities and commitments			
Direct credit substitutes.....	5,942	9,535	7,272
Transaction-related contingencies .....	1,744	2,269	1,771
Trade-related contingencies .....	1,235	1,561	1,045
Commitments that are unconditionally cancellable without prior notice ..	40,213	51,952	41,692
Other commitments with an original maturity			
— up to 1 year.....	5,155	4,716	5,651
— over 1 year .....	23,809	13,035	18,737
	<u>78,098</u>	<u>83,068</u>	<u>76,168</u>
Fair value			
Exchange rate contracts .....	288	366	488
Interest rate contracts.....	670	673	1,012
Options purchased			
— exchange rate contracts.....	3	11	3
— equity contracts.....	47	721	231
	<u>1,008</u>	<u>1,771</u>	<u>1,734</u>
Notional amounts of derivatives			
Exchange rate contracts .....	44,175	84,112	40,652
Interest rate contracts.....	48,527	52,099	44,724
Equity contracts .....	2,024	11,039	3,186
Others .....	—	63	—
	<u>94,726</u>	<u>147,313</u>	<u>88,562</u>
Credit risk weighted amounts			
Contingent liabilities and commitments.....	21,978	24,405	20,642
Exchange rate contracts .....	417	474	391
Interest rate contracts.....	300	123	225
Equity contracts .....	74	170	181
Debt security & other commodity.....	15	108	22
	<u>22,784</u>	<u>25,280</u>	<u>21,461</u>

The replacement costs and credit risk weighted amounts of the off-balance sheet exposures do not take into account the effects of bilateral netting arrangements.

## (b) Capital Commitments

Capital commitments on purchase of properties outstanding as at 30th June and 31st December and not provided for in the accounts were as follows:

	30/6/2009	30/6/2008	31/12/2008
	HK\$ Mn	HK\$ Mn	HK\$ Mn
Expenditure authorised and contracted for .....	108	2,256	1,459
Expenditure authorised but not contracted for.....	—	62	—
	<u>108</u>	<u>2,318</u>	<u>1,459</u>

## 30. Material Related Party Transactions

The Group maintains certain retirement benefit schemes for its staff. In the six month ended 30th June, 2009, the total amount of contributions the Group made to the schemes was HK\$37 million (six months ended 30th June, 2008: HK\$52 million).

The Group enters into a number of transactions with the Group's related parties, including its associates, and key management personnel and their close family members and companies controlled or significantly influenced by them. The transactions include accepting deposits from and extending credit facilities to them. Except that there is interest free shareholder's advance extended to one (31st December, 2008: one) associate amounting to HK\$7 million at 30th June, 2009 (31st December, 2008: HK\$7 million), all interest rates in connection with the deposits taken and credit facilities extended are under terms and conditions normally applicable to customers of comparable standing.

On 27th February, 2009, the Bank entered into a sale and purchase agreement with Kerry Media Limited ("Kerry") in respect of the sale and purchase of 75,000,000 shares of par value HK\$0.10 in SCMP Group Limited, representing approximately 4.8% of the issued share capital of SCMP Group Limited ("Sale Shares") for aggregate consideration of HK\$127,500,000; and an option agreement with Kerry in respect of the grant by Kerry to the Bank of put options in relation to the Sale Shares.

The interest received from and interest paid to the Group's related parties for the six months ended 30th June, 2009, outstanding balances of amounts due from and due to them at 30th June, 2009 and maximum outstanding balance of amounts due from and due to them for the six months ended 30th June, 2009 are aggregated as follows:

	Key management personnel		Subsidiaries		Associates	
	30/6/2009	30/6/2008	30/6/2009	30/6/2008	30/6/2009	30/6/2008
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Interest income .....	106	135	266	468	1	5
Interest expense .....	18	52	52	77	—	—
Amounts due from .....	7,307	11,305	10,671	20,435	50	532
Amounts due to.....	3,624	3,781	1,622	2,739	6	3
Maximum amounts due from ...	8,702	12,151	15,953	20,435	282	519
Maximum amounts due to.....	7,574	6,359	2,295	2,739	18	17

## 31. Basis of Consolidation

Unless otherwise stated, all financial information contained in this interim report is prepared according to the consolidation basis for accounting purposes.

The capital adequacy ratio and liquidity ratio of the Group are prepared according to the basis of consolidation for regulatory purposes. The main difference between the consolidation base for accounting and regulatory purposes is that the former includes the Bank and all its subsidiaries whereas the latter includes the Bank and only some of the Group's subsidiaries which mainly conduct banking business or other businesses incidental to banking business.

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List of subsidiaries for financial reporting consolidation:

Abacus (Nominees) Limited	EA Nominees Limited
Abacus Business Consultants Sdn. Bhd.	EA Securities Limited
Abacus Company Administration Sdn. Bhd.	EACS (First director) Inc.
Abacus Share Registrars Ltd	East Asia Corporate Services (BVI) Limited
Acheson Limited	East Asia Corporate Services (Nominees) Limited
Alamo Investments Limited	* East Asia Electronic Data Processing (Guangzhou) Limited
Albridge Corporate Advisory Services Ltd	* East Asia Facility Management Limited
Albridge Services London Ltd	East Asia Financial Services (BVI) Limited
Alhart Limited	East Asia Futures Limited
Ample Delight Limited	* East Asia Holding Company, Inc.
Asia Strategic Capital Limited	East Asia Holding (BVI) Limited
Asia Strategic Investment Management Limited	East Asia Indonesian Holdings Limited
Bagatelle Services Limited	East Asia International Trustees Holdings (BVI) Limited
* Bank of East Asia (Trustees) Limited	* East Asia Investment Holdings Limited
Barbinder & Co. Pte. Limited	* East Asia Investment Holdings (BVI) Limited
Barbinder & Co. Sdn. Bhd.	East Asia Liquidators Limited
BC (BVI) Holdings Limited	East Asia Marketing Limited
BEA Life Limited	* East Asia Properties (US), Inc.
BEA Pacific Limited (In Members' Voluntary Winding-Up)	East Asia Properties Holding Company Limited
BEA Pacific Asia Limited	East Asia Properties Investment Company Limited
BEA Pacific Holding Company Limited	East Asia Property Agency (China) Company Limited
BEA Pacific Nominee Limited	East Asia Property Agency Company Limited
BEA Pacific (Vanuatu) Limited (In Members' Voluntary Winding-Up)	East Asia Property Development (Shanghai) Limited
BEA Union Investment Management Limited	East Asia Property Holdings (Jersey) Limited
Becmac Limited	East Asia Property Management (China) Limited
Beecroft Limited	East Asia Property Management (Guangzhou) Limited
Bentley Services Limited	East Asia Secretarial Services Limited
Blue Care (BVI) Holdings Limited	East Asia Secretaries (BVI) Limited
Blue Care JV (BVI) Holdings Limited	East Asia Secretaries Limited
Blue Care Medical Services Limited	East Asia Securities Company Limited
Blue Cross (Asia-Pacific) Insurance Limited	* East Asia Services (Holdings) Limited
Branford Investments Limited	East Asia Strategic Holdings Limited
Camceb Limited	Elemen Limited
Cane Garden Bay Limited	Epsilon Registration Services Sdn. Bhd.
Capico Asset Management Sdn. Bhd.	Equity Trustee Limited
Caribbean Corporate Services Limited	Essex Nominees Limited
CCSL St. Lucia Limited	Evatthouse Corporate Services Pte. Limited
Central Town Limited	Far East Bank Nominees Limited
Century Able Limited	FEB (1989) Limited
Cheam Holdings Limited	Flowery World Corporation
Cheam Nominees Limited	Fortra Services Limited
Chua, Woo & Company Sdn. Bhd.	Gainsville Limited
Clacton Company Limited	Gladwood Limited
Clancy Limited	Glencoe Limited
Corona Light Limited	Global Success Limited
* Credit Gain Finance Company Limited	Golden Empire International Inc.
Crystal Gleaming Limited	Golden Properties Finance Limited
Delanez Limited	Golden Queen International Limited
Denroy Nominees Limited	Golden Wings International Limited
Dersale Limited	Goldmond Company Limited
Digex Limited	Goldmond Finance Company Limited
Directra Overseas Services Inc.	Grimma Company Limited
Directra Services Limited	International Holdings Corporation
EA China Finance Limited	Kaliwood Corporation

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Keen Sight Development Limited	Tricor (Labuan) Limited
Leader One Limited	Tricor Abacus Limited
Linkwall Investments Limited	Tricor Aldbridge LLP
Maccabee (Nominees) Limited	Tricor Asia Limited
Mache Holdings Limited	Tricor Caribbean Limited
Mache Nominees Limited	Tricor China Limited
Mactors Limited	Tricor Consultancy (Beijing) Limited
Maintex Limited	Tricor Corporate Secretary Limited
Malplaquet Limited	Tricor Custodian Limited
Menroy Registrars Limited	Tricor EACS (Hong Kong) Limited
Nola Company Limited	Tricor Executive Recruitment Limited
Norpac Holdings Limited	Tricor Executive Resources Limited
Outsource Centre Pte. Limited	Tricor Firmley Limited
Overseas Nominees Limited	Tricor Friendly Limited
Pen Ling Limited	Tricor Global Limited
PFA Malaysia Sdn. Bhd.	Tricor Greater China Limited
PFA Registration Services Sdn. Bhd.	Tricor Holdings Limited
PFA Services Sdn. Bhd.	Tricor Holdings Pte. Limited
PFA Tax Services Sdn. Bhd.	Tricor International Trustee Limited
Powerhouse Worldwide Limited	Tricor Investor Services Limited
Premier Dragon Development Limited	Tricor Nominees Limited
Radstock Holdings Limited	Tricor Outsourcing (Thailand) Limited
Ramillies Limited	Tricor Outsourcing Solutions Sdn. Bhd.
Red Phoenix Limited	Tricor Progressive Limited
Richard Tozer Nominees Ltd	Tricor Representatives Limited
Roebuck Limited	Tricor Secretaries Limited
Rontors Limited	Tricor Services (Brunei) Ltd
Rosland Corporate Management Limited	Tricor Services (BVI) Limited
Secretaries Limited	Tricor Services (Macau) Limited
Secretarius Services Sdn. Bhd.	Tricor Services (Malaysia) Sdn. Bhd.
Shareg Nominees Limited	Tricor Services (UK) Limited
Skyray Holdings Limited	Tricor Services Limited
Speedfull Limited	Tricor Signatory Limited
Standard Registrars Ltd	Tricor Singapore Pte. Limited
Strath Corporate Services Holdings Limited	Tricor Standard Limited
Strath Corporate Services Limited	Tricor Strath Limited
Strath Fiduciaries Limited	Tricor Tengis Limited
Sunshine Dynamic Company Limited	Tricor Trustco (Labuan) Limited
Swan Nominees Limited	Trident Corporate Management Limited
Tabernacle Assets Limited	Trident Nominees Limited
Teeroy Limited	Tristan Company Limited
Tenaga Koperat Sdn. Bhd.	Tudor Nominees Limited
Tengis International Limited	Tung Shing Holdings (BVI) Limited
Tengis Services Limited	Turquandia Limited
* The Bank of East Asia (BVI) Limited	U Care Hong Kong Medical Limited
* The Bank of East Asia (Canada)	United Chinese (Nominee) Limited
* The Bank of East Asia (China) Limited	Vanceburg Limited
The Bank of East Asia (Nominees) Limited	Virtual Success Limited
The Bank of East Asia (Nominees) Private Limited	Vitaway (Mauritius) Limited
* The Bank of East Asia (U.S.A.) N.A.	W.T. (Secretaries) Limited
The Bank of East Asia Nominees (UK) Limited	Wai Chiu Company Limited
Total Corporate Compliance Sdn. Bhd.	Wai Hop Company Limited
Total Express & Document Storage Sdn. Bhd.	Westboro Limited
Travelsafe Limited	Wilfred Co., Limited
Tricor (B) Sdn. Bhd.	Witcombe Corporation

\* “regulated financial entities” as defined by the Banking (Capital) Rules and included in the basis of consolidation for regulatory reporting purpose.

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### **32. Non-adjusting post balance sheet events**

On 20th July 2009, The Bank of East Asia (China) Limited, which is the wholly-owned subsidiary of the Bank, fully utilised the RMB4 billion bond issue principal amount approved by the People's Bank of China and the National Development and Reform Commission. The net proceeds of the sale of the bonds are used to fund Renminbi-denominated loans and for working capital and general corporate purposes.

### **33. Provision for repurchase of Lehman Mini-bonds subscribed or purchased through the Bank**

On 22nd July, 2009, on a without liability basis, the Bank entered into an agreement with the Hong Kong Monetary Authority, the Securities and Futures Commission and 15 other distributing banks under which the Bank would offer to certain customers to repurchase certain structured investments, commonly known as Lehman Mini-bonds subscribed or purchased through the Bank. The Bank has made an announcement on the same date setting out the details of the offer.

In the event that all eligible investors accept the offer and there is no future recovery from the underlying collateral, the maximum commitment of the Bank is HK\$109 million in accordance with the available information up to the end of June 2009. On this basis, the Bank has already made full provision for the expected cost in respect of the repurchase of the above mentioned structured investment products.

### **34. Comparative figures**

The comparative figures for the first half of 2008 have been restated due to the unauthorised manipulation on the valuation of certain equity derivatives held by the Bank, which was announced to the public on 18th September, 2008.

As a result of the application of HKAS 1 (revised 2007), Presentation of Financial Statements, and HKFRS 8, Operating Segments, certain comparative figures have been adjusted to conform to current period's presentation and to period comparative amounts in respect of items disclosed for the first time in 2009.

Certain comparative figures have been restated to conform with current period's presentation.

### **35. Statement of Compliance**

The Interim Results together with the Supplementary Financial Information on pages F-32 to F-38 complies fully with the Banking (Disclosure) Rules issued by the Hong Kong Monetary Authority, the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and HKAS 34 "Interim Financial Reporting" issued by the HKICPA in October 2004.

## SUPPLEMENTARY FINANCIAL INFORMATION

### A. Capital Adequacy Ratio and Capital Base

#### (a) Capital adequacy ratio

	30/6/2009	30/6/2008 Restated	31/12/2008
	%	%	%
Capital adequacy ratio .....	13.0	14.6	13.8
Core capital adequacy ratio .....	8.4	9.4	9.1

Capital ratios were compiled in accordance with the Banking (Capital) Rules (“the Capital Rules”) issued by the Hong Kong Monetary Authority under Section 98A of the Hong Kong Banking Ordinance for the implementation of the “Basel II” capital accord, which became effective on 1st January, 2007. In accordance with the Capital Rules, the Bank has adopted the foundation internal ratings-based approach for the calculation of the risk-weighted assets for credit risk, the internal models approach for the calculation of market risk and the standardised approach for operational risk.

The basis of consolidation for calculation of capital ratios under the Capital Rules follows the basis of consolidation for financial reporting with the exclusion of subsidiaries which are “regulated financial entities” (e.g. insurance and securities companies) as defined by the Capital Rules. Accordingly, the investment costs of these unconsolidated regulated financial entities are deducted from the capital base.

#### (b) Group capital base after deductions

	30/6/2009	30/6/2008 Restated	31/12/2008
	HK\$ Mn	HK\$ Mn	HK\$ Mn
Core capital			
Paid up ordinary share capital .....	4,604	4,177	4,183
Share premium .....	4,509	4,924	4,922
Reserves .....	18,438	18,469	18,308
Profit and loss account .....	332	106	(71)
Deduct: Goodwill .....	(1,624)	(1,625)	(1,624)
Net deferred tax assets .....	(154)	—	(119)
Other intangible assets .....	(957)	(25)	(29)
	25,148	26,026	25,570
Less: Core capital items deductions .....	(2,955)	(2,825)	(2,749)
Total core capital .....	22,193	23,201	22,821
Eligible supplementary capital			
Reserves attributable to fair value gains on revaluation of holdings of land and buildings .....	869	936	801
Revaluation reserves for fair value gains on revaluation of holdings of available-for-sale equities and debt securities .....	—	—	—
Unrealised fair value gains arising from holdings of equities and debt securities designated at fair value through profit or loss .....	240	—	—
Regulatory reserve for general banking risks .....	121	226	156
Collectively assessed impairment allowances .....	79	44	42
Surplus provisions .....	955	869	1,024
Perpetual subordinated debt .....	3,877	4,659	3,356
Term subordinated debt .....	8,902	8,955	8,899
	15,043	15,689	14,278
Less: Supplementary capital items deductions .....	(2,955)	(2,825)	(2,749)
Total supplementary capital .....	12,088	12,864	11,529
Total capital base .....	34,281	36,065	34,350

## B. Liquidity Ratio

	6 months ended 30/6/2009	6 months ended 30/6/2008	The year ended 31/12/2008
	%	%	%
Average liquidity ratio for the period.....	43.8	38.8	38.4

The average liquidity ratio for the period is the simple average of each calendar month's average liquidity ratio, which is computed on the consolidated basis as required by the Hong Kong Monetary Authority for its regulatory purposes, and is in accordance with the Fourth Schedule to the Hong Kong Banking Ordinance.

## C. 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 disclosed.

	30/6/2009			
	Banks and other financial institutions	Public sector entities	Others	Total
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
People's Republic of China.....	12,581	17,217	45,984	75,782
Asian countries, excluding People's Republic of China .....	20,006	2,796	11,785	34,587
North America .....	10,157	240	9,055	19,452
Western Europe .....	63,883	—	1,737	65,620
	30/6/2008			
	Banks and other financial institutions	Public sector entities	Others	Total
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
People's Republic of China.....	19,808	1,922	51,102	72,832
Asian countries, excluding People's Republic of China .....	12,317	1,450	12,876	26,643
North America .....	4,982	5,270	9,263	19,515
Western Europe .....	56,782	—	4,312	61,094
	31/12/2008			
	Banks and other financial institutions	Public sector entities	Others	Total
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
People's Republic of China.....	31,237	2,867	49,999	84,103
Asian countries, excluding People's Republic of China .....	17,388	1,703	11,797	30,888
North America .....	11,688	10	10,028	21,726
Western Europe .....	70,048	—	2,383	72,431

#### D. Non-bank Mainland Exposures

The total direct non-bank Mainland exposures and the individual impairment allowances are as follows:

	30/6/2009			
	On-balance sheet exposure	Off-balance sheet exposure	Total	Individual impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>Type of counterparties</b>				
Mainland entities.....	89,804	18,643	108,447	86
Companies and individuals outside Mainland where the credit is granted for use in Mainland .....	13,651	2,245	15,896	22
Other counterparties the exposures to whom are considered to be non-bank Mainland exposures .....	4,712	8	4,720	2
Total .....	<u>108,167</u>	<u>20,896</u>	<u>129,063</u>	<u>110</u>
	30/6/2008			
	On-balance sheet exposure	Off-balance sheet exposure	Total	Individual impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>Type of counterparties</b>				
Mainland entities.....	93,252	17,908	111,160	35
Companies and individuals outside Mainland where the credit is granted for use in Mainland .....	14,514	2,736	17,250	5
Other counterparties the exposures to whom are considered to be non-bank Mainland exposures .....	3,359	27	3,386	—
Total .....	<u>111,125</u>	<u>20,671</u>	<u>131,796</u>	<u>40</u>
	31/12/2008			
	On-balance sheet exposure	Off-balance sheet exposure	Total	Individual impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>Type of counterparties</b>				
Mainland entities.....	92,563	14,764	107,327	60
Companies and individuals outside Mainland where the credit is granted for use in Mainland .....	13,804	2,192	15,996	37
Other counterparties the exposures to whom are considered to be non-bank Mainland exposures .....	4,266	43	4,309	—
Total .....	<u>110,633</u>	<u>16,999</u>	<u>127,632</u>	<u>97</u>

## E. Overdue, Rescheduled and Repossessed Assets

### (a) Overdue and rescheduled advances

	30/6/2009		30/6/2008		31/12/2008	
	HK\$ Mn	% of total advances to customers	HK\$ Mn	% of total advances to customers	HK\$ Mn	% of total advances to customers
Advances to customers overdue for						
- 6 months or less but over 3 months.....	258	0.1	109	0.1	233	0.1
- 1 year or less but over 6 months ..	531	0.2	359	0.1	229	0.1
- Over 1 year .....	197	0.1	159	0.1	171	0.1
	<u>986</u>	<u>0.4</u>	<u>627</u>	<u>0.3</u>	<u>633</u>	<u>0.3</u>
Rescheduled advances to customers ....	<u>390</u>	<u>0.2</u>	<u>263</u>	<u>0.1</u>	<u>239</u>	<u>0.1</u>
Total overdue and rescheduled advances .....	<u>1,376</u>	<u>0.6</u>	<u>890</u>	<u>0.4</u>	<u>872</u>	<u>0.4</u>
Secured overdue advances .....	<u>436</u>	<u>0.2</u>	<u>490</u>	<u>0.2</u>	<u>261</u>	<u>0.1</u>
Unsecured overdue advances .....	<u>550</u>	<u>0.2</u>	<u>137</u>	<u>0.1</u>	<u>372</u>	<u>0.2</u>
Market value of security held against secured overdue advances .....	<u>2,129</u>		<u>2,233</u>		<u>1,542</u>	
Individual impairment allowance made on loans overdue for more than 3 months .....	<u>489</u>		<u>115</u>		<u>231</u>	

Loans and advances with a specific repayment date are classified as overdue when the principal or interest is overdue and remains unpaid at the period-end. Loans repayable by regular instalments are treated as overdue when an instalment payment is overdue and remains unpaid at period end. Loans 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 demand notice, and/or when the loans have remained continuously outside the approved limit advised to the borrower for more than the overdue period in question.

An asset considered as an eligible collateral should generally satisfy the following:

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

The two main types of "Eligible Collateral" are as follows:

- (i) "Eligible Financial Collateral" mainly comprises cash deposits and shares.
- (ii) "Eligible Physical Collateral" mainly comprises land and buildings, vehicles and equipment.

When the Bank's clients face financial difficulties and fail to settle their loans, depending on different situations, the Bank usually takes the following actions to recover the debt:

- (a) Debt Rescheduling/Restructuring

- (b) Enforcement of security
- (c) Legal Action
- (d) Recovery via Debt Collector

There were no advances to banks and other financial institutions which were overdue for over 3 months as at 30th June, 2009, 30th June, 2008 and 31st December, 2008; nor were there any rescheduled advances to banks and other financial institutions on these three dates.

**(b) Other overdue and rescheduled assets**

	30/06/2009		
	Accrued interest	Debt securities	Other assets*
	HK\$ Mn	HK\$ Mn	HK\$ Mn
Other assets overdue for			
- 6 months or less but over 3 months.....	—	—	—
- 1 year or less but over 6 months.....	—	—	10
- Over 1 year.....	1	—	—
	<u>1</u>	<u>—</u>	<u>10</u>
Rescheduled assets.....	—	—	—
Total other overdue and rescheduled assets.....	<u>1</u>	<u>—</u>	<u>10</u>

	30/06/2008		
	Accrued interest	Debt securities	Other assets*
	HK\$ Mn	HK\$ Mn	HK\$ Mn
Other assets overdue for			
- 6 months or less but over 3 months.....	—	—	—
- 1 year or less but over 6 months.....	1	1	1
- Over 1 year.....	—	—	—
	<u>1</u>	<u>1</u>	<u>1</u>
Rescheduled assets.....	—	—	—
Total other overdue and rescheduled assets.....	<u>1</u>	<u>1</u>	<u>1</u>

	31/12/2008		
	Accrued interest	Debt securities	Other assets*
	HK\$ Mn	HK\$ Mn	HK\$ Mn
Other assets overdue for			
- 6 months or less but over 3 months.....	—	—	3
- 1 year or less but over 6 months.....	1	—	—
- Over 1 year.....	—	—	—
	<u>1</u>	<u>—</u>	<u>3</u>
Rescheduled assets.....	—	—	—
Total other overdue and rescheduled assets.....	<u>1</u>	<u>—</u>	<u>3</u>

\* Other assets refer to trade bills and receivables.

(c) Repossessed assets

	30/6/2009	30/6/2008	31/12/2008
	HK\$ Mn	HK\$ Mn	HK\$ Mn
Repossessed land and buildings .....	47	150	57
Repossessed vehicles and equipment.....	1	1	1
Total repossessed assets.....	<u>48</u>	<u>151</u>	<u>58</u>

The amount represents the estimated market value of the repossessed assets as at 30th June, 2009, 30th June, 2008 and 31st December, 2008.

**F. Currency Concentrations**

The net positions or net structural positions in foreign currencies are disclosed when each currency constitutes 10% or more of the respective total net position or total net structural position in all foreign currencies.

	30/6/2009			
	USD	CNY	Others	Total
	HK\$ Mn			
Spot assets .....	73,785	108,771	50,045	232,601
Spot liabilities .....	(72,807)	(102,527)	(52,373)	(227,707)
Forward purchases .....	60,064	15,509	18,892	94,465
Forward sales .....	(58,633)	(15,766)	(15,021)	(89,420)
Net options position.....	9	—	(7)	2
Net long position.....	<u>2,418</u>	<u>5,987</u>	<u>1,536</u>	<u>9,941</u>
	30/6/2008			
	USD	CNY	Others	Total
	HK\$ Mn			
Spot assets .....	86,020	89,608	50,951	226,579
Spot liabilities .....	(76,276)	(84,100)	(52,237)	(212,613)
Forward purchases .....	63,057	10,544	21,152	94,753
Forward sales .....	(69,706)	(10,791)	(18,815)	(99,312)
Net options position.....	51	—	(15)	36
Net long position.....	<u>3,146</u>	<u>5,261</u>	<u>1,036</u>	<u>9,443</u>
	31/12/2008			
	USD	CNY	Others	Total
	HK\$ Mn			
Spot assets .....	83,532	109,311	44,459	237,302
Spot liabilities .....	(75,673)	(103,348)	(45,670)	(224,691)
Forward purchases .....	51,244	18,872	11,843	81,959
Forward sales .....	(55,976)	(18,781)	(8,713)	(83,470)
Net options position.....	3	—	(4)	(1)
Net long position.....	<u>3,130</u>	<u>6,054</u>	<u>1,915</u>	<u>11,099</u>

	30/6/2009			
	USD	CNY	Others	Total
	<i>HK\$ Mn</i>			
Net structural position .....	<u>2,179</u>	<u>6,596</u>	<u>964</u>	<u>9,739</u>
	30/6/2008			
	USD	CNY	Others	Total
	<i>HK\$ Mn</i>			
Net structural position .....	<u>1,996</u>	<u>6,615</u>	<u>1,056</u>	<u>9,667</u>
	31/12/2008			
	USD	CNY	Others	Total
	<i>HK\$ Mn</i>			
Net structural position .....	<u>2,179</u>	<u>6,602</u>	<u>940</u>	<u>9,721</u>

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**INDEPENDENT AUDITOR'S REPORT  
TO THE SHAREHOLDERS OF THE BANK OF EAST ASIA, LIMITED  
(incorporated in Hong Kong with limited liability)**

We have audited the consolidated accounts of The Bank of East Asia, Limited ("the Bank") set out on pages F-40 to F-137, which comprise the consolidated and the Bank balance sheets as at 31st December, 2008, and the consolidated profit and loss account, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

**DIRECTORS' RESPONSIBILITY FOR THE ACCOUNTS**

The Directors of the Bank are responsible for the preparation and the true and fair presentation of these accounts 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 the accounts 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 accounts based on our audit. This report is made solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the accounts, 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 accounts 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 accounts.

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 accounts give a true and fair view of the state of affairs of the Bank and of the Group as at 31st 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.

KPMG  
*Certified Public Accountants*  
8th Floor, Prince's Building  
10 Chater Road  
Central, Hong Kong

Hong Kong, 17th February, 2009

**THE BANK OF EAST ASIA, LIMITED**  
**CONSOLIDATED PROFIT AND LOSS ACCOUNT**  
**FOR THE YEAR ENDED 31ST DECEMBER, 2008**

		2008	2007
	Notes	HK\$ Mn	HK\$ Mn
Interest income.....	3	17,465	18,309
Interest expense.....	4	(10,672)	(12,332)
Net interest income.....		6,793	5,977
Fee and commission income.....	5	2,618	2,608
Fee and commission expense.....		(473)	(471)
Net fee and commission.....		2,145	2,137
Net trading (losses)/profits.....	6	(1,292)	1,417
Net result from financial instruments designated at fair value through profit or loss.....	7	(1,612)	(1,154)
Other operating income.....	8	423	437
Non-interest (expense)/income.....		(336)	2,837
Operating income.....		6,457	8,814
Operating expenses.....	9	(5,779)	(4,691)
Operating profit before impairment losses.....		678	4,123
Impairment losses on loans and advances.....	10	(558)	(216)
Impairment losses on held-to-maturity investments.....	26	(44)	(42)
Impairment losses on available-for-sale financial assets.....		(352)	(228)
Impairment losses on associates.....		—	(41)
Write back of impairment losses on bank premises.....	30	6	132
Impairment losses.....		(948)	(395)
Operating (loss)/profit after impairment losses.....		(270)	3,728
Net profit on sale of held-to-maturity investments.....		25	—
Net profit on sale of available-for-sale financial assets.....	11	197	667
Net profit on disposal of loans and receivable.....		1	—
Net (loss)/profit on sale of subsidiaries/associates.....		(8)	406
Net profit/(loss) on sale of fixed assets.....		178	(1)
Valuation (losses)/gains on investment properties.....	30	(168)	293
Share of profits less losses on associates.....		53	92
Profit for the year before taxation.....		8	5,185
Income tax.....	12	96	(964)
Profit for the year after taxation.....		104	4,221
Attributable to:			
Equity holders of the Group.....		39	4,144
Minority interests.....	38	65	77
Profit after taxation.....		104	4,221
Appropriations:			
Dividends attributable to the year			
Interim paid.....		384	753
Final paid in respect of previous year.....		98	3
Final proposed.....		33	1,858
Earnings per share		HK\$	HK\$
Basic.....	15	0.02	2.65
Diluted.....	15	0.02	2.63

The notes on pages F-46 to F-137 form part of these accounts.

**THE BANK OF EAST ASIA, LIMITED**  
**CONSOLIDATED BALANCE SHEET**  
**AS AT 31ST DECEMBER, 2008**

		2008	2007
	Notes	HK\$ Mn	HK\$ Mn
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions .....	19	28,105	17,853
Placements with banks and other financial institutions .....	20	96,574	94,704
Trade bills .....	21	1,164	812
Trading assets .....	22	3,437	4,847
Financial assets designated at fair value through profit or loss .....	23	4,130	8,658
Advances to customers and other accounts .....	24	243,725	231,740
Available-for-sale financial assets .....	25	18,560	12,217
Held-to-maturity investments .....	26	5,006	10,761
Investments in associates .....	28	2,486	2,793
Fixed assets .....	30	9,146	6,856
- Investment properties .....		1,839	1,726
- Other property and equipment .....		7,307	5,130
Goodwill and intangible assets .....	29	2,734	2,668
Deferred tax assets .....	32(b)	187	70
<b>Total Assets .....</b>		<b><u>415,254</u></b>	<b><u>393,979</u></b>
<b>EQUITY AND LIABILITIES</b>			
Deposits and balances of banks and other financial institutions .....		27,045	39,060
Deposits from customers .....		323,802	284,186
Trading liabilities .....	33(a)	2,846	2,372
Certificates of deposit issued .....		5,491	12,165
- At fair value through profit or loss .....		3,777	7,660
- At amortised cost .....		1,714	4,505
Current taxation .....	32(a)	333	229
Deferred tax liabilities .....	32(b)	77	872
Other accounts and provisions .....	33(b)	12,139	10,997
Loan capital .....	34	11,036	13,652
- At fair value through profit or loss .....		6,395	8,983
- At amortised cost .....		4,641	4,669
<b>Total Liabilities .....</b>		<b><u>382,769</u></b>	<b><u>363,533</u></b>
Share capital .....	36	4,183	3,936
Reserves .....	37	27,963	26,163
<b>Total equity attributable to equity holders of the Group .....</b>		<b><u>32,146</u></b>	<b><u>30,099</u></b>
Minority interests .....	38	339	347
<b>Total Equity .....</b>		<b><u>32,485</u></b>	<b><u>30,446</u></b>
<b>Total Equity and Liabilities .....</b>		<b><u>415,254</u></b>	<b><u>393,979</u></b>

Approved and authorised for issue by the Board of Directors on 17th February, 2009.

Chairman and Chief Executive  
David LI Kwok-po

Directors  
WONG Chung-hin  
Allan WONG Chi-yun  
Winston LO Yau-lai

The notes on pages F-46 to F-137 form part of these accounts.

**THE BANK OF EAST ASIA, LIMITED**  
**BALANCE SHEET**  
**AS AT 31ST DECEMBER, 2008**

		2008	2007
	Notes	HK\$ Mn	HK\$ Mn
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions .....	19	4,852	3,133
Placements with banks and other financial institutions .....	20	92,735	83,123
Trade bills .....	21	521	470
Trading assets .....	22	2,914	4,621
Financial assets designated at fair value through profit or loss .....	23	4,114	8,641
Advances to customers and other accounts.....	24	138,640	141,692
Amounts due from subsidiaries .....	31(a)	16,398	17,964
Available-for-sale financial assets.....	25	10,985	10,608
Held-to-maturity investments .....	26	3,318	8,773
Investments in subsidiaries.....	27	11,673	10,604
Investments in associates .....	28	1,984	1,965
Fixed assets .....	30	5,587	5,407
- Investment properties .....		1,819	1,829
- Other property and equipment .....		3,768	3,578
Goodwill and intangible assets .....	29	1,460	1,460
Deferred tax assets.....	32(b)	38	12
<b>Total Assets.....</b>		<b><u>295,219</u></b>	<b><u>298,473</u></b>
<b>EQUITY AND LIABILITIES</b>			
Deposits and balances of banks and other financial institutions .....		1,093	2,581
Deposits from customers .....		240,029	232,588
Trading liabilities .....	33(a)	2,549	2,175
Certificates of deposit issued .....		7,691	14,365
- At fair value through profit or loss.....		3,777	7,660
- At amortised cost .....		3,914	6,705
Amounts due to subsidiaries.....	31(b)	1,994	1,634
Current taxation .....	32(a)	60	81
Deferred tax liabilities .....	32(b)	63	754
Other accounts and provisions .....	33(b)	3,479	4,462
Loan capital.....	34	11,036	13,652
- At fair value through profit or loss.....		6,395	8,983
- At amortised cost .....		4,641	4,669
<b>Total Liabilities .....</b>		<b><u>267,994</u></b>	<b><u>272,292</u></b>
Share capital .....	36	4,183	3,936
Reserves .....	37	23,042	22,245
<b>Total equity attributable to equity holders of the Bank .....</b>		<b><u>27,225</u></b>	<b><u>26,181</u></b>
<b>Total Equity and Liabilities .....</b>		<b><u>295,219</u></b>	<b><u>298,473</u></b>

Approved and authorised for issue by the Board of Directors on 17th February, 2009.

Chairman and Chief Executive  
**David LI Kwok-po**

Directors  
**WONG Chung-hin**  
**Allan WONG Chi-yun**  
**Winston LO Yau-lai**

The notes on pages F-46 to F-137 form part of these accounts.

**THE BANK OF EAST ASIA, LIMITED**  
**CONSOLIDATED SUMMARY STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED 31ST DECEMBER, 2008**

		2008	2007
	<i>Notes</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Total equity as at 1st January .....		30,446	27,644
Net (loss)/income recognised directly in equity			
Release/(recognition) of net deferred tax liabilities on			
- Revaluation reserve on bank premises .....	37(c)	3	(6)
- Investment revaluation reserve on available-for-sale financial assets .....	37(h)	98	16
Revaluation surplus on bank premises transferred to investment properties .....	37(c)	10	36
Capital reserve on share-based transactions.....	37(g)	66	28
Reversal upon disposal of available-for-sale financial assets .....	37(h)	(115)	27
Changes in fair value of available-for-sale financial assets .....	37(h)	(830)	(421)
Exchange and other adjustments .....	37(c), 37(f), 37(h)	477	480
		<u>(291)</u>	<u>160</u>
Net profit for the year			
Attributable to:			
Equity holders of the Group .....	37(i)	39	4,144
Minority interests .....	38	65	77
		<u>104</u>	<u>4,221</u>
Total recognised income and expenses for the year (of which HK\$65 million (2007: HK\$77 million) is attributable to minority interests) ....		<u>(187)</u>	<u>4,381</u>
Dividends declared or approved during the year .....	37(i)	<u>(2,340)</u>	<u>(2,352)</u>
Movements in shareholders' equity arising from capital transactions with equity holders of the Group:			
Shares issued under Staff Share Option Schemes.....	36, 37(a)	100	155
Shares issued in lieu of dividends.....	37(b)	597	730
Subscription for new shares .....	36, 37(a)	3,942	—
		<u>4,639</u>	<u>885</u>
Movements in minority interests			
Sale of interests in businesses to minority interests investors.....	38	—	50
Purchase of interests in businesses from minority interests investors ...	38	(64)	(15)
Final dividend in respect of previous year .....	38	(7)	—
Reversal upon disposal of available-for-sale financial assets .....	38	—	(149)
Exchange and other adjustments .....	38	(2)	2
		<u>(73)</u>	<u>(112)</u>
Balance as at 31st December.....		<u>32,485</u>	<u>30,446</u>

The notes on pages F-46 to F-137 form part of these accounts.

**THE BANK OF EAST ASIA, LIMITED**  
**CONSOLIDATED CASH FLOW STATEMENT**  
**FOR THE YEAR ENDED 31ST DECEMBER, 2008**

		2008	2007
	Notes	HK\$ Mn	HK\$ Mn
<b>OPERATING ACTIVITIES</b>			
Profit for the year before taxation .....		8	5,185
Adjustments for:			
Charge for impairment losses on loans and advances .....	10	558	216
Charge for impairment allowances on held-to-maturity investments, available-for-sale financial assets and associates .....		396	311
Share of profits less losses of associates .....		(53)	(92)
Net profit on sale of held-to-maturity investments .....		(25)	—
Net profit on sale of available-for-sale financial assets .....		(197)	(667)
Net loss/(profit) on sale of subsidiaries, associates and equities .....		8	(406)
Net (profit)/loss on sale of fixed assets .....		(178)	1
Interest expense on loan capital, certificates of deposit and bonds issued .		1,014	1,115
Depreciation on fixed assets .....	9,30	437	326
Write back of impairment loss on bank premises .....		(6)	(132)
Dividend income from available-for-sale financial assets .....		(50)	(63)
Amortisation of intangible assets .....	9	3	2
Amortisation of premium/discount on certificates of deposit and loan capital issued .....		78	65
Revaluation (gains)/losses on certificates of deposit and loan capital issued .....		(2,624)	84
Net (profit)/loss on sale of other financial assets .....		(3)	2
Valuation losses/(gains) on investment properties .....	30	168	(293)
Equity-settled share-based payment expenses .....		66	28
<b>OPERATING (LOSS)/PROFIT BEFORE CHANGES IN WORKING CAPITAL .....</b>			
		(400)	5,682
(Increase)/decrease in operating assets:			
Cash and balances with banks with original maturity beyond three months .....		(4,397)	(3,117)
Placements with banks and other financial institutions with original maturity beyond three months .....		(18,823)	(4,256)
Trade bills .....		(352)	(191)
Trading assets .....		1,410	(2,008)
Financial assets designated at fair value through profit or loss .....		4,528	(14)
Advances to customers .....		(12,366)	(52,158)
Advances to banks and other financial institutions .....		1,158	(3,220)
Held-to-maturity debt securities .....		5,863	(279)
Available-for-sale financial assets .....		(6,000)	(4,794)
Other accounts and accrued interest .....		(1,323)	(799)
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions .....		(12,015)	7,101
Deposits from customers .....		39,616	74,662
Trading liabilities .....		474	1,430
Other accounts and provisions .....		1,273	2,712
Exchange adjustments .....		362	376

		2008	2007
	Notes	HK\$ Mn	HK\$ Mn
NET CASH (OUTFLOW)/INFLOW FROM OPERATIONS .....		(992)	21,127
Income tax paid			
Hong Kong profits tax paid.....		(143)	(394)
Overseas profits tax paid .....		<u>(383)</u>	<u>(306)</u>
NET CASH FLOWS (USED IN)/GENERATED FROM OPERATING ACTIVITIES .....		<u>(1,518)</u>	<u>20,427</u>
INVESTING ACTIVITIES			
Dividends received from associates.....		163	103
Dividends received from available-for-sale equity securities .....		50	63
Purchase of equity securities .....		(444)	(832)
Proceeds from sale of equity securities .....		512	1,455
Purchase of Intangible assets.....		(6)	—
Purchase of fixed assets.....	30	(2,557)	(924)
Purchase of investment properties.....		(291)	—
Proceeds from disposal of fixed assets.....		213	13
Purchase/increase in shareholding in associates .....		(18)	(1,735)
Proceeds from disposal of associates .....		51	1
Purchase of subsidiaries .....	42(a)	(21)	(38)
Proceeds from sale of interests in a subsidiary .....	42(b)	—	455
Purchase of interests in business from minority interest investors.....		<u>(64)</u>	<u>(15)</u>
NET CASH USED IN INVESTING ACTIVITIES .....		<u>(2,412)</u>	<u>(1,454)</u>
FINANCING ACTIVITIES			
Ordinary dividends paid .....		(1,750)	(1,622)
Issue of ordinary share capital .....	36, 37(a)	100	155
Issue of loan capital .....		—	9,255
Subscription for new shares .....		3,942	—
Issue of certificates of deposit .....		4,656	9,655
Redemption of certificates of deposit issued.....		(11,434)	(4,620)
Redemption of loan capital.....		—	(3,907)
Interest paid on loan capital .....		(708)	(656)
Interest paid on certificates of deposit issued .....		<u>(488)</u>	<u>(224)</u>
NET CASH (USED IN)/GENERATING FROM FINANCING ACTIVITIES.....		<u>(5,682)</u>	<u>8,036</u>
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS.....		(9,612)	27,009
CASH AND CASH EQUIVALENTS AT 1ST JANUARY.....	42(c)	<u>103,718</u>	<u>76,709</u>
CASH AND CASH EQUIVALENTS AT 31ST DECEMBER .....	42(c)	<u><u>94,106</u></u>	<u><u>103,718</u></u>
Cash flows from operating activities included:			
Interest received.....		17,514	17,570
Interest paid .....		10,305	11,601
Dividend received.....		93	101

The notes on pages F-46 to F-137 form part of these accounts.

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## **THE BANK OF EAST ASIA, LIMITED**

### **NOTES ON THE ACCOUNTS**

#### **1. Principal Activities**

The Bank and its subsidiaries (the “Group”) are engaged in the provision of banking and related financial services, and business, corporate and investor services.

#### **2. Significant Accounting Policies**

##### **(a) Statement of Compliance**

These accounts have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”), and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. These accounts also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Bank. The adoption of these new and revised HKFRSs did not result in significant changes to the Group’s and the Bank’s accounting policies applied in these accounts for the years presented.

##### **(b) Basis of Preparation of the Accounts**

The accounts for the year ended 31st December, 2008 comprise the Group and the Group’s interest in associates.

The measurement basis used in the preparation of the accounts is historical cost except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- financial instruments classified as trading, designated at fair value through profit or loss and available-for-sale (Note 2(f)(ii)); and
- investment properties (Note 2(h)(ii))

The preparation of accounts in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Details of judgements made by management in the application of HKFRSs that have significant effect on the accounts and estimates with a significant risk of material adjustment in the next year are set out in Note 47.

##### **(c) Basis of Consolidation**

###### *(i) Subsidiaries and minority interests*

The consolidated accounts include the accounts of the Bank and all its subsidiaries made up to 31st December each year. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

All material intercompany transactions and balances are eliminated on consolidation. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from or to the date of their acquisition or disposal, as appropriate.

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Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Bank, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of these interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meet the definition of a financial liability. They are presented in the consolidated balance sheet and consolidated summary statement of changes in equity within equity, separately from equity attributable to equity holders of the Group. Minority interests in the results of the Group are presented on the face of the consolidated profit and loss account as an allocation of the net profit for the year between minority interests and equity holders of the Group.

In the Bank's balance sheet, its investments in subsidiaries are stated at cost less any impairment losses (Note 2(k)).

*(ii) Associates*

An associate is a company in which the Group or the Bank has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

An investment in an associate is accounted for in the consolidated accounts under the equity method and is initially recorded at cost and adjusted thereafter for the post-acquisition change in the Group's share of the associate's net assets.

The consolidated profit and loss account reflects the Group's share of the post-acquisition, post-tax results of the associates for the year, including any impairment loss on goodwill relating to the investment in associates recognised for the year in accordance with Notes 2(j) and 2(k).

When the Group's share of losses exceeds its interest in the associates, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. For these purposes, the Group's interest in the associate is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates, except when unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

The Bank accounts for the results of associates to the extent of dividends received. Investments in associates are stated at cost less any impairment losses (Note 2(k)).

**(d) Translation of Foreign Currencies**

Transactions in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the balance sheet date. Exchange differences are dealt with in the profit and loss account.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into Hong Kong dollars using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

Exchange differences relating to investments at fair value through profit or loss and derivative financial instruments are included in gains less losses from trading securities or financial instruments designated at fair value through profit or loss. All other exchange differences relating to monetary items are presented as gains less losses from dealing in foreign currencies in the profit and loss account.

The results of foreign operations are translated into Hong Kong dollars at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items, including goodwill arising on consolidation of foreign operations acquired on or after 1st January, 2005, are translated into Hong Kong dollars

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at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in a separate component of equity. Goodwill arising on consolidation of a foreign operation acquired before 1st January, 2005 is translated at the foreign exchange rate that applied at the date of acquisition of the foreign operation.

On disposal of a foreign enterprise, the cumulative amount of the exchange differences which relate to that foreign enterprise is included in the calculation of the profit or loss on disposal.

**(e) Revenue Recognition**

Provided it is probable that economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the profit and loss account as follows.

Interest income for all interest-bearing financial instruments, except those classified as held for trading or designated at fair value through profit or loss, is recognised as interest income in the profit and loss account on an accruals basis using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating the interest income 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. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discontinued, but any increase in the present value of impaired loans due to the passage of time is reported as interest income.

Net income from financial instruments designated at fair value through profit or loss and net trading income comprises all gains and losses from changes in fair value (net of accrued coupon) of such financial assets and financial liabilities, together with dividend income attributable to those financial instruments.

Fee and commission income is recognised in the profit and loss account when the corresponding service is provided, except where the fee is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised as income in the accounting period in which the costs or risk is incurred and is accounted for as interest income.

Origination or commitment fees received/paid by the Group which result in the creation or acquisition of a financial asset are deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the Group making a loan, the fee is recognised as revenue on a straight-line basis over the commitment period.

Finance income implicit in finance leases is recognised as interest income over the period of the lease so as to produce an approximately constant periodic rate of return of the outstanding net investment in the leases for each accounting period.

Rental income received under operating leases is recognised as other operating income in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives granted are recognised in the profit and loss account as an integral part of the aggregate net lease payments receivable. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established. Dividend income from listed investments is recognised when the share price of the investment is quoted ex-dividend.

**(f) Financial Instruments**

*(i) Initial recognition*

The Group classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets and other financial liabilities.

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Financial instruments are measured initially at fair value, which normally will be equal to the transaction price plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset or issue of the financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. A regular way purchase or sale of financial assets is recognised using trade date accounting. From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities at fair value through profit or loss are recorded.

*ii) Categorisation*

*Fair value through profit or loss*

This category comprises financial assets and financial liabilities held for trading, and those designated at fair value through profit or loss upon initial recognition, but excludes those investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

Trading financial instruments are financial assets or financial liabilities which are acquired or incurred principally for the purpose of trading, or are 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. Non-hedging derivatives are accounted for as trading instruments.

Financial instruments are designated at fair value through profit or loss upon initial recognition when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise;
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract; or
- the separation of the embedded derivatives from the financial instrument is not prohibited.

Financial assets and financial liabilities under this category are carried at fair value. Changes in the fair value are included in the profit and loss account in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the profit and loss account.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Group intends to sell immediately or in the near term, which will be classified as held for trading; (b) those that the Group, upon initial recognition, designates as at fair value through profit or loss or as available-for-sale; or (c) those where the Group may not recover substantially all of its initial investment, other than because of credit deterioration, which will be classified as available-for-sale. Loans and receivables mainly comprise placements with banks and other financial institutions, trade bills and loans and advances to customers.

Securities classified as loans and receivables typically comprise securities issued by the same customers with whom the Group has a lending relationship in its wholesale banking business. Investment decisions for credit substitute securities are subject to the same credit approval processes as loans, and the Group bears the same customer risk as it does for loans extended to those customers. Additionally the yield and maturity terms are generally directly negotiated by the Group with the issuer. These securities include commercial paper, short term debentures and preference shares issued by the borrower.

Loans and receivables and securities classified as loans and receivables are carried at amortised cost using the effective interest method, less impairment losses, if any (Note 2(k)).

*Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity which the Group has the positive intention and ability to hold to maturity, other than (a) those that the Group, upon initial recognition, designates as at fair value through profit or loss or available-for-sale; and (b) those that meet the definition of loans and receivables.

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Held-to-maturity investments are carried at amortised cost using the effective interest method less impairment losses, if any (Note 2(k)).

*Available-for-sale financial assets*

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the other three categories above. They include financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

Available-for-sale financial assets are carried at fair value except for investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, which are carried at cost less impairment losses, if any (Note 2(k)). Unrealised gains and losses arising from changes in the fair value are recognised directly in the investment revaluation reserve, except for foreign exchange gains and losses on monetary items such as debt securities which are recognised in the profit and loss account.

When the available-for-sale financial assets are sold, gains or losses on disposal include the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments which are released from the investment revaluation reserve.

*Other financial liabilities*

Financial liabilities, other than trading liabilities and those designated at fair value through profit or loss, are measured at amortised cost using the effective interest method.

*(iii) Fair value measurement principles*

The fair value of financial instruments is based on their quoted market prices at the balance sheet date without any deduction for estimated future selling costs.

If there is no publicly available latest traded price nor a quoted market price on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments or if the market for it is not active, the fair value of the instrument is estimated using valuation techniques that provide a reliable estimate of prices which could be obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the balance sheet date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the balance sheet date.

*(iv) Derecognition*

The Group derecognises a financial asset when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership, have been transferred.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

The Group uses the weighted average method to determine realised gains and losses to be recognised in the profit and loss account on derecognition.

*(v) Offsetting*

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet only where 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.

*(vi) Embedded derivatives*

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to

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a stand-alone derivative. The embedded derivatives are separated from the host contract and accounted for as a derivative when (a) the economic characteristics and risks of the embedded derivative are not closely related to the host contract; and (b) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in the profit and loss account.

When the embedded derivative is separated, the host contract is accounted for in accordance with note (ii) above.

**(g) Hedging**

*(i) Cash flow hedges*

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction and the hedge is effective, the gain or loss on the derivative financial instrument in relation to the hedged risk is recognised directly in equity.

*(ii) Fair value hedge*

A fair value hedge seeks to offset risks of changes in the fair value of an existing asset or liability that will give rise to a gain or loss being recognised in the profit and loss account.

The hedging instrument is measured at fair value, with fair value changes recognised in the profit and loss account. The carrying amount of the hedged item is adjusted by the amount of the changes in fair value of hedging instrument attributable to the risk being hedged. This adjustment is recognised in the profit and loss account to offset the effect of the gain or loss on the hedging instrument.

The Group currently does not use hedge accounting.

**(h) Properties**

- (i) Bank premises are stated in the balance sheet at cost or at Directors' valuation, by reference to an independent professional valuation, less accumulated depreciation and accumulated impairment loss (Note 2(k)).

When a deficit arises on revaluation, it will be charged to the profit and loss account, to the extent that it exceeds the amount held in the bank premises revaluation reserve in respect of that same asset immediately prior to the revaluation; and when a surplus arises on revaluation, it will be credited to the profit and loss account, to the extent that a deficit on revaluation in respect of that same asset had previously been charged to the profit and loss account.

In preparing these accounts, advantage has been taken of the transitional provisions set out in paragraph 80A of HKAS 16 "Property, Plant and Equipment" issued by the Hong Kong Institute of Certified Public Accountants, with the effect that bank premises have not been revalued to fair value at the balance sheet date.

- (ii) Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. Investment properties are stated at fair value. Investment properties are valued annually by external independent valuation companies, having an appropriate recognised professional qualification and recent experience in the location and category of property being valued. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. No allowance has been made in the valuations for any charges, mortgages or amounts owing on the properties nor any expenses or taxation which may be incurred in effecting a sale.

Any gain or loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for as described in Note 2(e).

When a bank property is transferred to investment property following a change in its use, any differences arising at the date of transfer between the carrying amount of the bank property immediately prior to transfer and its fair value is recognised as a revaluation of bank premises as described in Note 2(h)(i).

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If an investment property becomes owner-occupied, it is reclassified as bank premises and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes.

A property interest under an operating lease is classified and accounted for as an investment property when the Group holds it to earn rentals or for capital appreciation or both. Any such property interest under an operating lease classified as an investment property is carried at fair value. Lease payments are accounted for as described in Note 2(l).

- (iii) Profit or loss on disposal of bank premises and investment properties is determined as the difference between the net sales proceeds and the carrying amount of the asset and is recognised in the profit and loss account upon disposal. Any surplus that is included in the bank premises revaluation reserve of the related bank premises disposed is transferred to the general reserve.

**(i) Amortisation and Depreciation**

*(i) Bank premises*

Freehold land is not amortised. Leasehold land held for own use under an operating lease, the fair value of which cannot be measured separately from the fair value of a building situated thereon at the inception of the lease, is accounted for as being held under a finance lease. Leasehold land is amortised on a straight line basis over the remaining term of the lease. Buildings are depreciated on a straight line basis at rates calculated to write off the cost or valuation of each building over its estimated useful life of 50 years or the remaining lease period of the land on which it is situated, whichever is the shorter.

Investment properties are not depreciated.

*(ii) Other fixed assets*

Other fixed assets are stated in the balance sheet at cost less accumulated depreciation, which is calculated on a straight line basis to write off the assets over their estimated useful lives from 4 to 20 years.

**(j) Goodwill**

Goodwill represents the excess of the cost of a business combination or an investment in an associate over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (Note 2(k)). In respect of associates, the carrying amount of goodwill is included in the carrying amount of the interest in the associates.

Any excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate is recognised immediately in the profit and loss account.

On disposal of a cash generating unit, or an associate during the year, any attributable amount of purchased goodwill is included in the calculation of the profit and loss on disposal.

**(k) Impairment of Assets**

At each balance sheet date, the carrying amount of the Group's assets are reviewed to determine whether there is objective evidence of impairment. If internal and external sources of information indicate such evidence exists, the carrying amount is reduced to the estimated recoverable amount and an impairment loss is recognised in the profit and loss account.

*(i) Loans and receivables*

The impairment losses of loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets.) Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for impairment losses consists of two components: individual impairment allowances, and collective impairment allowances.

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The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The individual impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgements about the borrower's financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Group. Each impaired asset is assessed on its own merits.

In assessing the need for collective loan loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Group makes assumptions both to define the way the Group models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the impairment allowances the Group makes depends on how well the Group can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Group believes that the impairment allowances on loans and advances to customers are reasonable and supportable.

All loans and receivables are reviewed and analysed periodically. Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and will be charged or credited to the profit and loss account. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years.

Where there is no reasonable prospect of recovery, the loan and the related interest receivables are written off.

*(ii) Held-to-maturity investments*

Impairment on held-to-maturity investments is considered at both an individual and collective level. The individual impairment allowance is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at asset's original effective interest rate, where the effect of discounting is material.

All significant assets found not to be individually impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets with similar risk characteristics.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the profit and loss account. A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

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*(iii) Available-for-sale financial assets*

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in the profit and loss account. The amount of the cumulative loss that is recognised in the profit and loss account is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in the profit and loss account.

For unquoted available-for-sale equity securities that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the equity securities and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset, where the effect of discounting is material.

Impairment losses recognised in the profit and loss account in respect of available-for-sale equity securities are not reversed through profit and loss account. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the profit and loss account.

*(iv) Other assets*

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property and equipment (other than properties carried at revalued amounts);
- investments in subsidiaries and associates;
- goodwill; and
- intangible assets

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment.

*Calculation of recoverable amount*

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

*Recognition of impairment losses*

An impairment loss is recognised in the profit and loss account whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

*Reversals of impairment losses*

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

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Reversals of impairment losses are credited to the profit and loss account in the year in which the reversals are recognised.

*(v) Interim financial reporting and impairment*

Under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the Group is required to prepare an interim financial report in compliance with HKAS34, Interim financial reporting, in respect of the first six months of the year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the year (Note 2(k)(i) to (iv)).

Impairment losses recognised in an interim period in respect of goodwill and available-for-sale equity securities carried at cost are not reversed in a subsequent period. This is the case even if no loss, or a smaller loss, would have been recognised had the impairment been assessed only at the end of the year to which the interim period relates.

**(l) Leased Assets**

Leases of assets under which the lessee assumes substantially all the risks and benefits of ownership are classified as finance leases. Leases of assets under which the lessor has not transferred all the risks and benefits of ownership are classified as operating leases.

*(i) Assets held under finance leases*

The amounts due from lessees in respect of finance leases are recorded in the balance sheet as advances to customers at the amounts of net investment which represent the total rentals receivable under finance leases less unearned income. Revenue arising from finance leases is recognised in accordance with the Group's revenue recognition policies, as set out in Note 2(e).

*(ii) Assets held for use in operating leases*

Where the Group leases out assets under operating leases, the leased assets are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies, as set out in Note 2(i). Impairment losses are accounted for in accordance with the accounting policy as set out in Note 2(k). Revenue arising from operating leases is recognised in accordance with the Group's revenue recognition policies, as set out in Note 2(e).

*(iii) Operating lease charges*

Where the Group has the use of assets under operating leases, payments made under the leases are charged to the profit and loss account in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in the profit and loss account as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the profit and loss account in the accounting period in which they are incurred.

**(m) Repossession of Assets**

In the recovery of impaired loans and advances, the Group may take possession of the collateral assets through court proceedings or voluntary delivery of possession by the borrowers. In accordance with the Group's accounting policy set out in Note 2(k), impairment allowances for impaired loans and advances are maintained after taking into account the net realisable value of the collateral assets, usually resulting in a partial write-off of the loans and advances against impairment allowances. Repossessed assets are reported under other assets if it is highly probable that their carrying amount will be recovered through a sale transaction rather than through continuing use and the assets are available for sale in their present condition. Related loans and advances are then written off.

Repossessed assets are recorded at the lower of the amount of the related loans and advances and fair value less costs to sell at the date of exchange. They are not depreciated or amortised.

Impairment losses on initial classification and on subsequent remeasurement are recognised in the profit and loss account.

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(n) **Income Tax**

- (i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the profit and loss account except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.
- (ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.
- (iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing deductible temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

- (iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Bank or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:
  - in the case of current tax assets and liabilities, the Bank or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
  - in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
    - the same taxable entity; or
    - different taxable entities, which in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

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**(o) Insurance Reserves and Provisions for Outstanding Claims**

Insurance reserves, except those attributable to long term business, represent the proportion of retained premiums written in the year relating to the period of risk from 1st January in the following year to the subsequent date of expiry of policies which is carried forward as a provision for unearned premiums and calculated on a daily basis.

The insurance reserve for long term business is ascertained by actuarial valuation.

Full provision is made for the estimated cost of claims notified but not settled at the balance sheet date and for the estimated cost of claims incurred but not reported by that date, after deducting the amounts due from reinsurers. Provision has also been made for the estimated cost of servicing claims notified but not settled at the balance sheet date and to meet expenses on claims incurred but not reported at the balance sheet date.

These reserves and provisions are classified as other accounts and provisions.

**(p) Provisions and Contingent Liabilities**

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Bank has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

**(q) Employee Benefits**

*(i) Salaries, bonuses and leave benefits*

Employee entitlements to salaries, annual bonuses, paid annual leave, leave passage and the cost to the Group of non-monetary benefits are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are recognised when the absences occur.

*(ii) Performance-related bonus plan*

Liabilities for performance-related bonus plan, which are due wholly within twelve months after the balance sheet date, are recognised 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.

*(iii) Retirement benefits*

Retirement benefits are provided to eligible staff of the Group. Hong Kong employees enjoy retirement benefits under either the Mandatory Provident Fund Exempted ORSO Scheme (“MPFEOS”) or the Mandatory Provident Fund Scheme (“MPFS”). Both are defined contribution schemes. The employer’s monthly contributions to both schemes are at a maximum of 10% of each employee’s monthly salary.

The pension schemes covering all the Group’s PRC and overseas employees are defined contribution schemes at various funding rates, and are in accordance with local practices and regulations.

The cost of all these schemes is charged to the profit and loss account for the period concerned and the assets of all these schemes are held separately from those of the Group. Under the MPFEOS, the employer’s contribution is not reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions. Under the MPFS, the employer’s contribution is reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

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*(iv) Share based payments*

The option exercise price is equal to the higher of:

- (a) the closing price of the Bank's shares in the Stock Exchange's daily quotations sheet on the date of grant of the relevant options;
- (b) an amount equivalent to the average closing price of the Bank's shares as stated in the Stock Exchange's daily quotation sheets for the 5 business days immediately preceding the date of grant of the relevant options; and
- (c) the nominal value of the Bank's shares.

When the options are exercised, equity is increased by the amount of the proceeds received. The fair value of share options granted to employees is recognised as an expense in the profit and loss account with a corresponding increase in a capital reserve within equity. The fair value is measured at the grant date using the trinomial model, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to those share options, the total estimated fair value of the share options is spread over the vesting period, taking into account the probability that the options will vest.

During the vesting period, the number of share options that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged or credited to the profit and loss account for the year of the review unless the original expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of share options that vest (with a corresponding adjustment to capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the Bank's shares.

The amount recognised in capital reserve is retained until either the option is exercised (when it is transferred to share premium) or the option expires (when it is released directly to retained profits)

**(r) Related Parties**

For the purposes of these accounts, a party is considered to be related to the Group if:

- (i) The party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;
- (ii) The Group and the party are subject to common control;
- (iii) The party is an associate of the Group;
- (iv) The party is a member of key management personnel of the Group, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) The party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) The party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

**(s) Segment Reporting**

A segment is a distinguishable component of the Group that is engaged either in providing services (business segment), or in providing services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

The Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment and those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between Group enterprises within a single segment. The allocation of revenue reflects the benefits of capital and other funding resources allocated to the business or geographical segments by way of internal capital allocation and fund transfer mechanisms. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets (both tangible and intangible) that are expected to be used for more than one year.

#### (t) Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including cash, balances with banks and other financial institutions, treasury bills, other eligible bills and certificates of deposit that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

### 3. Interest Income

	<u>2008</u>	<u>2007</u>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Listed securities classified as held-to-maturity or available-for-sale.....	261	154
Trading assets		
- listed .....	2	4
- unlisted .....	8	35
Interest rate swaps .....	917	770
Financial assets designated at fair value through profit or loss		
- listed .....	128	152
- unlisted .....	310	426
Loans, deposits with banks and financial institutions, trade bills, and other unlisted securities that are not at fair value through profit or loss.....	<u>15,839</u>	<u>16,768</u>
Total interest income.....	<u>17,465</u>	<u>18,309</u>

Included above is interest income accrued on impaired financial assets of HK\$73 million (2007: HK\$29 million) which includes interest income on effect of discounting of HK\$12 million (2007: HK\$8 million) (Note 24(b)) for the year ended 31st December, 2008.

### 4. Interest Expense

	<u>2008</u>	<u>2007</u>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Customer deposits, deposits of banks and other financial institutions and certificates of deposit issued which are stated at amortised cost .....	8,696	10,433
Subordinated notes carried at amortised cost .....	184	265
Interest rate swaps .....	1,062	918
Financial instruments designated at fair value through profit or loss .....	725	712
Other borrowings.....	<u>5</u>	<u>4</u>
Total interest expense.....	<u>10,672</u>	<u>12,332</u>

## 5. Fee and Commission Income

Fee and commission income arises from the following services:

	<u>2008</u>	<u>2007</u>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Corporate services.....	818	753
Credit cards.....	462	400
Loans, overdrafts and guarantees .....	382	386
Securities and brokerage .....	255	443
Other retail banking services .....	187	191
Trade finance.....	160	113
Trust and other fiduciary activities .....	102	84
Others .....	252	238
Total fee and commission income.....	<u>2,618</u>	<u>2,608</u>

## 6. Net Trading (Losses)/Profits

	<u>2008</u>	<u>2007</u>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Profit on dealing in foreign currencies.....	316	173
(Loss)/profit on trading securities .....	(618)	852
(Loss)/profit on other dealing activities.....	(1,033)	354
Dividend income from listed trading securities.....	43	38
Total net trading (losses)/profits.....	<u>(1,292)</u>	<u>1,417</u>

## 7. Net Result from Financial Instruments Designated at Fair Value Through Profit or Loss

	<u>2008</u>	<u>2007</u>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Revaluation and disposal loss on Collateralised Debt Obligations .....	(3,549)	(1,085)
Revaluation gain/(loss) on debt issued.....	2,624	(84)
Net profit/(loss) on sale of other financial assets designated at fair value through profit or loss .....	3	(2)
Revaluation (loss)/gain on other financial assets designated at fair value through profit or loss .....	(690)	17
Total net result from financial instruments designated at fair value through profit or loss ...	<u>(1,612)</u>	<u>(1,154)</u>

## 8. Other Operating Income

	2008	2007
	HK\$ Mn	HK\$ Mn
Dividend income from available-for-sale financial assets		
- listed .....	20	42
- unlisted .....	30	21
Rental from safe deposit boxes.....	87	88
Net revenue from insurance activities.....	99	139
Rental income on properties.....	90	72
Others .....	97	75
Total other operating income.....	<u>423</u>	<u>437</u>

## 9. Operating Expenses

	2008	2007
	HK\$ Mn	HK\$ Mn
Contributions to defined contribution plan* .....	225	164
Equity-settled share-based payment expenses .....	66	28
Salaries and other staff costs.....	2,689	2,276
Total staff costs .....	<u>2,980</u>	<u>2,468</u>
Premises and equipment expenses excluding depreciation		
- Rental of premises .....	378	288
- Maintenance, repairs and others .....	445	343
Total premises and equipment expenses excluding depreciation .....	<u>823</u>	<u>631</u>
Depreciation on fixed assets (Note 30).....	437	326
Amortisation of intangible assets (Note 29(b)).....	3	2
Other operating expenses		
- Stamp duty, overseas and PRC** business taxes, and value added taxes .....	373	217
- Advertising expenses.....	287	270
- Communications, stationery and printing .....	274	233
- Legal and professional fees.....	193	165
- Business promotions and business travel.....	97	82
- Card related expenses.....	72	60
- Insurance expenses .....	43	33
- Donations .....	9	8
- Audit fee .....	8	7
- Administration expenses of corporate services.....	7	21
- Membership fees.....	7	6
- Bank charges.....	7	5
- Bank licence.....	4	5
- Others.....	155	152
Total other operating expenses .....	<u>1,536</u>	<u>1,264</u>
Total operating expenses*** .....	<u>5,779</u>	<u>4,691</u>

\* Forfeited contributions totalling HK\$10 million (2007: HK\$7 million) were utilised to reduce the Group's contribution available for reducing future contributions at the year end (2007: Nil).

\*\* PRC denotes the People's Republic of China.

\*\*\* Included in operating expenses are direct operating expenses of HK\$19 million (2007: HK\$21 million) in respect of investment properties which generated rental income during the year.

## 10. Impairment Losses on Loans and Advances

	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Net charge for impairment losses on loans and advances		
Individual impairment loss		
- new provisions (Note 24(b)) .....	596	346
- releases (Note 24(b)) .....	(81)	(88)
- recoveries (Note 24(b)).....	(140)	(107)
	<u>375</u>	<u>151</u>
Collective impairment loss		
- new provisions (Note 24(b)) .....	183	68
- releases (Note 24(b)) .....	—	(3)
Net charge to profit and loss account .....	<u>558</u>	<u>216</u>

## 11. Net Profit on Sale of Available-for-sale Financial Assets

	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Net revaluation gain/(loss) transferred from reserves (Note 37(h)) .....	115	(27)
Profit arising in current year .....	<u>82</u>	<u>694</u>
	<u>197</u>	<u>667</u>

## 12. Income Tax

### (a) Taxation in the consolidated profit and loss account represents:

	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Current tax - provision for Hong Kong Profits Tax		
Tax for the year (Note 32(a)) .....	64	265
Write back of over-provision in respect of prior years .....	—	(7)
	<u>64</u>	<u>258</u>
Current tax - overseas		
Tax for the year .....	601	347
Write back of over-provision in respect of prior years .....	(35)	(16)
	<u>566</u>	<u>331</u>
Deferred tax (Note 32(b))		
Origination and reversal of temporary differences .....	(712)	318
Movements in the value of investment properties .....	(14)	57
	<u>(726)</u>	<u>375</u>
	<u>(96)</u>	<u>964</u>

In February 2008, the Government of the Hong Kong Special Administrative Region announced a decrease in the Profits Tax rate from 17.5% to 16.5% applicable to the Group's operations in Hong Kong as from the year ended 31st December, 2008. This decrease is taken into account in the preparation of the Group's and the Bank's 2008 accounts. Accordingly, the provision for Hong Kong Profits Tax for 2008 is calculated at 16.5% (2007: 17.5%) of the estimated assessable profits for the year and the opening balance of deferred tax has been re-estimated accordingly.

Taxation for overseas branches and subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

(b) Reconciliation between tax (credit)/expense and accounting profit at applicable tax rates:

	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Profit before tax.....	8	5,185
Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned .....	149	1,032
Tax effect of non-deductible expenses .....	389	228
Tax effect of non-taxable revenue.....	(607)	(240)
Tax effect of tax losses not recognised .....	32	12
Recognition of deferred tax assets on prior year tax losses .....	(14)	(8)
Effect on opening deferred tax balances resulting from a decrease in tax rate during the year .....	(22)	—
Write back of over-provision in respect of prior years .....	(35)	(23)
Tax benefits derived from leasing partnerships.....	(6)	(27)
Others .....	18	(10)
Actual tax (credit)/expense.....	(96)	964

**13. (Loss)/Profit Attributable to Equity Holders of the Group**

The consolidated (loss)/profit attributable to equity holders of the Group includes a (loss)/profit of (HK\$882) million (2007: HK\$3,004 million) which has been dealt with in the accounts of the Bank.

Reconciliation of the above amount to the Bank's (loss)/profit for the year

	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Amount of consolidated (loss)/profit attributable to equity holders dealt with in the Bank's financial statements .....	(924)	2,876
Final dividends from subsidiaries and associates attributable to the profits of the previous financial year, approved and paid during the year .....	42	128
Bank's (loss)/profit for the year.....	(882)	3,004

## 14. Dividends

### (a) Dividends attributable to the year

	<u>2008</u>	<u>2007</u>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Interim dividend declared and paid of HK\$0.23 per share on 1,670,869,419 shares (2007: HK\$0.48 per share on 1,568,758,481 shares) (Note 37(i)) .....	384	753
Final dividend paid in respect of the previous financial year on shares issued under the share option schemes subsequent to the balance sheet date and before the close of the Register of Members of the Bank, of HK\$1.18 (2007: HK\$1.03) .....	98	3
Final dividend proposed after the balance sheet date of HK\$0.02 per share on 1,673,417,496 shares (2007: HK\$1.18 per share on 1,574,367,205 shares) .....	<u>33</u>	<u>1,858</u>
	<u>515</u>	<u>2,614</u>

The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

### (b) Dividends attributable to the previous financial year, approved and paid during the year

	<u>2008</u>	<u>2007</u>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Final dividend in respect of the previous financial year, approved and paid during the year, of HK\$1.18 per share on 1,574,367,205 shares (2007: HK\$1.03 per share on 1,550,142,050 shares) .....	<u>1,858</u>	<u>1,596</u>

## 15. Earnings per Share

### (a) Basic earnings per share

The calculation of basic earnings per share is based on earnings of HK\$39 million (2007: HK\$4,144 million) and on the weighted average of 1,666,446,266 (2007: 1,565,141,199) ordinary shares outstanding during the year, calculated as follows:

Weighted average number of ordinary shares

	<u>2008</u>	<u>2007</u>
	<i>Number of Shares</i>	<i>Number of Shares</i>
Issued ordinary shares at 1st January .....	1,574,367,205	1,550,142,050
Effect of share options exercised and shares issued in lieu of dividends .....	<u>92,079,061</u>	<u>14,999,149</u>
Weighted average number of ordinary shares at 31st December .....	<u>1,666,446,266</u>	<u>1,565,141,199</u>

**(b) Diluted earnings per share**

The calculation of diluted earnings per share is based on earnings of HK\$39 million (2007: HK\$4,144 million) and on 1,669,663,642 (2007: 1,574,625,151) ordinary shares, being the weighted average number of ordinary shares outstanding during the year, adjusted for the effects of all dilutive potential shares.

Weighted average number of ordinary shares (diluted)

	<u>2008</u>	<u>2007</u>
	<i>Number of Shares</i>	<i>Number of Shares</i>
Weighted average number of ordinary shares at 31st December .....	1,666,446,266	1,565,141,199
Effect of deemed issue of ordinary shares under the Bank's share option scheme for nil consideration .....	<u>3,217,376</u>	<u>9,483,952</u>
Weighted average number of ordinary shares (diluted) at 31st December .....	<u><u>1,669,663,642</u></u>	<u><u>1,574,625,151</u></u>

**16. Directors' Remuneration**

Directors' remuneration disclosed pursuant to Section 161 of the Hong Kong Companies Ordinance is as follows:

	Directors' fees	Salaries, allowances and benefits in kind	Discretionary bonuses	Share options	Retirement scheme contributions	2008 Total
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
<b>Chairman and Chief Executive</b>						
Dr. The Hon. Sir David LI Kwok-po .	0.3	8.3	—	24.1	0.8	33.5
<b>Executive Directors</b>						
Mr. Joseph PANG Yuk-wing.....	0.2	3.6	—	12.0	0.3	16.1
<b>Non-executive Directors</b>						
Dr. LI Fook-wo.....	—	—	—	—	—	—
Mr. Aubrey LI Kwok-sing .....	0.3	—	—	—	—	0.3
Dr. William MONG Man-wai .....	0.2	—	—	—	—	0.2
Tan Sri Dr. KHOO Kay-peng.....	0.2	—	—	—	—	0.2
Mr. Richard LI Tzar-kai .....	0.2	—	—	—	—	0.2
Mr. Eric LI Fook-chuen.....	0.3	—	—	—	—	0.3
Mr. Stephen Charles LI Kwok-sze.....	0.2	—	—	—	—	0.2
Prof. Arthur LI Kwok-cheung .....	0.2	—	—	—	—	0.2
Mr. William Doo Wai-hoi .....	0.3	—	—	—	—	0.3
Mr. Kuok Khoon-ean .....	0.3	—	—	—	—	0.3
<b>Independent Non-executive Directors</b>						
Mr. WONG Chung-hin.....	0.3	—	—	—	—	0.3
Dr. LEE Shau-kee .....	0.2	—	—	—	—	0.2
Dr. Allan WONG Chi-yun .....	0.3	—	—	—	—	0.3
Mr. Winston LO Yau-lai .....	0.3	—	—	—	—	0.3
Mr. Thomas KWOK Ping-kwong.....	0.3	—	—	—	—	0.3
Mr. TAN Man-kou.....	0.2	—	—	—	—	0.2
Mr. Kenneth LO Chin-ming.....	0.3	—	—	—	—	0.3
Mr. Valiant CHEUNG Kin-piu.....	—	—	—	—	—	—
	<u>4.6</u>	<u>11.9</u>	<u>—</u>	<u>36.1</u>	<u>1.1</u>	<u>53.7</u>

	Directors' fees	Salaries, allowances and benefits in kind	Discretionary bonuses	Share options	Retirement scheme contributions	2007 Total
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
<b>Chairman and Chief Executive</b>						
Dr. The Hon. Sir David LI Kwok-po ..	0.3	7.9	15.4	9.6	0.7	33.9
<b>Executive Directors</b>						
Mr. Joseph PANG Yuk-wing .....	0.2	3.4	3.9	4.8	0.3	12.6
Mr. CHAN Kay-cheung .....	0.1	1.2	1.3	1.0	0.1	3.7
<b>Non-executive Directors</b>						
Dr. LI Fook-wo.....	0.2	—	—	—	—	0.2
Mr. Aubrey LI Kwok-sing .....	0.2	—	—	—	—	0.2
Dr. William MONG Man-wai .....	0.2	—	—	—	—	0.2
Tan Sri Dr. KHOO Kay-peng.....	0.2	—	—	—	—	0.2
Mr. Richard LI Tzar-kai .....	0.2	—	—	—	—	0.2
Mr. Eric LI Fook-chuen.....	0.3	—	—	—	—	0.3
Mr. Stephen Charles LI Kwok-sze.....	0.2	—	—	—	—	0.2
<b>Independent Non-executive Directors</b>						
Mr. WONG Chung-hin.....	0.3	—	—	—	—	0.3
Dr. LEE Shau-kee .....	0.2	—	—	—	—	0.2
Dr. Allan WONG Chi-yun .....	0.3	—	—	—	—	0.3
Mr. Winston LO Yau-lai .....	0.3	—	—	—	—	0.3
Mr. Thomas KWOK Ping-kwong.....	0.3	—	—	—	—	0.3
Mr. TAN Man-kou.....	0.3	—	—	—	—	0.3
Mr. Kenneth LO Chin-ming.....	0.3	—	—	—	—	0.3
	<u>4.1</u>	<u>12.5</u>	<u>20.6</u>	<u>15.4</u>	<u>1.1</u>	<u>53.7</u>

Included in the above remuneration were share options granted to Executive Directors under the Bank's Staff Share Option Schemes. The details of these benefits in kind are disclosed under the paragraph "Information on Share Options" in the Report of the Directors and Note 35.

## 17. Five Top-Paid Employees

	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ M</i>
Salaries and other emoluments .....	21	19
Performance-related bonuses.....	3	25
Share options.....	52	21
Pension contributions.....	2	2
	<u>78</u>	<u>67</u>

The remuneration of the five top-paid employees is within the following bands:

	2008	2007
	<i>Number of Employees</i>	<i>Number of Employees</i>
HK\$		
6,000,001 - 6,500,000 .....	—	1
7,000,001 - 7,500,000 .....	—	2
8,500,001 - 9,000,000 .....	2	—
10,500,001 - 11,000,000 .....	1	—
12,500,001 - 13,000,000 .....	—	1
16,000,001 - 16,500,000 .....	1	—
33,500,001 - 34,000,000 .....	1	1

Included in the emoluments of the five top-paid employees were the emoluments of 2 (2007: 2) Directors. Their respective directors' emoluments have been included in Note 16 above.

## 18. Segment Reporting

Segment information is presented in respect of the Group's business or geographical segments. Business segment information is chosen as the primary reporting format because this is more relevant to the Group's internal financial reporting.

### (a) Business segments

The Group comprises the following main business segments:

Personal financial services include branch operations, personal Internet banking, consumer finance, property loans, credit card business and private banking to personal customers.

Corporate banking business includes corporate lending and loan syndication, asset based lending, commercial lending, enterprise lending, securities lending, trust services, mandatory provident fund business and corporate Internet banking.

Investment banking business includes treasury operations, securities broking and dealing, and provision of internet security trading services.

Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.

Other businesses include bancassurance, insurance business and property-related business.

Unallocated items mainly comprise the central management unit, bank premises, and any items which cannot be reasonably allocated to specific business segments.

## 2008

	Personal Financial Services	Corporate Banking	Investment Banking	Corporate Services	Others	Unallocated	Inter- segment elimination	Consolidated
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>The Group</b>								
Net interest income/(expense) .....	1,686	5,046	(122)	2	181	—	—	6,793
Other operating income/(expense) from external customers .....	808	(156)	(2,009)	815	146	60	—	(336)
Inter-segment income.....	—	—	—	—	—	213	(213)	—
Operating income.....	2,494	4,890	(2,131)	817	327	273	(213)	6,457
Operating expenses .....	(2,238)	(2,136)	(431)	(502)	(276)	(196)	—	(5,779)
Inter-segment expenses .....	(165)	(24)	(12)	—	(2)	(10)	213	—
Operating profit/(loss) before impairment losses .....	91	2,730	(2,574)	315	49	67	—	678
(Charge for)/Write back of impairment .....								
losses on loans and advances .....	(128)	(422)	—	(10)	2	—	—	(558)
Write back of impairment losses on bank premises .....	—	—	—	—	—	6	—	6
Impairment losses on available-for-sale financial assets, held-to-maturity investments and associates ....	—	—	(263)	—	(133)	—	—	(396)
Operating (loss)/profit after impairment losses .....	(37)	2,308	(2,837)	305	(82)	73	—	(270)
Profit/(Loss) on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments and subsidiaries/associates .....	1	(8)	230	—	(9)	179	—	393
Valuation losses on investment properties .....	—	—	—	—	(168)	—	—	(168)
Share of profits less losses of associates .....	(5)	167	17	—	(127)	1	—	53
(Loss)/Profit before taxation .....	(41)	2,467	(2,590)	305	(386)	253	—	8
Depreciation for the year .....	(169)	(116)	(37)	(17)	(10)	(88)	—	(437)
Segment assets .....	54,254	178,015	155,371	3,400	5,506	—	—	396,546
Investments in associates .....	42	2,126	113	—	204	1	—	2,486
Unallocated assets .....	—	—	—	—	—	16,222	—	16,222
Total assets .....	54,296	180,141	155,484	3,400	5,710	16,223	—	415,254
Segment liabilities .....	173,515	153,810	36,146	119	3,254	—	—	366,844
Unallocated liabilities .....	—	—	—	—	—	4,889	—	4,889
Loan capital.....	—	—	—	—	—	11,036	—	11,036
Total liabilities .....	173,515	153,810	36,146	119	3,254	15,925	—	382,769
Capital expenditure incurred during the year .....	105	366	397	72	8	1,667	—	2,615

## 2007

	Personal Financial Services	Corporate Banking	Investment Banking	Corporate Services	Others	Unallocated	Inter- segment elimination	Consolidated
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>The Group</b>								
Net interest income/(expense) .....	1,996	2,970	980	1	31	(1)	—	5,977
Other operating income from external customers .....	1,056	446	308	759	239	29	—	2,837
Inter-segment income.....	—	—	—	—	—	158	(158)	—
Operating income.....	3,052	3,416	1,288	760	270	186	(158)	8,814
Operating expenses .....	(1,898)	(1,327)	(570)	(441)	(222)	(233)	—	(4,691)
Inter-segment expenses .....	(126)	(17)	(7)	—	(2)	(6)	158	—
Operating profit/(loss) before impairment losses .....	1,028	2,072	711	319	46	(53)	—	4,123
(Charge for)/Write back of impairment losses on loans and advances .....	(43)	(172)	—	(5)	4	—	—	(216)
Write back of impairment losses on bank premises .....	—	—	—	—	—	132	—	132
Impairment losses on available-for-sale financial assets, held-to-maturity investments and associates ....	—	—	(311)	—	—	—	—	(311)
Operating profit after impairment losses .....	985	1,900	400	314	50	79	—	3,728
Profit/(loss) on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments and subsidiaries/associates .....	—	—	1,073	—	—	(1)	—	1,072
Valuation gains on investment properties .....	—	—	—	—	293	—	—	293
Share of profits less losses of associates .....	3	34	52	—	3	—	—	92
Profit before taxation.....	988	1,934	1,525	314	346	78	—	5,185
Depreciation for the year .....	(128)	(74)	(26)	(14)	(8)	(76)	—	(326)
Segment assets .....	56,901	159,796	151,171	1,106	8,218	1,014	—	378,206
Investments in associates.....	55	2,261	133	—	343	1	—	2,793
Unallocated assets .....	—	—	—	—	—	12,980	—	12,980
Total assets .....	56,956	162,057	151,304	1,106	8,561	13,995	—	393,979
Segment liabilities.....	171,181	114,690	55,647	126	2,677	—	—	344,321
Unallocated liabilities .....	—	—	—	—	—	5,560	—	5,560
Loan capital.....	—	—	—	—	—	13,652	—	13,652
Total liabilities.....	171,181	114,690	55,647	126	2,677	19,212	—	363,533
Capital expenditure incurred during the year .....	48	400	226	56	17	445	—	1,192

(b) Geographical Segments

The information concerning geographical analysis has been classified by the location of the principal operations of the subsidiaries, or in the case of the Bank itself, by the location of the branches of the Bank responsible for reporting the results or booking the assets.

	2008					
	Hong Kong	People's Republic of China	Other Asian Countries	Others	Inter- segment elimination	Consolidated
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
<b>The Group</b>						
Operating income.....	2,962	3,447	525	492	(969)	6,457
Profit/(loss) before taxation .....	(1,876)	1,484	381	19	—	8
Total assets.....	284,089	141,012	18,735	28,946	(57,528)	415,254
Total liabilities.....	255,882	129,123	15,778	24,372	(42,386)	382,769
Contingent liabilities and commitments.....	53,162	15,944	3,818	3,244	—	76,168
Capital expenditure during the year .....	477	2,028	70	40	—	2,615

	2007					
	Hong Kong	People's Republic of China	Other Asian Countries	Others	Inter- segment elimination	Consolidated
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
<b>The Group</b>						
Operating income.....	5,938	2,391	446	578	(539)	8,814
Profit before taxation.....	3,568	1,227	229	161	—	5,185
Total assets.....	288,115	111,711	19,472	29,968	(55,287)	393,979
Total liabilities.....	261,012	101,516	16,609	26,037	(41,641)	363,533
Contingent liabilities and commitments .....	52,063	14,431	7,045	5,197	—	78,736
Capital expenditure during the year .....	250	617	238	87	—	1,192

## 19. Cash and Balances with Banks and Other Financial Institutions (Note 42(c))

	The Group		The Bank	
	2008	2007	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Cash in hand .....	1,083	824	698	632
Balances with central banks .....	17,911	10,605	167	129
Balances with banks and other financial institutions .....	9,111	6,424	3,987	2,372
	<u>28,105</u>	<u>17,853</u>	<u>4,852</u>	<u>3,133</u>

## 20. Placements with Banks and other Financial Institutions

	The Group		The Bank	
	2008	2007	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Placements with banks and authorised institutions .....	96,458	92,930	92,735	82,967
Placements with other financial institutions .....	116	1,774	—	156
	<u>96,574</u>	<u>94,704</u>	<u>92,735</u>	<u>83,123</u>
Maturing				
- within one month .....	46,714	65,361	43,009	56,569
- between one month and one year.....	49,860	29,343	49,726	26,554
	<u>96,574</u>	<u>94,704</u>	<u>92,735</u>	<u>83,123</u>

## 21. Trade Bills

	The Group		The Bank	
	2008	2007	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Gross trade bills .....	<u>1,164</u>	<u>812</u>	<u>521</u>	<u>470</u>

## 22. Trading Assets

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Treasury bills (including Exchange Fund Bills) .....	400	1,195	400	1,195
Debt securities .....	126	18	126	18
Equity securities.....	989	1,808	949	1,744
Investment funds .....	188	274	188	274
Trading securities.....	1,703	3,295	1,663	3,231
Positive fair values of derivatives (Note 41(b)) .....	1,734	1,552	1,251	1,390
	<u>3,437</u>	<u>4,847</u>	<u>2,914</u>	<u>4,621</u>
Issued by:				
Central governments and central banks .....	400	1,195	400	1,195
Public sector entities.....	13	19	13	19
Banks and other financial institutions .....	443	546	433	533
Corporate entities.....	840	1,524	810	1,473
Other entities.....	7	11	7	11
	<u>1,703</u>	<u>3,295</u>	<u>1,663</u>	<u>3,231</u>
Analysed by place of listing:				
Listed in Hong Kong.....	825	1,627	785	1,563
Listed outside Hong Kong .....	294	211	294	211
	1,119	1,838	1,079	1,774
Unlisted .....	584	1,457	584	1,457
	<u>1,703</u>	<u>3,295</u>	<u>1,663</u>	<u>3,231</u>

## 23. Financial Assets Designated at Fair Value through Profit or Loss

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Certificates of deposit held.....	—	50	—	50
Debt securities .....	4,130	8,608	4,114	8,591
	<u>4,130</u>	<u>8,658</u>	<u>4,114</u>	<u>8,641</u>
Issued by:				
Public sector entities.....	142	184	142	184
Banks and other financial institutions .....	1,642	1,096	1,634	1,087
Corporate entities.....	2,346	7,378	2,338	7,370
	<u>4,130</u>	<u>8,658</u>	<u>4,114</u>	<u>8,641</u>
Analysed by place of listing:				
Listed in Hong Kong.....	1,325	1,755	1,325	1,755
Listed outside Hong Kong .....	1,178	796	1,161	779
	2,503	2,551	2,486	2,534
Unlisted .....	1,627	6,107	1,628	6,107
	<u>4,130</u>	<u>8,658</u>	<u>4,114</u>	<u>8,641</u>

## 24. Advances to Customers and other Accounts

### (a) Advances to customers and other accounts

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
(i) Advances to customers .....	230,339	218,184	131,123	134,858
Less: Impairment allowances				
- Individual .....	(523)	(264)	(438)	(79)
- Collective.....	(521)	(433)	(392)	(332)
	<u>229,295</u>	<u>217,487</u>	<u>130,293</u>	<u>134,447</u>
(ii) Other accounts				
Advances to banks and other financial institutions* ..	850	2,008	205	209
Notes and bonds .....	129	262	125	258
Certificates of deposit held.....	39	39	39	39
Accrued interest.....	1,863	1,912	1,119	1,414
Bankers acceptances .....	2,989	1,426	272	309
Other accounts .....	8,592	8,637	6,587	5,016
	<u>14,462</u>	<u>14,284</u>	<u>8,347</u>	<u>7,245</u>
Less: Impairment allowances				
- Individual .....	(23)	(25)	—	—
- Collective.....	(9)	(6)	—	—
	<u>14,430</u>	<u>14,253</u>	<u>8,347</u>	<u>7,245</u>
	<u>243,725</u>	<u>231,740</u>	<u>138,640</u>	<u>141,692</u>

\* The above advances to banks and other financial institutions include:—

Receivables from reverse repurchase agreements under which the Group obtains securities on terms which permit it to re-pledge or resell securities to others in the absence of default. At 31st December, 2008, the fair value of financial assets accepted as collateral that the Group is permitted to sell or re-pledge under such terms is HK\$155 million (2007: HK\$1,275 million).

(b) Impairment allowances against advances and other accounts for 2008

	The Group					
	Advances to customers		Other Accounts		Total	
	Individual	Collective	Individual	Collective	Individual	Collective
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
At 1st January.....	264	433	25	6	289	439
New provisions charged to profit and loss account (Note 10) .....	583	183	13	—	596	183
Net provisions released back to profit and loss account (Note 10)	(204)	—	(5)	—	(209)	—
Amounts written off.....	(245)	(96)	(10)	—	(255)	(96)
Recoveries (Note 10).....	140	—	—	—	140	—
Additions through acquisition of subsidiaries .....	—	—	—	3	—	3
Effect of discounting (Note 3) .....	(12)	—	—	—	(12)	—
Exchange adjustments.....	(3)	1	—	—	(3)	1
At 31st December .....	<u>523</u>	<u>521</u>	<u>23</u>	<u>9</u>	<u>546</u>	<u>530</u>

	The Bank					
	Advances to customers		Other Accounts		Total	
	Individual	Collective	Individual	Collective	Individual	Collective
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
At 1st January.....	79	332	—	—	79	332
New provisions charged to profit and loss account .....	460	149	6	—	466	149
Net provisions released back to profit and loss account .....	(153)	—	—	—	(153)	—
Amounts written off.....	(50)	(87)	(6)	—	(56)	(87)
Recoveries .....	115	—	—	—	115	—
Effect of discounting .....	(10)	—	—	—	(10)	—
Exchange adjustments.....	(3)	(2)	—	—	(3)	(2)
At 31st December .....	<u>438</u>	<u>392</u>	<u>—</u>	<u>—</u>	<u>438</u>	<u>392</u>

(b) Impairment allowances against advances and other accounts for 2007

	The Group					
	Advances to customers		Other Accounts		Total	
	Individual	Collective	Individual	Collective	Individual	Collective
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
At 1st January.....	254	444	26	8	280	452
New provisions charged to profit and loss account (Note 10) .....	336	68	10	—	346	68
Net provisions released back to profit and loss account (Note 10)	(183)	—	(4)	(3)	(187)	(3)
Amounts written off.....	(246)	(87)	(8)	—	(254)	(87)
Recoveries (Note 10).....	107	—	—	—	107	—
Additions through acquisition of subsidiaries .....	—	—	—	1	—	1
Effect of discounting (Note 3) .....	(8)	—	—	—	(8)	—
Exchange adjustments.....	4	8	1	—	5	8
At 31st December .....	<u>264</u>	<u>433</u>	<u>25</u>	<u>6</u>	<u>289</u>	<u>439</u>

	The Bank					
	Advances to customers		Other Accounts		Total	
	Individual	Collective	Individual	Collective	Individual	Collective
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
At 1st January.....	160	432	—	—	160	432
New provisions charged to profit and loss account .....	251	102	—	—	251	102
Net provisions released back to profit and loss account .....	(153)	—	—	—	(153)	—
Amounts written off.....	(241)	(84)	—	—	(241)	(84)
Recoveries .....	80	—	—	—	80	—
Transfer to The Bank of East Asia (China) Limited .....	(17)	(122)	—	—	(17)	(122)
Effect of discounting .....	(5)	—	—	—	(5)	—
Exchange adjustments.....	4	4	—	—	4	4
At 31st December .....	<u>79</u>	<u>332</u>	<u>—</u>	<u>—</u>	<u>79</u>	<u>332</u>

(c) **Advances to customers — by industry sectors**

The analysis of gross advances to customers and the percentage of secured advances by industry sector is based on the categories and definitions used by the Hong Kong Monetary Authority.

	2008		2007	
	Gross Advances	% of secured advances	Gross Advances	% of secured advances
	HK\$ Mn	%	HK\$ Mn	%
<b>The Group</b>				
Loans for use in Hong Kong Industrial, commercial and financial				
- Property development .....	8,855	61.25	9,080	66.41
- Property investment .....	27,431	86.88	26,023	87.04
- Financial concerns.....	2,542	69.94	1,932	76.71
- Stockbrokers .....	550	99.75	659	99.60
- Wholesale and retail trade .....	2,405	64.60	1,469	50.12
- Manufacturing .....	2,055	52.54	1,934	48.35
- Transport and transport equipment .....	3,642	74.80	4,345	70.36
- Recreational activities .....	285	91.11	285	90.81
- Information technology .....	4	49.13	5	38.89
- Others .....	9,954	71.52	9,673	72.40
- Sub-total.....	57,723	76.78	55,405	77.27
Individuals				
- Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme .....	1,318	100.00	1,041	100.00
- Loans for the purchase of other residential properties ...	24,297	99.74	36,245	99.68
- Credit card advances .....	2,997	0.00	2,619	0.00
- Others .....	6,553	74.35	5,450	70.57
- Sub-total.....	35,165	86.52	45,355	90.43
Total loans for use in Hong Kong .....	92,888	80.47	100,760	83.20
Trade finance.....	2,905	59.03	3,714	57.09
Loans for use outside Hong Kong* .....	134,546	76.56	113,710	72.67
Total advances to customers .....	230,339	77.91	218,184	77.27

\* Loans for use outside Hong Kong includes the following loans for use in the PRC.

	2008		2007	
	Gross Advances	% of secured advances	Gross Advances	% of secured advances
	<i>HK\$Mn</i>	%	<i>HK\$Mn</i>	%
Property development.....	14,351	78.64	11,399	72.07
Property investment.....	24,215	87.95	22,049	92.58
Wholesale and retail trade.....	19,021	88.93	11,276	84.46
Manufacturing.....	9,547	63.58	7,418	47.35
Others.....	31,906	69.99	27,173	59.45
	<u>99,040</u>	78.66	<u>79,315</u>	72.90
<b>The Bank</b>				
Loans for use in Hong Kong Industrial, commercial and financial				
- Property development.....	8,844	61.32	8,967	67.25
- Property investment.....	27,345	86.84	25,939	87.00
- Financial concerns.....	2,542	69.95	1,931	76.73
- Stockbrokers.....	550	99.75	659	99.60
- Wholesale and retail trade.....	2,353	63.82	1,457	49.72
- Manufacturing.....	2,055	52.54	1,935	48.35
- Transport and transport equipment.....	3,642	74.80	4,345	70.36
- Recreational activities.....	285	91.11	285	90.81
- Information technology.....	4	49.13	5	38.89
- Others.....	9,830	71.16	9,454	71.76
- Sub-total.....	<u>57,450</u>	76.69	<u>54,977</u>	77.30
Individuals				
- Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme.....	1,318	100.00	1,041	100.00
- Loans for the purchase of other residential properties ...	24,273	99.75	36,220	99.68
- Credit card advances.....	2,997	0.00	2,619	0.00
- Others.....	6,147	74.92	5,318	71.35
- Sub-total.....	<u>34,735</u>	86.76	<u>45,198</u>	90.58
Total loans for use in Hong Kong.....	92,185	80.49	100,175	83.29
Trade finance.....	2,684	58.87	3,353	54.92
Loans for use outside Hong Kong*.....	36,254	57.35	31,330	58.35
Total advances to customers.....	<u>131,123</u>	73.65	<u>134,858</u>	76.79

\* Loans for use outside Hong Kong includes the following loans for use in the PRC.

	2008		2007	
	Gross Advances	% of secured advances	Gross Advances	% of secured advances
	HK\$ Mn	%	HK\$ Mn	%
Property development.....	2,310	0.00	1,381	9.95
Property investment.....	951	98.95	824	96.36
Wholesale and retail trade.....	12	99.97	—	0.00
Manufacturing.....	1,878	74.86	672	13.92
Others.....	2,733	8.17	1,870	0.00
	<u>7,884</u>	32.75	<u>4,747</u>	21.59

Individually impaired loans, as well as relevant information, in respect of industry sectors which constitute 10% or more of total advances to customers are as follows:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
(i) Property development				
a. Individually impaired loans.....	207	305	171	181
b. Individual impairment allowance .....	8	90	2	—
c. Collective impairment allowance .....	36	35	20	23
d. Provision charged to profit and loss				
- individual impairment loss.....	2	—	2	—
- collective impairment loss .....	12	12	7	8
e. Written off.....	84	—	—	—
(ii) Property investment				
a. Individually impaired loans.....	145	23	6	13
b. Individual impairment allowance .....	29	—	—	—
c. Collective impairment allowance .....	96	89	62	59
d. Provision charged to profit and loss				
- individual impairment loss.....	29	—	—	—
- collective impairment loss .....	24	27	16	20
e. Written off.....	—	—	—	—
(iii) Loans for purchase of residential properties				
a. Individually impaired loans.....	117	189	108	166
b. Individual impairment allowance .....	2	6	2	6
c. Collective impairment allowance .....	30	25	21	18
d. Provision charged to profit and loss				
- individual impairment loss.....	5	7	5	7
- collective impairment loss .....	6	3	3	—
e. Written off.....	3	6	3	6
(iv) Wholesale and retail trade				
a. Individually impaired loans.....	222	112	181	96
b. Individual impairment allowance .....	129	24	120	24
c. Collective impairment allowance .....	48	27	24	14
d. Provision charged to profit and loss				
- individual impairment loss.....	133	39	116	37
- collective impairment loss .....	21	11	12	3
e. Written off.....	4	8	4	6

(d) **Advances to customers — by geographical areas**

The information concerning the breakdown of the gross amount of advances to customers by countries or geographical areas 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.

	<b>The Group</b>				
	<b>2008</b>				
	<b>Total advances to customers</b>	<b>Advances overdue for over three months</b>	<b>Impaired advances to customers</b>	<b>Individual impairment allowance</b>	<b>Collective impairment allowance</b>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Hong Kong.....	112,038	207	642	267	278
People's Republic of China.....	85,741	242	454	78	115
Other Asian Countries .....	10,798	159	246	168	103
Others.....	21,762	25	244	10	25
<b>Total .....</b>	<b>230,339</b>	<b>633</b>	<b>1,586</b>	<b>523</b>	<b>521</b>
% of total advances to customers .....			0.69%		
Market value of security held against impaired advances to customers .....			3,769		

	<b>The Group</b>				
	<b>2007</b>				
	<b>Total advances to customers</b>	<b>Advances overdue for over three months</b>	<b>Impaired advances to customers</b>	<b>Individual impairment allowance</b>	<b>Collective impairment allowance</b>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Hong Kong.....	123,539	296	622	148	265
People's Republic of China.....	62,518	114	334	87	84
Other Asian Countries .....	10,340	57	90	28	60
Others.....	21,787	1	196	1	24
<b>Total .....</b>	<b>218,184</b>	<b>468</b>	<b>1,242</b>	<b>264</b>	<b>433</b>
% of total advances to customers .....			0.57%		
Market value of security held against impaired advances to customers .....			3,647		

The Bank					
2008					
Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance	
<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	
Hong Kong.....	93,211	169	556	232	248
People's Republic of China.....	14,271	95	280	36	26
Other Asian Countries .....	9,856	159	246	168	102
Others.....	13,785	14	192	2	16
Total .....	<u>131,123</u>	<u>437</u>	<u>1,274</u>	<u>438</u>	<u>392</u>
% of total advances to customers .....			<u>0.97%</u>		
Market value of security held against impaired advances to customers .....			<u>2,168</u>		

The Bank					
2007					
Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance	
<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	
Hong Kong.....	104,082	206	442	50	237
People's Republic of China.....	8,521	2	189	1	23
Other Asian Countries .....	9,511	56	89	28	60
Others.....	12,744	—	177	—	12
Total .....	<u>134,858</u>	<u>264</u>	<u>897</u>	<u>79</u>	<u>332</u>
% of total advances to customers .....			<u>0.67%</u>		
Market value of security held against impaired advances to customers .....			<u>2,282</u>		

Impaired loans and advances are individually assessed loans with objective evidence of impairment on an individual basis. The above information by countries or geographical areas is derived according to the location of the counterparties after taking into account any transfer of risk.

There were no impaired advances to banks and other financial institutions as at 31st December, 2008 and 31st December, 2007, nor were there any individual impairment allowances made for them on these two dates.

(e) **Advances to customers — Net investment in finance leases**

Advances to customers include net investment in equipment leased under finance leases. The total minimum lease payments receivable under finance leases and their present values at the year end are as follows:

	The Group and The Bank					
	2008			2007		
	Present value of the minimum lease payments	Interest income relating to future periods	Total minimum lease payments	Present value of the minimum lease payments	Interest income relating to future periods	Total minimum lease payments
<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	
Amounts receivable:						
Within one year.....	1,280	152	1,432	1,087	202	1,289
After one year but within five years .....	1,512	206	1,718	1,434	401	1,835
After five years .....	1,468	246	1,714	1,900	632	2,532
	4,260	604	4,864	4,421	1,235	5,656
Less: Individual impairment allowances.....	(21)			(4)		
Net investment in finance leases .....	4,239			4,417		

The net investment in finance leases is carried on the balance sheet as a receivable. No accrual is made for the interest income relating to future periods.

## 25. Available-for-Sale Financial Assets

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Treasury bills (including Exchange Fund Bills) .....	10,391	2,869	4,558	2,838
Certificates of deposit held.....	762	807	508	766
Debt securities .....	6,398	6,797	5,210	5,682
Equity securities.....	899	1,602	611	1,248
Investment funds .....	110	142	98	74
	<u>18,560</u>	<u>12,217</u>	<u>10,985</u>	<u>10,608</u>
Issued by:				
Central governments and central banks.....	10,419	2,914	4,558	2,858
Public sector entities.....	231	2,337	126	2,297
Banks and other financial institutions.....	5,773	4,076	4,759	3,616
Corporate entities.....	2,027	2,586	1,444	1,601
Other entities.....	110	304	98	236
	<u>18,560</u>	<u>12,217</u>	<u>10,985</u>	<u>10,608</u>
Analysed by place of listing:				
Listed in Hong Kong.....	397	1,025	197	760
Listed outside Hong Kong .....	9,329	2,548	2,619	1,619
	9,726	3,573	2,816	2,379
Unlisted .....	8,834	8,644	8,169	8,229
	<u>18,560</u>	<u>12,217</u>	<u>10,985</u>	<u>10,608</u>

## 26. Held-to-maturity investments

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Treasury bills (including Exchange Fund Bills) .....	180	67	180	67
Certificates of deposit held.....	1,717	1,625	1,056	702
Debt securities .....	3,216	9,111	2,189	8,046
	5,113	10,803	3,425	8,815
Less: Impairment allowances.....	(107)	(42)	(107)	(42)
	5,006	10,761	3,318	8,773
Issued by:				
Central governments and central banks.....	243	5,411	239	5,407
Public sector entities.....	318	664	231	544
Banks and other financial Institutions .....	3,344	3,507	2,117	2,051
Corporate entities.....	1,101	1,179	731	771
	5,006	10,761	3,318	8,773
Analysed by place of listing:				
Listed in Hong Kong.....	287	194	268	174
Listed outside Hong Kong .....	1,863	2,129	1,477	1,696
	2,150	2,323	1,745	1,870
Unlisted .....	2,856	8,438	1,573	6,903
	5,006	10,761	3,318	8,773
Market value:				
Listed securities .....	2,028	2,330	1,640	1,882
Unlisted securities.....	2,870	8,463	1,569	6,914
	4,898	10,793	3,209	8,796

## Movement of impairment allowances

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1st January .....	42	—	42	—
Charge for the year .....	44	42	44	42
Exchange and other adjustments.....	21	—	21	—
At 31st December.....	107	42	107	42

## 27. Investments in Subsidiaries

	The Bank	
	2008	2007
	HK\$ Mn	HK\$ Mn
Unlisted shares, at cost.....	11,906	10,774
Less: impairment allowances.....	(233)	(170)
	<u>11,673</u>	<u>10,604</u>

The following list contains only the particulars of subsidiaries which principally affected the results, assets or liabilities of the Group. The class of shares held is ordinary.

Details of these companies are as follows:-

Name of company	Place of incorporation and operation	Issued and paid-up capital	% Held by		Nature of business
			The Bank	The Group	
Bank of East Asia (Trustees) Limited	Hong Kong	HK\$150,000,000	100%		Trustee
BEA Life Limited	Hong Kong	HK\$500,000,000	100%		Life insurance
BEA Pacific Asia Limited	Hong Kong	US\$ 13,000,000		100%	Investment holding
BEA Pacific Holding Company Limited	Bermuda	HK\$ 10,000	100%		Investment holding
Blue Cross (Asia-Pacific) Insurance Limited	Hong Kong	HK\$750,000,000	100%		Insurance
BEA Union Investment Management Limited	Hong Kong	HK\$ 10,000,000	51%		Asset management
Caribbean Corporate Services Ltd.	Barbados	BDS\$ 2,000		60.49%	Corporate secretarial and accounting services
Credit Gain Finance Company Limited	Hong Kong	HK\$ 1	100%		Money lenders
East Asia Financial Services (BVI) Ltd.	BVI	US\$ 24,096,000	100%		Investment holding
East Asia Futures Limited	Hong Kong	HK\$ 7,000,000	100%		Futures and options trading
*East Asia Holding Company, Inc.	U.S.A.	US\$ 5	100%		Bank holding company
East Asia Indonesian Holdings Limited	Seychelles	US\$ 100,000		100%	Investment holding
East Asia Investments Holdings (BVI) Ltd.	BVI	HK\$186,038,725	100%		Investment holding
*East Asia Properties(US), Inc.	U.S.A.	US\$ 5		100%	Property holding
East Asia Secretaries(BVI) Limited	BVI	HK\$300,000,000		75.6%	Investment holding
East Asia Securities Company Limited	Hong Kong	HK\$ 25,000,000	100%		Securities broking
East Asia Strategic Holdings Limited	BVI	US\$ 50,000,000	100%		Investment holding
Flowery World Corporation	BVI	US\$ 1		75.6%	Holding company
PFA Malaysia Sdn. Bhd.	Malaysia	RM750,000		60.49%	Secretarial, finance & accounting services, and human resource consulting services
The Bank of East Asia(Canada)	Canada	C\$ 58,000,000	100%		Banking services
The Bank of East Asia (China) Limited (Note 1)	PRC	RMB¥8,000,000,000	100%		Banking and related financial services
*The Bank of East Asia(U.S.A.) N.A.	U.S.A.	US\$ 4,500		100%	Banking

Name of company	Place of incorporation and operation	Issued and paid-up capital	% Held by		Nature of business
			The Bank	The Group	
Tricor Consultancy (Beijing) Limited (Note 1)	PRC	US\$1,850,000		75.6%	Business consultancy in China
Tricor Holdings Limited	BVI	US\$ 7,001		75.6%	Investment holding
Tricor Investor Services Limited	Hong Kong	HK\$ 2		75.6%	Investor services
Tricor Services Limited	Hong Kong	HK\$ 2		75.6%	Business, corporate and investor services
Tricor Singapore Pte. Ltd.	Singapore	\$ 100,000		75.6%	Business management and consultancy services, and employment agency
Vitaway (Mauritius) Limited	Mauritius	US\$ 1		75.6%	Regional treasurer

*Notes:*

1. Represents a wholly foreign owned enterprise.
2. BVI denotes the British Virgin Islands and PRC denotes the People's Republic of China.

\* Companies not audited by KPMG. The accounts of the subsidiaries not audited by KPMG reflect total net assets and total income constituting approximately 1.6% and 522.0% respectively of the related consolidated totals.

## 28. Investments in Associates

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Listed shares, at cost .....	—	—	1,743	1,725
Unlisted shares, at cost .....	—	—	271	333
Share of net assets .....	2,260	2,607	—	—
Goodwill.....	226	227	—	—
	2,486	2,834	2,014	2,058
Less: impairment allowances.....	—	(41)	(30)	(93)
	<u>2,486</u>	<u>2,793</u>	<u>1,984</u>	<u>1,965</u>

Loans to associates amounting to HK\$76 million (2007: HK\$102 million) are included under advances to customers.

Share of associates' taxation for the year amounted to HK\$59 million (2007: HK\$22 million)

The following list contains only the particulars of associates which principally affected the results or assets of the Group:

Name of company	Place of incorporation and operation	% of ordinary shares held by		Nature of business
		The Bank	The Group	
<b>Listed</b>				
Affin Holdings Berhad	Malaysia	20.507%		Investment holding
<b>Unlisted</b>				
ICEA Finance Holdings Limited	BVI	25%		Investment holding
Mercedes-Benz Financial Services Hong Kong Limited	Hong Kong		20%	Financing, leasing and insurance services
Mercedes-Benz Financial Services Korea Limited	Republic of Korea		20%	Financial services
Platinum Holdings Company Limited	Cayman Islands	29.99%		Investment holding
PT. Bank Resona Perdania	Indonesia		30%	Banking and related financial services
Sunfire Enterprises Limited	BVI		20%	Property development
TCL Finance Co., Ltd.	PRC	20%		Financial services and cash management
Trans-Ocean Insurance Company, Limited	Hong Kong	48.7%		Insurance

#### Summary financial information on associates

	Assets	Liabilities	Equity	Revenues	Profit
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>2008</b>					
100 per cent.....	95,485	83,118	12,367	3,584	516
Group's effective interest .....	<u>19,756</u>	<u>17,496</u>	<u>2,260</u>	<u>767</u>	<u>53</u>
<b>2007</b>					
100 per cent.....	105,537	92,273	13,264	1,098	354
Group's effective interest .....	<u>22,248</u>	<u>19,641</u>	<u>2,607</u>	<u>295</u>	<u>92</u>

## 29. Goodwill and Intangible Assets

Goodwill and intangible assets include goodwill arising on business combinations and acquired intangible assets. Acquired intangible assets comprise core deposits which are amortised over their estimated economic useful life of ten years.

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Goodwill.....	2,705	2,656	1,460	1,460
Acquired intangible assets .....	29	12	—	—
	<u>2,734</u>	<u>2,668</u>	<u>1,460</u>	<u>1,460</u>

### (a) Goodwill

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1st January .....	2,656	2,592	1,460	1,460
Additions through acquisition of subsidiaries .....	52	40	—	—
Exchange adjustments .....	(3)	24	—	—
At 31st December.....	<u>2,705</u>	<u>2,656</u>	<u>1,460</u>	<u>1,460</u>

### *Impairment tests for cash-generating units containing goodwill*

Goodwill is allocated to the Group's cash-generating units (CGU) identified according to business segment as follows:

	2008	2007
	HK\$ Mn	HK\$ Mn
Personal Financial Services.....	849	849
Corporate Banking.....	453	453
Investment Banking.....	158	158
Corporate Services .....	1,067	1,027
Others .....	178	169
	<u>2,705</u>	<u>2,656</u>

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated rates stated below. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

The pre-tax discount rate used for value-in-use calculations is 8.28% (2007: 10.88%) and the long-term growth rate is 4% (2007: 5%).

Management determined the budgeted net profit based on past performance and its expectation for market development. The weighted average growth rates used are consistent with the forecasts included in industry reports.

(b) **Intangible assets (other than goodwill)**

Intangible assets include acquired core deposits. Intangible assets are stated at cost less accumulated amortisation and impairment loss (Note 2(k)(iv)).

Amortisation of intangible assets with finite useful lives is charged to the profit and loss account on a diminishing basis over the assets' estimated useful lives. The following intangible assets with finite useful lives are amortised from the date they are available to use and their estimated useful lives are as follows:—

Acquired core deposits 10 years

Naming rights over the shorter of the lease period of building or land

Both the period and method of amortisation are reviewed annually.

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Cost				
At 1st January .....	16	15	—	—
Additions .....	6	—	—	—
Formation of a new subsidiary .....	—	1	—	—
Exchange and other adjustments.....	16	—	—	—
At 31st December.....	<u>38</u>	<u>16</u>	<u>—</u>	<u>—</u>
Accumulated amortisation and impairment losses				
At 1st January .....	(4)	(2)	—	—
Amortisation charge for the year (Note 9) .....	(3)	(2)	—	—
Exchange adjustments .....	(2)	—	—	—
At 31st December.....	<u>(9)</u>	<u>(4)</u>	<u>—</u>	<u>—</u>
Carrying amount at 31st December .....	<u>29</u>	<u>12</u>	<u>—</u>	<u>—</u>

### 30. Fixed Assets

	2008				
	The Group				
	Investment Properties	Bank Premises	Furniture, Fixtures and Equipment	Sub-total	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Cost or valuation					
At 1st January, 2008.....	1,726	4,609	2,711	7,320	9,046
Additions.....	—	1,659	898	2,557	2,557
Additions through acquisition .....	303	—	15	15	318
Revaluation losses.....	(168)	—	—	—	(168)
Revaluation of bank premises transferred to investment properties...	—	9	—	9	9
Transfer from bank premises to investment properties.....	9	(9)	—	(9)	—
Disposals.....	(13)	(34)	(126)	(160)	(173)
Exchange adjustments.....	(18)	59	9	68	50
At 31st December, 2008 .....	<u>1,839</u>	<u>6,293</u>	<u>3,507</u>	<u>9,800</u>	<u>11,639</u>
Accumulated depreciation and amortisation					
At 1st January, 2008 .....	—	617	1,573	2,190	2,190
Additions through acquisition .....	—	—	11	11	11
Charge for the year (Note 9).....	—	81	356	437	437
Revaluation of bank premises transferred to investment properties...	—	(1)	—	(1)	(1)
Write back of impairment loss .....	—	(6)	—	(6)	(6)
Written back on disposals.....	—	(25)	(113)	(138)	(138)
Exchange adjustments.....	—	9	(9)	—	—
At 31st December, 2008 .....	<u>—</u>	<u>675</u>	<u>1,818</u>	<u>2,493</u>	<u>2,493</u>
Net book value at 31st December, 2008 ....	<u><u>1,839</u></u>	<u><u>5,618</u></u>	<u><u>1,689</u></u>	<u><u>7,307</u></u>	<u><u>9,146</u></u>
The gross amounts of the above assets are stated:					
At cost.....	—	5,466	3,507	8,973	8,973
At Directors' valuation					
- 1989 .....	—	827	—	827	827
At professional valuation					
- 2008 .....	<u>1,839</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,839</u>
	<u><u>1,839</u></u>	<u><u>6,293</u></u>	<u><u>3,507</u></u>	<u><u>9,800</u></u>	<u><u>11,639</u></u>

	2008				
	The Bank				
	Investment Properties	Bank Premises	Furniture, Fixtures and Equipment	Sub-total	Total
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Cost or valuation					
At 1st January, 2008.....	1,829	3,192	1,858	5,050	6,879
Additions.....	—	2	487	489	489
Revaluation losses.....	(87)	—	—	—	(87)
Revaluation of bank premises transferred to investment properties...	—	52	—	52	52
Transfer from bank premises to investment properties.....	89	(89)	—	(89)	—
Disposals.....	(12)	(20)	(79)	(99)	(111)
Exchange adjustments.....	—	(2)	(20)	(22)	(22)
At 31st December, 2008 .....	<u>1,819</u>	<u>3,135</u>	<u>2,246</u>	<u>5,381</u>	<u>7,200</u>
Accumulated depreciation and amortisation					
At 1st January, 2008.....	—	304	1,168	1,472	1,472
Charge for the year.....	—	43	218	261	261
Revaluation of bank premises transferred to investment properties...	—	(5)	—	(5)	(5)
Write back of impairment loss .....	—	(6)	—	(6)	(6)
Written back on disposals.....	—	(12)	(77)	(89)	(89)
Exchange adjustments.....	—	(1)	(19)	(20)	(20)
At 31st December, 2008 .....	<u>—</u>	<u>323</u>	<u>1,290</u>	<u>1,613</u>	<u>1,613</u>
Net book value at 31st December, 2008 ....	<u><u>1,819</u></u>	<u><u>2,812</u></u>	<u><u>956</u></u>	<u><u>3,768</u></u>	<u><u>5,587</u></u>
The gross amounts of the above assets are stated:					
At cost.....	—	2,308	2,246	4,554	4,554
At Directors' valuation					
- 1989 .....	—	827	—	827	827
At professional valuation					
- 2008 .....	<u>1,819</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,819</u>
	<u><u>1,819</u></u>	<u><u>3,135</u></u>	<u><u>2,246</u></u>	<u><u>5,381</u></u>	<u><u>7,200</u></u>

	2007				
	The Group				
	Investment Properties	Bank Premises	Furniture, Fixtures and Equipment	Sub-total	Total
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Cost or valuation					
At 1st January, 2007 .....	1,288	4,231	2,255	6,486	7,774
Additions .....	—	442	482	924	924
Additions through acquisition .....	—	—	1	1	1
Revaluation surplus .....	293	—	—	—	293
Revaluation of bank premises transferred to investment properties ..	—	21	—	21	21
Transfer from bank premises to investment properties .....	143	(143)	—	(143)	—
Disposals .....	—	(13)	(48)	(61)	(61)
Exchange adjustments .....	2	71	21	92	94
At 31st December, 2007 .....	<u>1,726</u>	<u>4,609</u>	<u>2,711</u>	<u>7,320</u>	<u>9,046</u>
Accumulated depreciation and amortisation					
At 1st January, 2007 .....	—	684	1,341	2,025	2,025
Additions through acquisition .....	—	—	1	1	1
Charge for the year (Note 9) .....	—	68	258	326	326
Revaluation of bank premises transferred to investment properties ..	—	(15)	—	(15)	(15)
Write back of impairment loss .....	—	(132)	—	(132)	(132)
Written back on disposals .....	—	(7)	(40)	(47)	(47)
Exchange adjustments .....	—	19	13	32	32
At 31st December, 2007 .....	<u>—</u>	<u>617</u>	<u>1,573</u>	<u>2,190</u>	<u>2,190</u>
Net book value at 31st December, 2007 ...	<u><u>1,726</u></u>	<u><u>3,992</u></u>	<u><u>1,138</u></u>	<u><u>5,130</u></u>	<u><u>6,856</u></u>
The gross amounts of the above assets are stated:					
At cost .....	—	3,775	2,711	6,486	6,486
At Directors' valuation					
- 1989 .....	—	834	—	834	834
At professional valuation					
- 2007 .....	<u>1,726</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,726</u>
	<u><u>1,726</u></u>	<u><u>4,609</u></u>	<u><u>2,711</u></u>	<u><u>7,320</u></u>	<u><u>9,046</u></u>

	2007				
	The Bank				
	Investment Properties	Bank Premises	Furniture, Fixtures and Equipment	Sub-total	Total
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Cost or valuation					
At 1st January, 2007 .....	1,317	3,976	1,937	5,913	7,230
Additions .....	—	228	206	434	434
Revaluation surplus .....	326	—	—	—	326
Revaluation loss on bank premises .....	—	(3)	—	(3)	(3)
Revaluation of bank premises transferred to investment properties ..	—	21	—	21	21
Transfer to The Bank of East Asia (China) Ltd. ....	(11)	(835)	(259)	(1,094)	(1,105)
Transfer from bank premises to investment properties .....	197	(197)	—	(197)	—
Disposals .....	—	—	(30)	(30)	(30)
Exchange adjustments .....	—	2	4	6	6
At 31st December, 2007 .....	<u>1,829</u>	<u>3,192</u>	<u>1,858</u>	<u>5,050</u>	<u>6,879</u>
Accumulated depreciation and amortisation					
At 1st January, 2007 .....	—	600	1,155	1,755	1,755
Charge for the year .....	—	50	184	234	234
Revaluation of bank premises transferred to investment properties ..	—	(15)	—	(15)	(15)
Transfer to The Bank of East Asia (China) Ltd. ....	—	(200)	(147)	(347)	(347)
Write back of impairment loss .....	—	(132)	—	(132)	(132)
Written back on disposals .....	—	—	(26)	(26)	(26)
Exchange adjustments .....	—	1	2	3	3
At 31st December, 2007 .....	<u>—</u>	<u>304</u>	<u>1,168</u>	<u>1,472</u>	<u>1,472</u>
Net book value at 31st December, 2007 ...	<u><u>1,829</u></u>	<u><u>2,888</u></u>	<u><u>690</u></u>	<u><u>3,578</u></u>	<u><u>5,407</u></u>
The gross amounts of the above assets are stated:					
At cost .....	—	2,358	1,858	4,216	4,216
At Directors' valuation .....					
- 1989 .....	—	834	—	834	834
At professional valuation					
- 2007 .....	<u>1,829</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,829</u>
	<u><u>1,829</u></u>	<u><u>3,192</u></u>	<u><u>1,858</u></u>	<u><u>5,050</u></u>	<u><u>6,879</u></u>

The net book value of bank premises and investment properties comprises:

	The Group			
	2008		2007	
	Investment Properties	Bank Premises	Investment Properties	Bank Premises
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Freeholds				
Held outside Hong Kong .....	78	1,748	114	408
Leaseholds				
Held in Hong Kong				
On long lease (over 50 years) .....	1,449	1,477	1,247	1,477
On medium-term lease (10 - 50 years) .....	303	1,354	352	1,387
Held outside Hong Kong				
On long lease (over 50 years) .....	—	193	—	175
On medium-term lease (10 - 50 years) .....	9	846	13	545
	<u>1,839</u>	<u>5,618</u>	<u>1,726</u>	<u>3,992</u>

	The Bank			
	2008		2007	
	Investment Properties	Bank Premises	Investment Properties	Bank Premises
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Freeholds				
Held outside Hong Kong .....	—	150	—	153
Leaseholds				
Held in Hong Kong .....				
On long lease (over 50 years) .....	1,365	1,391	1,315	1,421
On medium-term lease (10 - 50 years) .....	454	1,267	514	1,302
Held outside Hong Kong .....				
On long lease (over 50 years) .....	—	3	—	11
On medium-term lease (10 - 50 years) .....	—	1	—	1
	<u>1,819</u>	<u>2,812</u>	<u>1,829</u>	<u>2,888</u>

The carrying amount of the bank premises of the Group and the Bank would have been HK\$4,624 million (2007: HK\$2,937 million) and HK\$1,929 million (2007: HK\$1,955 million) respectively had they been stated at cost less accumulated depreciation.

Investment properties were valued by independent valuers. Investment properties in Hong Kong were valued at HK\$1,543 million as at 31st December, 2008 by an independent valuer, Savills Valuation and Professional Services Limited, Chartered Surveyors, who has among their staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of property being valued. The valuation has been incorporated in the accounts as at 31st December, 2008 and it was performed on an open market value basis.

The Group leases out investment properties under operating leases. The leases typically run for an initial period from 1 to 10 years, with an option to renew the leases after that date at which time all terms are renegotiated. None of the leases includes contingent rentals.

Rental income receivable from investment properties held for use under operating leases amounted to HK\$90 million in 2008 (2007: HK\$72 million). There was no contingent rental recognised during the year 2008 (2007: Nil).

The total future minimum lease payments of bank premises and investment properties held for use under non—cancellable operating leases are receivable as follows:

	The Group		The Bank	
	2008	2007	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Within one year .....	74	62	69	56
After one year but within five years .....	62	71	47	36
	<u>136</u>	<u>133</u>	<u>116</u>	<u>92</u>

### 31. Amounts Due from and Due to Subsidiaries

During the year, the Bank entered into transactions with certain subsidiaries in the ordinary course of its banking business. Details of the amounts due from and due to subsidiaries are as follows:

#### (a) Amounts Due from Subsidiaries

	The Bank	
	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Financial institutions .....	15,454	16,316
Others .....	944	1,648
	<u>16,398</u>	<u>17,964</u>

#### (b) Amounts Due to Subsidiaries

	The Bank	
	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Financial institutions .....	47	53
Others .....	1,947	1,581
	<u>1,994</u>	<u>1,634</u>

## 32. Income Tax in the Balance Sheet

### (a) Current Taxation in the Balance Sheet Represents:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Provision for Hong Kong Profits Tax for the year (Note 12(a)) .....	64	265	—	153
Provisional Profits Tax paid .....	(51)	(189)	—	(134)
	13	76	—	19
Balance of Profits Tax provision relating to prior years .....	(1)	15	(14)	10
Overseas taxation .....	321	138	74	52
	<u>333</u>	<u>229</u>	<u>60</u>	<u>81</u>

### (b) Deferred Tax Assets and Liabilities Recognised

The components of deferred tax (assets)/liabilities recognised in the consolidated balance sheet and the movements during the year are as follows:

	The Group						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available-for-sale securities	Tax losses	Others	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<i>Deferred tax arising from:</i>							
At 1st January, 2008 .....	321	274	58	94	(59)	114	802
Charged/(credited) to profit and loss account (Note 12(a)) .....	26	(14)	(114)	—	(601)	(23)	(726)
Credited to reserves (Notes 37(c) and (h)) .....	—	(3)	—	(98)	—	—	(101)
Additions through acquisition .....	14	—	—	—	(2)	—	12
Exchange and other adjustments .....	—	—	7	—	1	(105)	(97)
At 31st December, 2008 .....	<u>361</u>	<u>257</u>	<u>(49)</u>	<u>(4)</u>	<u>(661)</u>	<u>(14)</u>	<u>(110)</u>

	The Group						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available-for-sale securities	Tax losses	Others	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<i>Deferred tax arising from:</i>							
At 1st January, 2007 .....	277	211	(18)	110	(23)	2	559
Write off against investment .....	—	—	—	—	—	(121)	(121)
Charged/(credited) to profit and loss account (Note 12(a)) .....	45	57	76	—	(35)	232	375
Charged to reserves (Notes 37(c) and (h)) .....	—	6	—	(16)	—	—	(10)
Exchange and other adjustments .....	(1)	—	—	—	(1)	1	(1)
At 31st December, 2007 .....	<u>321</u>	<u>274</u>	<u>58</u>	<u>94</u>	<u>(59)</u>	<u>114</u>	<u>802</u>

	The Bank						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available-for-sale securities	Tax losses	Others	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>Deferred tax arising from:</b>							
At 1st January, 2008 .....	313	274	(43)	94	(9)	113	742
Charged/(credited) to profit and loss account .....	34	(14)	(1)	—	(519)	(11)	(511)
Credited to reserves (Notes 37(c) and (h)) .....	—	(3)	—	(99)	—	—	(102)
Exchange and other adjustments .....	—	—	—	—	—	(104)	(104)
At 31st December, 2008 .....	<u>347</u>	<u>257</u>	<u>(44)</u>	<u>(5)</u>	<u>(528)</u>	<u>(2)</u>	<u>25</u>

	The Bank						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available-for-sale securities	Tax losses	Others	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>Deferred tax arising from:</b>							
At 1st January, 2007 .....	275	211	(12)	110	(23)	11	572
Write off against investment .....	—	—	—	—	—	(121)	(121)
Charged to profit and loss account ...	38	57	3	—	10	223	331
Charged to reserves (Notes 37(c) and (h)) .....	—	6	—	(16)	—	—	(10)
Transfer to The Bank of East Asia (China) Ltd. ....	—	—	(34)	—	4	—	(30)
At 31st December, 2007 .....	<u>313</u>	<u>274</u>	<u>(43)</u>	<u>94</u>	<u>(9)</u>	<u>113</u>	<u>742</u>

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Net deferred tax assets recognised on the balance sheet .....	(187)	(70)	(38)	(12)
Net deferred tax liabilities recognised on the balance sheet .	77	872	63	754
	<u>(110)</u>	<u>802</u>	<u>25</u>	<u>742</u>

### (c) Deferred Tax Assets Not Recognised

The Group has not recognised deferred tax assets in respect of cumulative tax losses of HK\$737 million (2007: HK\$674 million) as it is not probable that future taxable profits against which the losses can be utilized will be available in the relevant tax jurisdiction and entity. Under the current tax legislation, the expiry dates of the tax losses were as follows:

	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Expiring within 5 years .....	57	95
Expiring more than 5 years .....	7	8
No expiry date .....	<u>673</u>	<u>571</u>
	<u>737</u>	<u>674</u>

### 33. Other Liabilities

	The Group		The Bank	
	2008	2007	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>Mn</i>
(a) Trading Liabilities				
Exchange fund bills sold .....	330	1,098	330	1,098
Exchange fund notes sold .....	—	33	—	33
	<u>330</u>	<u>1,131</u>	<u>330</u>	<u>1,131</u>
Negative fair value of derivatives .....	<u>2,516</u>	<u>1,241</u>	<u>2,219</u>	<u>1,044</u>
	<u>2,846</u>	<u>2,372</u>	<u>2,549</u>	<u>2,175</u>
(b) Other Accounts and Provisions				
Accrued interest payable .....	1,953	1,586	1,035	1,186
Bankers acceptances .....	2,989	1,426	272	309
Other accounts .....	<u>7,197</u>	<u>7,985</u>	<u>2,172</u>	<u>2,967</u>
	<u>12,139</u>	<u>10,997</u>	<u>3,479</u>	<u>4,462</u>

### 34. Loan Capital

	The Group		The Bank	
	2008	2007	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
USD550 million 5.625% subordinated notes, measured at fair value through profit or loss .....	3,644	4,383	3,644	4,383
GBP300 million 6.125% step-up perpetual subordinated notes, measured at fair value through profit or loss .....	2,751	4,600	2,751	4,600
USD600 million floating rate step-up subordinated notes, measured at amortised cost .....	<u>4,641</u>	<u>4,669</u>	<u>4,641</u>	<u>4,669</u>
	<u>11,036</u>	<u>13,652</u>	<u>11,036</u>	<u>13,652</u>

Loan capital of face value of HK\$4,263 million (USD550 million) and carrying amount of HK\$3,644 million represents 5.625% subordinated notes qualifying as tier 2 capital which were issued on 13th December, 2005 by the Bank. The notes are listed on the Hong Kong Stock Exchange and will mature on 13th December, 2015.

Loan capital of face value of HK\$3,364 million (GBP300 million) and carrying amount of HK\$2,751 million represents 6.125% step-up perpetual subordinated notes qualifying as tier 2 capital which were issued on 20th March, 2007 by the Bank. The notes are listed on the Singapore Stock Exchange.

The carrying amount of financial liabilities designated at fair value through profit or loss as at 31st December, 2008 was HK\$1,232 million (2007: HK\$16 million) lower than the contractual amount at maturity for the Group and the Bank respectively. The difference in the accumulated amount of the changes in fair value attributable to changes in credit risk were HK\$1,858 million (2007: HK\$325 million) for the Group and the Bank respectively. The charge for the year ended 31st December, 2008 was HK\$2,183 million (2007: HK\$334 million) for the Group and the Bank respectively.

Loan capital of face value of HK\$4,650 million (USD600 million) and carrying amount of HK\$4,641 million represents floating rate step-up subordinated notes qualifying as tier 2 capital which were issued on 21st June, 2007 by the Bank. The notes are listed on the Singapore Stock Exchange and will mature on 22nd June, 2017. The fair value as of 31st December, 2008 was HK\$3,953 million (USD510 million). There was no material difference between the carrying amount and the fair value as of 31st December, 2007.

### 35. Equity Settled Share-based Transactions

The Bank has adopted Staff Share Option Schemes whereby the Board of the Bank may at its discretion grant to any employees, including Executive Directors and Chief Executive, of the Group options to subscribe for shares of the Bank. The options may be exercised during the period beginning on the first anniversary of the Date of Grant and ending on the fifth anniversary of the Date of Grant. All options were granted for nil consideration.

#### (a) Particulars of share options

Date of Grant	Vesting Period	Exercise Period	Exercise Price Per Share HK\$
02/5/2003 .....	02/5/2003 - 01/5/2004	02/5/2004 - 02/5/2008	14.90
22/4/2004 .....	22/4/2004 - 21/4/2005	22/4/2005 - 22/4/2009	23.23
03/5/2005 .....	03/5/2005 - 02/5/2006	03/5/2006 - 03/5/2010	22.95
03/5/2006 .....	03/5/2006 - 02/5/2007	03/5/2007 - 03/5/2011	33.05
10/5/2007 .....	10/5/2007 - 09/5/2008	10/5/2008 - 10/5/2012	47.13
05/8/2008 .....	05/5/2008 - 04/5/2009	05/5/2009 - 05/5/2013	44.10

#### (b) The number and weighted average exercise prices of share options are as follows:

	2008		2007	
	Weighted average exercise price HK\$	Number of options Mn	Weighted average exercise price HK\$	Number of options Mn
Outstanding at the beginning of the year .....	27.21	19	22.86	24
Exercised during the year .....	20.42	(5)	20.58	(8)
Granted during the year .....	44.10	6	47.13	3
Lapsed during the year .....	23.23	—	—	—
Outstanding at the end of the year .....	33.59	20	27.21	19
Exercisable at the end of the year .....	29.55	14	23.90	16

The weighted average share price at the date of exercise for shares options exercised during the year was HK\$33.72 (2007: HK\$46.16).

The options outstanding at 31st December, 2008 had an exercise price from HK\$22.95 to HK\$47.13 (2007: from HK\$14.90 to HK\$47.13) and a weighted average remaining contractual life of 2.44 years (2007: 2.35 years).

**(c) Fair value of share options and assumptions**

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the share option granted is measured based on a trinomial lattice model. The contractual life of the option is used as an input into this model.

	2008	2007
Fair value at measurement date .....	HK\$15.27	HK\$11.13
Share price .....	HK\$44.10	HK\$47.00
Exercise price .....	HK\$44.10	HK\$47.13
Expected volatility (expressed as weighted average volatility used in the modelling under trinomial lattice model) .....	48.88%	30.92%
Option life .....	5 years	5 years
Expected dividends .....	4.64%	4.82%
Risk-free interest rate (based on Exchange Fund Notes) .....	2.48%	4.10%

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility based on publicly available information. Expected dividends are based on historical dividends. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. There were no market conditions associated with the share option grants.

**36. Share Capital**

	2008		2007	
	No. of shares	Nominal value	No. of shares	Nominal value
	<i>million</i>	<i>HK\$ Mn</i>	<i>million</i>	<i>HK\$ Mn</i>
Authorised: Ordinary shares of HK\$2.50 each .....	<u>2,600</u>	<u>6,500</u>	<u>2,600</u>	<u>6,500</u>
Issued and fully paid:				
At 1st January .....	1,574	3,936	1,550	3,875
Shares issued under Staff Share Option Schemes.....	5	12	7	19
Subscription for new shares .....	79	197	—	—
Shares issued in lieu of dividends .....	15	38	17	42
At 31st December .....	<u>1,673</u>	<u>4,183</u>	<u>1,574</u>	<u>3,936</u>

Pursuant to the approved Staff Share Option Schemes (the “Schemes”), options to purchase ordinary shares in the Bank were granted to eligible employees. The option price of the Schemes equals the fair value of the underlying shares at the date of grant. The options granted under the Schemes will be exercisable between the first and the fifth anniversaries of the date of grant.

(a) **Shares Issued under Staff Share Option Scheme**

During the year, options were exercised to subscribe for 4,910,000 ordinary shares in the Bank at a consideration of HK\$100 million of which HK\$12 million was credited to share capital and the balance of HK\$88 million was credited to the share premium account (Note 37). HK\$9 million has been transferred from the capital reserve to the share premium account in accordance with policy set out in Note 2(q)(iv).

(b) **Terms of Unexpired and Unexercised Share Options at Balance Sheet Date**

<i>Date of options granted</i>	<i>Option price</i>	<u>2008</u>	<u>2007</u>
		<i>No. of shares</i>	<i>No. of shares</i>
02/5/2003 .....	HK\$14.90	—	2,205,000
22/4/2004 .....	HK\$23.23	2,765,000	3,915,000
03/5/2005 .....	HK\$22.95	6,105,000	7,230,000
03/5/2006 .....	HK\$33.05	2,700,000	3,200,000
10/5/2007 .....	HK\$47.13	2,750,000	2,750,000
05/5/2008 .....	HK\$44.10	5,500,000	—
		<u>19,820,000</u>	<u>19,300,000</u>

**37. Reserves**

	<u>2008</u>	
	<u>The Group</u>	<u>The Bank</u>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
(a) Share premium (undistributable)		
At 1st January .....	1,118	1,118
Net premium on shares issued under Staff Share Option Schemes .....	88	88
Transfer of the fair value of options from capital reserve - share options issued.....	9	9
Shares issued in lieu of dividends.....	(38)	(38)
Subscription for new shares .....	3,745	3,745
As 31st December .....	<u>4,922</u>	<u>4,922</u>
(b) General reserve		
At 1st January .....	14,004	13,757
Transfer from retained profits.....	18	—
Shares issued in lieu of dividends.....	597	597
Realised surplus on disposals transferred from property revaluation reserve.....	15	15
At 31st December .....	<u>14,634</u>	<u>14,369</u>
(c) Revaluation reserve on bank premises (undistributable)		
At 1st January .....	866	854
Recognition of net deferred tax liabilities (Note 32(b)).....	3	3
Revaluation surplus on bank premises transferred to investment properties .....	10	57
Realised surplus on disposals transferred to general reserve .....	(15)	(15)
Exchange adjustments .....	(1)	—
At 31st December .....	<u>863</u>	<u>899</u>
(d) Statutory reserves (undistributable)		
At 1st January .....	—	—
Transfer from retained profits.....	1,216	—
At 31st December .....	<u>1,216</u>	<u>—</u>

	2008	
	The Group	The Bank
	HK\$ Mn	HK\$ Mn
(e) Capital reserve (undistributable)		
At 1st January and 31st December .....	86	—
(f) Exchange revaluation reserve (undistributable)		
At 1st January .....	672	80
Exchange adjustments .....	334	(32)
At 31st December .....	1,006	48
(g) Capital reserve - staff share options issued (undistributable)		
At 1st January .....	68	68
Transfer of the fair value of options to share premium.....	(9)	(9)
Additions.....	66	66
At 31st December .....	125	125
(h) Investment revaluation reserve (undistributable)		
At 1st January .....	475	422
Changes in fair value of securities .....	(830)	(472)
Reversal upon disposal (Note 11).....	(115)	(114)
Recognition of deferred tax liabilities (Note 32(b)).....	98	99
Impairment loss.....	153	20
Exchange adjustments .....	(9)	—
At 31st December .....	(228)	(45)
(i) Retained Profits		
At 1st January .....	8,874	5,946
Net profit/(loss) for the year .....	39	(882)
Transfer to general reserve .....	(18)	—
Transfer to statutory reserve .....	(1,216)	—
Dividends (Note 14)		
- Interim dividend .....	(384)	(384)
- Final dividend in respect of previous year.....	(1,956)	(1,956)
At 31st December .....	5,339	2,724
(j) Total Reserves .....	27,963	23,042

	2007	
	The Group	The Bank
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
(a) Share premium (undistributable)		
At 1st January .....	1,012	1,012
Net premium on shares issued under Staff Share Option Schemes .....	136	136
Transfer of the fair value of options from capital reserve - share options issued.....	12	12
Shares issued in lieu of dividends.....	(42)	(42)
As 31st December .....	<u>1,118</u>	<u>1,118</u>
(b) General reserve At 1st January	13,257	13,027
Transfer from retained profits.....	17	—
Shares issued in lieu of dividends.....	730	730
At 31st December .....	<u>14,004</u>	<u>13,757</u>
(c) Revaluation reserve on bank premises (undistributable)		
At 1st January .....	836	838
Recognition of net deferred tax liabilities (Note 32(b)).....	(6)	(6)
Revaluation surplus on bank premises transferred to investment properties .....	36	36
Transfer to The Bank of East Asia (China) Ltd.....	—	(14)
At 31st December .....	<u>866</u>	<u>854</u>
(d) Statutory reserves (undistributable)		
At 1st January and 31st December.....	<u>—</u>	<u>—</u>
(e) Capital reserve (undistributable)		
At 1st January and 31st December.....	<u>86</u>	<u>—</u>
(f) Exchange revaluation reserve (undistributable)		
At 1st January .....	184	125
Exchange adjustments.....	488	(45)
At 31st December .....	<u>672</u>	<u>80</u>
(g) Capital reserve - staff share options issued (undistributable)		
At 1st January .....	52	52
Transfer of the fair value of options to share premium.....	(12)	(12)
Additions.....	28	28
At 31st December .....	<u>68</u>	<u>68</u>
(h) Investment revaluation reserve (undistributable)		
At 1st January .....	861	642
Changes in fair value of securities .....	(421)	(323)
Reversal upon disposal (Note 11).....	27	99
Recognition of deferred tax liabilities (Note 32(b)).....	16	16
Exchange adjustments .....	(8)	(12)
At 31st December .....	<u>475</u>	<u>422</u>

	2007	
	The Group	The Bank
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
(i) Retained profits		
At 1st January .....	7,099	5,294
Net profit for the year .....	4,144	3,004
Transfer to general reserve .....	(17)	—
Dividends (Note 14)		
- Interim dividend .....	(753)	(753)
- Final dividend in respect of previous year .....	(1,599)	(1,599)
At 31st December .....	<u>8,874</u>	<u>5,946</u>
(j) Total Reserves .....	<u>26,163</u>	<u>22,245</u>

The application of the share premium account is governed by Section 48B of the Hong Kong Companies Ordinance.

General reserve was set up from the transfer of retained earnings, the realised revaluation surplus on disposal of properties and the value of shares issued in lieu of dividend.

Revaluation reserve on bank premises and exchange revaluation reserve have been set up and are dealt with in accordance with the accounting policies adopted for the revaluation of bank premises and foreign currency translation.

Statutory reserves are set up to supplement the paid-up capital until the sum of paid-up capital and the statutory reserves is equal to the registered capital for a subsidiary and certain associates.

Capital reserve represents the capitalization of subsidiaries' reserves.

Capital reserve — staff share options issued comprises the fair value of the actual or estimated number of unexercised share options granted to employees of the Bank recognised in accordance with the accounting policy adopted for share based payment in Note 2(q)(iv).

Investment revaluation reserve comprises the cumulative net change in the fair value of available-for-sale securities held until the securities are derecognised and is dealt with in accordance with the accounting policies in Notes 2(f) and (k).

A regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purposes by earmarking amounts in respect of losses which the Bank will or may incur on loans and advances and investments in addition to impairment losses recognised. Movements in the reserve are earmarked directly through retained earnings and in consultation with the Hong Kong Monetary Authority. As at 31st December, 2008, HK\$1,996 million (2007: HK\$2,100 million) was included in the retained profits in this respect which was distributable to equity holders of the Group subject to consultation with the Hong Kong Monetary Authority.

At 31st December, 2008, the aggregate amount of reserves available for distribution to equity holders of the Bank was HK\$17,093 million (2007: HK\$19,703 million). After the balance sheet date the directors proposed a final dividend of HK\$0.02 per ordinary share (2007: HK\$1.18 per share), amounting to HK\$33 million (2007: HK\$1,858 million). The dividend has not been recognised as a liability at the balance sheet date.

### 38. Minority Interests

	2008	2007
	<u>HK\$ Mn</u>	<u>HK\$ Mn</u>
At 1st January .....	347	382
- sale of interests in businesses to minority interests investors .....	—	50
- purchase of interests in businesses from minority interests investors .....	(64)	(15)
- reversal upon disposal of available-for-sale financial assets .....	—	(149)
- final dividend in respect of previous year .....	(7)	—
- exchange adjustments .....	(2)	2
Profit for the year .....	<u>65</u>	<u>77</u>
At 31st December .....	<u><u>339</u></u>	<u><u>347</u></u>

### 39. Financial Risk Management

This section presents information on the Group's management of principal risks.

The Group has in place a risk management system to identify, measure, monitor and control the various types of risk that the Group faces and, where appropriate, to set strategy and allocate capital against those risks. The risk management policies covering credit risk, market risk, operational risk, liquidity risk, interest rate risk and foreign exchange risk of the Group are reviewed regularly by the Management and specialized risk management committees, and recommendations are made by the Risk Management Committee, which comprises the Group's Chairman and Chief Executive, Executive Director and Deputy Chief Executive, General Manager and Head of Investment Banking Division, General Manager and Head of Strategic Planning & Control Division who is also Group Chief Financial Officer and Chief Compliance Officer, Head of Operations Support Division and Chief Risk Officer, for the approval of the Board of Directors. There is an independent centralized risk management unit responsible for monitoring the activities relating to these principal risks. The internal auditors also perform regular audits on business units to check compliance with policies and procedures.

#### (a) Credit Risk Management

Credit risk arises from the possibility that a customer or counterparty in a transaction may default. Such risk may arise from counterparty risks from loan and advances, issuer risks from the securities business and counterparty risks from trading activities.

The Board of Directors has delegated authority to the Credit Committee to oversee management of the Group's credit risk, independent of the business units. The Credit Committee reports to the Board of Directors via the Risk Management Committee, which deals with all risk management related issues of the Group. Credit risk control limits are set at different levels and dimensions. The Board of Directors approves the core control limits and delegates the Credit Committee to approve the detailed control limits. Risk, return and market situations are considered in the limits setting. Active limit monitoring process is undertaken.

The Credit Committee is responsible for all credit risk related issues of the Group. The Group identifies and manages credit risk through defining target market segment, formulation of credit policies, credit approval process and monitoring of asset quality.

In evaluating the credit risk associated with an individual customer or counterparty, financial strength and repayment ability are always the primary considerations. Credit risk may be mitigated by obtaining collateral from the customer or counterparty.

The Group has established policies, procedures and rating systems to identify, measure, monitor and control credit risk. In this connection, guidelines for management of credit risk have been laid down in the Group's Credit Manual. These guidelines stipulate delegated lending authorities, credit extension criteria, credit monitoring process, internal rating structure, credit recovery and provisioning policy. They are reviewed and enhanced on an on-going basis to cater for the market change, statutory requirement and best practice risk management processes. The independent centralized risk management unit of the Group is responsible for monitoring activities relating to credit risk.

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The Group's credit risk management for the major types of credit risk is depicted as follows:

*(i) Corporate and bank credit risk*

The Group has laid down policies and procedures to evaluate the potential credit risk of a particular counterparty or transaction and to approve the transaction. For corporate and bank customers, the Group has different internal rating systems that are applied to each counterparty. For exposure classified as Specialized Lending in particular, supervisory slotting criteria are used. To monitor concentration risk, the Group has preset limits for exposures to individual industries and for borrowers and groups of borrowers. The Group also has a review process to ensure that the level of review and approval is proper and will depend on the size of the facility and rating of the credit.

The Group undertakes on-going credit analysis and monitoring at several levels. The policies are designed to promote early detection of counterparty, industry or product exposures that require special monitoring. The overall portfolio risk as well as individual impaired loans and potential impaired loans are monitored on a regular basis.

*(ii) Retail credit risk*

The Group's retail credit policy and approval process are designed for the fact that there are high volumes of relatively homogeneous and small value transactions in each retail loan category. The design of internal rating system and formulation of credit policies are primarily based on the demographic factors and the loss experience of the loan portfolios. The Group monitors its own and industry experience to determine and periodically revise product terms and desired customer profiles.

*(iii) Credit for treasury transactions*

The credit risk of the Group's treasury transactions is managed in the same way as the Group manages its corporate lending risk. The Group applies an internal rating system to its counterparties and sets individual counterparty limits.

*(iv) Credit-related commitment*

The risks involved in credit-related commitments and contingencies are essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans.

*(v) Concentrations of credit risk*

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio of financial instruments is diversified along geographic, industry and product sectors.

The Group monitors its concentration risk by adopting appropriate risk control measures, such as setting limits on exposures to different industries and loan portfolios.

(vi) *Maximum exposure*

The maximum exposure to credit risk at the balance sheet date without taking into consideration of any collateral held or other credit enhancements is represented by the carrying amount of each financial assets in the balance sheet after deducting any impairment allowance. A summary of the maximum exposure is as follows:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Cash and balances with banks, central banks and other financial institutions .....	27,022	17,029	4,154	2,501
Placements with banks, central banks and other financial institutions .....	96,574	94,704	92,735	83,123
Trade bills.....	1,164	812	521	470
Trading assets.....	2,260	2,765	1,777	2,603
Financial assets designated at fair value through profit or loss .....	4,130	8,658	4,114	8,641
Loans and advances to customers.....	230,339	218,184	131,123	134,858
Available-for-sale financial assets .....	17,551	10,473	10,276	9,286
Held-to-maturity investments.....	5,006	10,761	3,318	8,773
Other assets .....	11,478	12,312	7,376	6,209
Financial guarantees and other credit related contingent liabilities .....	10,088	10,965	9,138	10,891
Loan commitments and other credit related commitments ..	66,080	67,771	53,283	52,858
	<u>471,692</u>	<u>454,434</u>	<u>317,815</u>	<u>320,213</u>

(vii) *Credit quality of loans and advances*

Loans and advances to banks are only made to banks with good credit standing. At 31st December, 2008 and 2007, no loans and advances to bank are impaired. The credit quality of loans and advances to customers can be analysed as follows:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Gross loans and advances to customers				
- neither past due nor impaired .....	228,479	216,485	129,683	133,852
- past due but not impaired .....	274	457	166	109
- impaired.....	1,586	1,242	1,274	897
	<u>230,339</u>	<u>218,184</u>	<u>131,123</u>	<u>134,858</u>

Of which:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Gross loans and advances to customers that are neither past due nor impaired				
- Pass .....	226,550	214,476	128,219	132,488
- Special mention.....	1,929	2,009	1,464	1,364
	<u>228,479</u>	<u>216,485</u>	<u>129,683</u>	<u>133,852</u>

The Group classifies the loans and advances in accordance with the loan classification system required to be adopted for reporting to the HKMA.

The ageing analysis of loans and advances to customers that are past due but not impaired is as follows:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Gross loans and advances to customers that are past due but not impaired				
- Overdue 3 months or less.....	274	409	166	109
- 6 months or less but over 3 months .....	—	16	—	—
- 1 year or less but over 6 months .....	—	32	—	—
	<u>274</u>	<u>457</u>	<u>166</u>	<u>109</u>

Loans and advances that would be past due or impaired had the terms not been renegotiated amounted to HK\$239 million as at 31st December, 2008 (2007: HK\$283 million).

*(viii) Credit quality of financial assets other than loans and advances*

Credit risk of treasury transactions is managed in the same way as the Group manages its corporate lending risk and risk gradings are applied to the counterparties with individual counterparty limits set.

At the balance sheet date, the credit quality of investment in debt securities analysed by designation of external credit assessment institution, Moody's Investor Services, or equivalent, is as follow:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Aaa .....	1,790	9,983	1,608	9,869
Aa1 to Aa3.....	5,706	4,524	4,604	3,355
A1 to A3 .....	2,706	1,919	2,029	1,413
Lower than A3 .....	<u>1,121</u>	<u>5,319</u>	<u>851</u>	<u>4,911</u>
	11,323	21,745	9,092	19,548
Unrated.....	<u>2,440</u>	<u>2,747</u>	<u>2,440</u>	<u>2,747</u>
Total .....	<u>13,763</u>	<u>24,492</u>	<u>11,532</u>	<u>22,295</u>

(ix) *Collateral and other credit enhancements*

The Group holds collateral against loans and advances to customers in the forms of mortgages over property, other registered securities over assets, cash deposits and guarantees. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collaterals held as security for financial assets other than loans and advances is determined by the nature of the instrument.

Debt securities, treasury and other eligible bills are generally unsecured with the exception of asset-based securities and similar instruments, which are secured by pools of financial assets. The Group entered into the ISDA Master Agreement which contractually binds both parties to apply close-out netting arrangement across outstanding derivatives.

The lower of gross loan amount and the estimate of the fair value of collateral and other credit enhancements held against financial assets is as follows:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Fair value of collateral and other credit enhancements held against financial assets that are:				
- neither past due nor impaired .....	178,200	167,370	95,567	102,777
- past due but not impaired .....	210	360	147	86
	<u>178,410</u>	<u>167,730</u>	<u>95,714</u>	<u>102,863</u>

(b) **Market risk management**

Market risk arises from all market risk sensitive financial instruments, including debt securities, foreign exchange contracts, equity and derivative instruments, as well as from balance sheet or structural positions. The objective of market risk management is to reduce the Group's exposure to the volatility inherent in financial instruments.

The Board of Directors reviews and approves policies for the management of market risks. The Board has delegated the responsibility for ongoing market risk management to the Asset and Liability Management Committee. The Asset and Liability Management Committee reports to the Board of Directors via the Risk Management Committee.

The Asset and Liability Management Committee deals with all market risk and liquidity risk related issues of the Group. It is also responsible for deciding the future business strategy with respect to interest rates trend review.

The use of derivatives for proprietary trading and their sale to customers as risk management products is an integral part of the Group's business activities. These instruments are also used to manage the Group's own exposures to market risk, as part of its asset and liability management process. The principal derivatives instruments used by the Group are interest rate, foreign exchange and equity related contracts, in the form of both over-the-counter derivatives and exchange traded derivatives. Most of the Group's derivatives positions have been entered into to meet customer demand and to manage the risk of these and other trading positions.

In this connection, the key types of risk to manage are:

(i) *Currency risk*

The Group's foreign currency positions arise from foreign exchange dealing, commercial banking operations and structural foreign currency exposures. All foreign currency positions are managed within limits approved by the Board.

Structural foreign currency positions, which arise mainly from foreign currency investments in the Group's branches, subsidiaries and associated companies, are excluded from VaR measurements, as related gains or losses are taken to reserves. Such foreign currency positions are managed with the principal objective of ensuring that the Group's reserves are protected from exchange rate fluctuations. The Group seeks to match closely its foreign currency denominated assets with corresponding liabilities in the same currencies.

The following table indicates the concentration of currency risk at the balance sheet date:

### The Group

	2008				2007			
	USD	CNY	Other foreign currencies	Total	USD	CNY	Other foreign currencies	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>Assets</b>								
Cash and balances with banks and other financial institutions .....	2,425	23,215	1,263	26,903	1,331	11,133	870	13,334
Placements with banks and other financial institutions .....	28,670	1,252	18,795	48,717	36,794	2,179	19,554	58,527
Trade bills .....	1,078	—	72	1,150	564	198	31	793
Trading assets .....	652	438	160	1,250	792	—	192	984
Financial assets designated at fair value through profit or loss ...	2,158	—	631	2,789	6,278	—	316	6,594
Advances to customers and other accounts .....	42,442	75,119	17,419	134,980	38,066	61,919	18,670	118,655
Available-for-sale financial assets .....	3,261	6,184	3,594	13,039	2,427	118	2,588	5,133
Held-to-maturity investments .....	1,941	—	1,864	3,805	7,786	—	1,540	9,326
Investment in associates .....	292	—	—	292	327	—	—	327
Fixed assets .....	211	3,083	267	3,561	188	53	303	544
Goodwill and intangible assets ....	241	20	386	647	249	1	331	581
Deferred tax assets .....	161	—	8	169	57	—	10	67
Spot assets .....	<u>83,532</u>	<u>109,311</u>	<u>44,459</u>	<u>237,302</u>	<u>94,859</u>	<u>75,601</u>	<u>44,405</u>	<u>214,865</u>
<b>Liabilities</b>								
Deposits and balances of banks and other financial institutions .....	(1,456)	(25,020)	(297)	(26,773)	(742)	(35,965)	(2,174)	(38,881)
Deposits from customers .....	(59,678)	(73,464)	(41,000)	(174,142)	(69,467)	(33,681)	(37,959)	(141,107)
Trading liabilities .....	(1,595)	(148)	(199)	(1,942)	(317)	—	(141)	(458)
Certificates of deposit issued .....	(2,452)	—	(426)	(2,878)	(1,497)	—	(553)	(2,050)
Current taxation .....	(27)	(192)	(31)	(250)	(14)	(68)	(53)	(135)
Deferred tax liabilities .....	(4)	—	—	(4)	(4)	—	—	(4)
Other accounts and provisions ....	(2,176)	(4,524)	(966)	(7,666)	(1,494)	(669)	(1,640)	(3,803)
Loan capital .....	(8,285)	—	(2,751)	(11,036)	(9,052)	—	(4,600)	(13,652)
Spot liabilities .....	<u>(75,673)</u>	<u>(103,348)</u>	<u>(45,670)</u>	<u>(224,691)</u>	<u>(82,587)</u>	<u>(70,383)</u>	<u>(47,120)</u>	<u>(200,090)</u>
Forward purchases .....	51,244	18,872	11,843	81,959	36,089	3,399	15,231	54,719
Forward sales .....	(55,976)	(18,781)	(8,713)	(83,470)	(45,224)	(4,418)	(11,369)	(61,011)
Net option position .....	3	—	(4)	(1)	(10)	—	22	12
Net long non-structural position .	<u>3,130</u>	<u>6,054</u>	<u>1,915</u>	<u>11,099</u>	<u>3,127</u>	<u>4,199</u>	<u>1,169</u>	<u>8,495</u>
Net structural position .....	<u>2,179</u>	<u>6,602</u>	<u>940</u>	<u>9,721</u>	<u>1,792</u>	<u>4,771</u>	<u>891</u>	<u>7,454</u>

## The Bank

	2008				2007			
	USD	CNY	Other foreign currencies	Total	USD	CNY	Other foreign currencies	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
<b>Assets</b>								
Cash and balances with banks and other financial institutions .....	1,107	1,373	962	3,442	557	1,375	680	2,612
Placements with banks and other financial institutions .....	26,730	—	18,795	45,525	29,405	—	19,228	48,633
Trade bills .....	454	—	55	509	425	—	26	451
Trading assets .....	611	1	159	771	778	—	44	822
Financial assets designated at fair value through profit or loss ...	2,141	—	631	2,772	6,262	—	316	6,578
Advances to customers and other accounts .....	20,184	18	14,602	34,804	17,532	7	14,810	32,349
Available-for-sale financial assets..	2,178	428	3,511	6,117	1,305	118	2,487	3,910
Amounts due from subsidiaries ...	12,663	549	—	13,212	206	—	634	840
Held-to-maturity investments .....	1,098	—	1,738	2,836	6,823	—	1,384	8,207
Investment in subsidiaries and associates.....	1,786	—	361	2,147	1,233	—	209	1,442
Fixed assets .....	9	—	203	212	7	—	189	196
Deferred tax assets.....	33	—	5	38	6	—	6	12
Spot assets.....	<u>68,994</u>	<u>2,369</u>	<u>41,022</u>	<u>112,385</u>	<u>64,539</u>	<u>1,500</u>	<u>40,013</u>	<u>106,052</u>
<b>Liabilities</b>								
Deposits and balances of banks and other financial institutions .....	(620)	—	(202)	(822)	(647)	—	(1,755)	(2,402)
Deposits from customers .....	(48,260)	(2,488)	(39,107)	(89,855)	(52,751)	(1,477)	(36,323)	(90,551)
Trading liabilities .....	(1,464)	—	(181)	(1,645)	(207)	—	(53)	(260)
Certificates of deposit issued .....	(2,452)	—	(426)	(2,878)	(1,497)	—	(553)	(2,050)
Amounts due to subsidiaries.....	(552)	—	(198)	(750)	(1,111)	—	(2)	(1,113)
Current taxation .....	(29)	—	(45)	(74)	(5)	—	(47)	(52)
Other accounts and provisions ....	(821)	(6)	(829)	(1,656)	(927)	(2)	(745)	(1,674)
Loan capital .....	(8,285)	—	(2,751)	(11,036)	(9,052)	—	(4,600)	(13,652)
Spot liabilities .....	<u>(62,483)</u>	<u>(2,494)</u>	<u>(43,739)</u>	<u>(108,716)</u>	<u>(66,197)</u>	<u>(1,479)</u>	<u>(44,078)</u>	<u>(111,754)</u>
Forward purchases.....	44,169	15	11,820	56,004	33,069	216	14,800	48,085
Forward sales.....	(49,326)	(19)	(8,184)	(57,529)	(43,248)	(371)	(10,749)	(54,368)
Net option position .....	<u>3</u>	<u>—</u>	<u>(4)</u>	<u>(1)</u>	<u>(10)</u>	<u>—</u>	<u>22</u>	<u>12</u>
Net long/(short) non-structural position .....	<u>1,357</u>	<u>(129)</u>	<u>915</u>	<u>2,143</u>	<u>(11,847)</u>	<u>(134)</u>	<u>8</u>	<u>(11,973)</u>
Net structural position.....	<u>2,179</u>	<u>6,602</u>	<u>940</u>	<u>9,721</u>	<u>1,792</u>	<u>4,771</u>	<u>891</u>	<u>7,454</u>

### (ii) Interest rate risk

The Group's interest rate positions arise from treasury and commercial banking activities. Interest rate risk arises in both trading portfolios and non-trading portfolios. Interest rate risk primarily results from the timing differences in the repricing of interest-bearing assets, liabilities and commitments. It also relates to positions from non-interest bearing liabilities including shareholders' funds and current accounts, as well as from certain fixed rate loans and liabilities. Interest rate risk is managed daily by the Treasury Department within the limits approved by the Board of Directors. The instruments used to manage interest rate risk include interest rate swaps and other derivatives.

(iii) *Equity risk*

The Group's equity positions arise from equity investment and dynamic hedging of equity options in connection with the Bank's linked deposit business. Equity risk is managed daily by the Investment Department within the limits approved by the Board of Directors.

Market risk control limits have been set at varying levels according to the practical requirements of different units. The Board of Directors approves the core control limits and has delegated the power to set detailed control limits to the Asset and Liability Management Committee. Risk, return and market conditions are considered when setting limits. Active limit monitoring is carried out.

In this connection, the Asset and Liability Management Committee monitors the related market risk arising from risk-taking activities of the Group, to ensure that overall and individual market risks are within the Group's risk tolerance level. Risk exposures are monitored on a frequent basis to ensure that they are within established control limits.

The Group quantifies the market risk of the underlying trading portfolio by means of value-at-risk ("VaR"). VaR is a statistical estimate that measures the potential losses in market value of a portfolio as a result of unfavourable movements in market rates and prices, if positions are held unchanged over a certain horizon time period.

The Group estimates VaR for the Group's trading portfolio by the Parametric Approach, where the VaR is derived from the underlying variances and covariances of the constituents of a portfolio. This methodology uses historical movements in market rates and prices, a 99% confidence level, a one-day holding period, a one-year historical observation period with higher weights being assigned to more recent observations, and takes into account correlations between different markets and rates.

Structural foreign exchange positions arising from net investments in branches and subsidiaries are not included in the VaR for the foreign exchange trading position.

The book value of listed shares, as well as the book value of private equity funds and unlisted equities (excluding credit-related unlisted securities) (collectively the "Unlisted Securities"), are subject to limits and these are monitored by the management of the Group. The Unlisted Securities and listed non-trading equities are not included in the VaR for the equity trading position, and are managed through delegated limits. The limits are subject to regular review by the Board.

**Value-at-risk statistics**

	2008			
	At 31st	Maximum	Minimum	Mean
	December			
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
VaR for total trading activities.....	70	139	39	73
VaR for foreign exchange trading positions* .....	12	21	1	5
VaR for interest rate trading positions.....	1	2	—	1
VaR for equity trading positions.....	57	123	38	69
	2007			
	At 31st	Maximum	Minimum	Mean
	December			
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
VaR for total trading activities.....	62	98	22	54
VaR for foreign exchange trading positions* .....	1	9	1	1
VaR for interest rate trading positions.....	1	1	—	—
VaR for equity trading positions.....	61	95	21	53

\* Included all foreign exchange positions but excluded structured foreign exchange positions.

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**(c) Operational risk management**

Operational risk is the risk arising from the potential loss due to inadequate or failed internal processes, people and systems or from external events.

The objective of operational risk management is to identify, assess and monitor operational risk and, in particular, to comply with the relevant regulatory requirements.

The Group has implemented a centralized risk management framework since January 2006. The Board of Directors reviews and approves the policies for operational risk management, and it has delegated the responsibility for ongoing operational risk management to the Operational Risk Management Committee. The Operational Risk Management Committee regularly reports status of operational risk management to the Board of Directors via the Risk Management Committee. The independent centralized risk management unit of the Group is responsible for monitoring activities relating to operational risk.

Operational risk management tools adopted include operational risk incidents reporting, control self-assessment, key risk indicators, operation manuals, insurance policies, business continuity planning, etc.

Furthermore, the independent centralized risk management unit of the Group has also performed self-assessment on the Group's compliance with the requirements of HKMA Supervisory Policy Manual on Operational Risk Management, with satisfactory result which has been reviewed independently by the Internal Audit Department.

**(d) Liquidity risk management**

The purpose of liquidity management is to ensure sufficient cash flows to meet all financial commitment and to capitalize on opportunities for business expansion. This includes the Group's ability to meet deposit withdrawals either on demand or at contractual maturity, to repay borrowings as they mature, to comply with the statutory liquidity ratio, and to make new loans and investments as opportunities arise.

The management of the Bank's liquidity risk is governed by the Liquidity Risk Management Policy, endorsed by the Risk Management Committee and approved by the Board of Directors. The Asset and Liability Management Committee is delegated by the Board of Directors to oversee the Bank's liquidity risk management, set the strategy and policy for managing liquidity risk and the means for ensuring that such strategy and policy are implemented. Liquidity risk is daily managed by the Treasury Department within the limits approved by the Board of Directors. The independent centralized risk management unit of the Group is responsible for monitoring the activities of the Treasury Department in compliance with the Liquidity Risk Management Manual and Policy. The Internal Audit Department performs periodic review to make sure the liquidity risk management functions are effectively carried out.

The Group manages liquidity risk by holding sufficient liquid assets (e.g. cash and short term funds and securities) of appropriate quality to ensure that short term funding requirements are covered within prudent limits. Adequate standby facilities are maintained to provide strategic liquidity to meet unexpected and material cash outflows in the ordinary course of business.

The Group conducts stress testing regularly to analyze liquidity risk and has formulated a contingency plan that sets out a strategy for dealing with a liquidity problem and the procedures for making up cash flow deficits in emergency situations.

In addition to observing the statutory liquidity ratio, the Bank also monitors the loan to deposit ratio and maturity mismatch between assets and liabilities to control the Bank's liquidity risk.

Analysis of assets and liabilities by remaining maturity:

The Group

	2008						Total
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
<b>Assets</b>							
Cash and balances with banks and other financial institutions .....	19,099	67	—	—	—	8,939	28,105
Placements with banks and other financial institutions .....	—	82,624	13,950	—	—	—	96,574
Trade bills.....	18	991	139	—	—	16	1,164
Trading assets .....	—	400	2	81	43	2,911	3,437
Financial assets designated at fair value through profit or loss .....	—	140	448	3,104	438	—	4,130
Advances to customers and other accounts.....	4,431	43,750	42,249	86,169	55,285	11,841	243,725
Available-for-sale financial assets.....	—	5,441	5,651	5,510	949	1,009	18,560
Held-to-maturity investments .....	—	980	1,546	2,160	320	—	5,006
Undated assets .....	—	—	—	—	—	14,553	14,553
Total assets .....	<u>23,548</u>	<u>134,393</u>	<u>63,985</u>	<u>97,024</u>	<u>57,035</u>	<u>39,269</u>	<u>415,254</u>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .....	871	18,150	7,644	362	10	8	27,045
Deposits from customers .....	86,109	192,093	35,341	9,237	1,022	—	323,802
— Demand deposits and current accounts.....	36,332	—	—	—	—	—	36,332
— Savings deposit.....	45,781	—	—	—	—	—	45,781
— Time, call and notice deposits .....	3,996	192,093	35,341	9,237	1,022	—	241,689
Trading liabilities .....	—	130	200	—	—	2,516	2,846
Certificates of deposit issued .....	—	1,941	881	2,028	641	—	5,491
Current taxation .....	—	—	333	—	—	—	333
Loan capital.....	—	—	—	11,036	—	—	11,036
Undated liabilities .....	—	—	—	—	—	12,216	12,216
Total liabilities .....	<u>86,980</u>	<u>212,314</u>	<u>44,399</u>	<u>22,663</u>	<u>1,673</u>	<u>14,740</u>	<u>382,769</u>
Net gap .....	<u>(63,432)</u>	<u>(77,921)</u>	<u>19,586</u>	<u>74,361</u>	<u>55,362</u>		

	2007						Total
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
<b>Assets</b>							
Cash and balances with banks and other financial institutions .....	13,583	63	—	—	—	4,207	17,853
Placements with banks and other financial institutions .....	—	90,574	4,130	—	—	—	94,704
Trade bills .....	58	624	91	—	—	39	812
Trading assets .....	—	798	397	—	18	3,634	4,847
Financial assets designated at fair value through profit or loss .....	—	155	523	7,980	—	—	8,658
Advances to customers and other accounts.....	4,211	36,840	34,529	83,440	61,708	11,012	231,740
Available-for-sale financial assets.....	—	1,922	4,681	2,899	971	1,744	12,217
Held-to-maturity investments .....	—	970	6,096	2,607	1,088	—	10,761
Undated assets .....	—	—	—	—	—	12,387	12,387
Total assets .....	<u>17,852</u>	<u>131,946</u>	<u>50,447</u>	<u>96,926</u>	<u>63,785</u>	<u>33,023</u>	<u>393,979</u>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .....	3,722	17,592	17,685	50	10	1	39,060
Deposits from customers .....	81,228	178,156	17,107	7,659	36	—	284,186
— Demand deposits and current accounts.....	29,990	—	—	—	—	—	29,990
— Savings deposit.....	49,216	—	—	—	—	—	49,216
— Time, call and notice deposits .....	2,022	178,156	17,107	7,659	36	—	204,980
Trading liabilities .....	—	1,098	—	33	—	1,241	2,372
Certificates of deposit issued .....	—	288	9,663	1,326	888	—	12,165
Current taxation .....	—	—	229	—	—	—	229
Loan capital.....	—	—	—	9,269	4,383	—	13,652
Undated liabilities .....	—	—	—	—	—	11,869	11,869
Total liabilities .....	<u>84,950</u>	<u>197,134</u>	<u>44,684</u>	<u>18,337</u>	<u>5,317</u>	<u>13,111</u>	<u>363,533</u>
Net gap .....	<u>(67,098)</u>	<u>(65,188)</u>	<u>5,763</u>	<u>78,589</u>	<u>58,468</u>		

## The Bank

	2008						Total
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
<b>Assets</b>							
Cash and balances with banks and other financial institutions .....	4,189	—	—	—	—	663	4,852
Placements with banks and other financial institutions .....	—	78,787	13,948	—	—	—	92,735
Trade bills .....	14	356	135	—	—	16	521
Trading assets .....	—	400	2	81	43	2,388	2,914
Financial assets designated at fair value through profit or loss .....	—	140	448	3,088	438	—	4,114
Advances to customers and other accounts.....	4,319	27,088	16,085	51,694	31,570	7,884	138,640
Available-for-sale financial assets.....	—	1,136	3,947	5,067	126	709	10,985
Held-to-maturity investments .....	—	462	1,092	1,653	111	—	3,318
Undated assets .....	—	—	—	—	—	37,140	37,140
<b>Total assets .....</b>	<b>8,522</b>	<b>108,369</b>	<b>35,657</b>	<b>61,583</b>	<b>32,288</b>	<b>48,800</b>	<b>295,219</b>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .....	329	749	7	—	—	8	1,093
Deposits from customers .....	54,219	166,314	18,439	1,057	—	—	240,029
— Demand deposits and current accounts.....	10,272	—	—	—	—	—	10,272
— Savings deposit.....	43,262	—	—	—	—	—	43,262
— Time, call and notice deposits .....	685	166,314	18,439	1,057	—	—	186,495
Trading liabilities .....	—	130	200	—	—	2,219	2,549
Certificates of deposit issued .....	—	1,941	881	2,028	2,841	—	7,691
Current taxation .....	—	—	60	—	—	—	60
Loan capital.....	—	—	—	11,036	—	—	11,036
Undated liabilities .....	—	—	—	—	—	5,536	5,536
<b>Total liabilities .....</b>	<b>54,548</b>	<b>169,134</b>	<b>19,587</b>	<b>14,121</b>	<b>2,841</b>	<b>7,763</b>	<b>267,994</b>
<b>Net gap .....</b>	<b>(46,026)</b>	<b>(60,765)</b>	<b>16,070</b>	<b>47,462</b>	<b>29,447</b>		

	2007						Total
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
<b>Assets</b>							
Cash and balances with banks and other financial institutions .....	2,721	—	—	—	—	412	3,133
Placements with banks and other financial institutions .....	—	80,493	2,630	—	—	—	83,123
Trade bills .....	34	312	85	—	—	39	470
Trading assets .....	—	798	397	—	18	3,408	4,621
Financial assets designated at fair value through profit or loss .....	—	154	523	7,964	—	—	8,641
Advances to customers and other accounts.....	3,862	23,246	12,886	52,567	42,388	6,743	141,692
Available-for-sale financial assets.....	—	1,903	4,393	2,745	244	1,323	10,608
Held-to-maturity investments .....	—	735	5,554	1,821	663	—	8,773
Undated assets .....	—	—	—	—	—	37,412	37,412
Total assets .....	<u>6,617</u>	<u>107,641</u>	<u>26,468</u>	<u>65,097</u>	<u>43,313</u>	<u>49,337</u>	<u>298,473</u>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .....	369	1,923	287	—	—	2	2,581
Deposits from customers .....	56,358	164,306	9,445	2,479	—	—	232,588
— Demand deposits and current accounts.....	10,144	—	—	—	—	—	10,144
— Savings deposit.....	46,189	—	—	—	—	—	46,189
— Time, call and notice deposits .....	25	164,306	9,445	2,479	—	—	176,255
Trading liabilities .....	—	1,099	—	33	—	1,043	2,175
Certificates of deposit issued .....	—	289	9,662	1,326	3,088	—	14,365
Current taxation .....	—	—	81	—	—	—	81
Loan capital.....	—	—	—	9,270	4,382	—	13,652
Undated liabilities .....	—	—	—	—	—	6,850	6,850
Total liabilities .....	<u>56,727</u>	<u>167,617</u>	<u>19,475</u>	<u>13,108</u>	<u>7,470</u>	<u>7,895</u>	<u>272,292</u>
Net gap .....	<u>(50,110)</u>	<u>(59,976)</u>	<u>6,993</u>	<u>51,989</u>	<u>35,843</u>		

As the trading and available-for-sale portfolios may be sold before maturity or deposits from customers may mature without being withdrawn, the contractual maturity dates do not represent expected dates of future cash flows.

The following tables provide an analysis of the residual contractual maturities of non-derivatives financial liabilities of the Group at the balance sheet date:

## The Group

	2008							Undated HK\$ Mn
	Carrying Amount	Gross cash outflow	Repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
Deposits and balances of banks and other financial institutions .....	27,045	27,374	871	18,293	7,803	389	10	8
Deposits from customers .....	323,802	326,711	86,289	193,188	36,028	9,964	1,242	—
— Demand deposits and current accounts .....	36,332	36,332	36,332	—	—	—	—	—
— Savings deposit.....	45,781	45,781	45,781	—	—	—	—	—
— Time, call and notice deposits .....	241,689	244,598	4,176	193,188	36,028	9,964	1,242	—
Trading liabilities .....	2,846	2,846	—	130	200	—	—	2,516
Certificates of deposit issued .....	5,491	5,625	—	1,996	911	2,077	641	—
Current taxation .....	333	333	—	—	333	—	—	—
Loan capital.....	11,036	12,621	—	130	422	12,069	—	—
Interest rate swaps.....	1,792	1,792	—	297	522	835	138	—
Other liabilities .....	12,216	12,216	—	—	—	—	—	12,216
Total.....	<u>384,561</u>	<u>389,518</u>	<u>87,160</u>	<u>214,034</u>	<u>46,219</u>	<u>25,334</u>	<u>2,031</u>	<u>14,740</u>

	2007							Undated HK\$ Mn
	Carrying Amount	Gross cash outflow	Repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
Deposits and balances of banks and other financial institutions .....	39,060	39,649	3,741	17,784	18,063	49	10	2
Deposits from customers .....	284,186	286,298	81,232	179,299	17,674	8,054	39	—
— Demand deposits and current accounts .....	29,990	29,990	29,990	—	—	—	—	—
— Savings deposit.....	49,216	49,216	49,216	—	—	—	—	—
— Time, call and notice deposits .....	204,980	207,092	2,026	179,299	17,674	8,054	39	—
Trading liabilities .....	2,372	2,377	—	1,099	2	35	—	1,241
Certificates of deposit issued .....	12,165	12,635	—	365	9,995	1,387	888	—
Current taxation .....	229	229	—	—	229	—	—	—
Loan capital.....	13,652	16,861	—	210	584	11,684	4,383	—
Interest rate swaps.....	2,247	2,247	72	151	366	1,449	209	—
Other liabilities .....	11,869	11,869	—	—	—	—	—	11,869
Total.....	<u>365,780</u>	<u>372,165</u>	<u>85,045</u>	<u>198,908</u>	<u>46,913</u>	<u>22,658</u>	<u>5,529</u>	<u>13,112</u>

## The Bank

2008

	Carrying Amount	Gross cash outflow	Repayable on demand	Less than three months	Between	Between one and five years	More than five years	Undated
					three months and one year			
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Deposits and balances of banks and other financial institutions .....	1,093	1,094	329	750	7	—	—	8
Deposits from customers .....	240,029	241,201	54,219	167,044	18,744	1,194	—	—
— Demand deposits and current accounts .....	10,272	10,272	10,272	—	—	—	—	—
— Savings deposit .....	43,262	43,262	43,262	—	—	—	—	—
— Time, call and notice deposits .....	186,495	187,667	685	167,044	18,744	1,194	—	—
Trading liabilities .....	2,549	2,549	—	130	200	—	—	2,219
Certificates of deposit issued .....	7,691	7,825	—	1,996	911	2,077	2,841	—
Current taxation .....	60	60	—	—	60	—	—	—
Loan capital .....	11,036	12,621	—	130	422	12,069	—	—
Interest rate swaps .....	1,285	1,285	—	226	373	616	70	—
Other liabilities .....	5,536	5,695	—	10	23	68	58	5,536
Total .....	<u>269,279</u>	<u>272,330</u>	<u>54,548</u>	<u>170,286</u>	<u>20,740</u>	<u>16,024</u>	<u>2,969</u>	<u>7,763</u>

2007

	Carrying Amount	Gross cash outflow	Repayable on demand	Less than three months	Between	Between one and five years	More than five years	Undated
					three months and one year			
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Deposits and balances of banks and other financial institutions .....	2,581	2,597	369	1,937	289	—	—	2
Deposits from customers .....	232,588	233,975	56,358	165,342	9,773	2,502	—	—
— Demand deposits and current accounts .....	10,144	10,144	10,144	—	—	—	—	—
— Savings deposit .....	46,189	46,189	46,189	—	—	—	—	—
— Time, call and notice deposits .....	176,255	177,642	25	165,342	9,773	2,502	—	—
Trading liabilities .....	2,175	2,179	—	1,099	2	35	—	1,043
Certificates of deposit issued .....	14,365	14,835	—	365	9,995	1,388	3,087	—
Current taxation .....	81	81	—	—	81	—	—	—
Loan capital .....	13,652	16,861	—	210	584	11,684	4,383	—
Interest rate swaps .....	2,247	2,247	73	150	365	1,449	210	—
Other liabilities .....	6,850	6,856	2	4	—	—	—	6,850
Total .....	<u>274,539</u>	<u>279,631</u>	<u>56,802</u>	<u>169,107</u>	<u>21,089</u>	<u>17,058</u>	<u>7,680</u>	<u>7,895</u>

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(e) **Interest rate risk management**

The management of the Bank's interest rate risk is governed by the Interest Rate Risk Management Policy endorsed by Risk Management Committee and approved by the Board of Directors. The Asset and Liability Management Committee is delegated by the Board of Directors to oversee the Bank's interest rate risk management, set the strategy and policy for managing interest rate risk and the means for ensuring that such strategy and policy are implemented. Interest rate risk is daily managed by the Treasury Department within the limits approved by the Board of Directors. The independent centralized risk management unit of the Group is responsible for monitoring the activities of the Treasury Department in compliance with the Interest Rate Risk Management Manual and Policy. The Internal Audit Department performs periodic review to make sure the interest rate risk management functions are effectively carried out.

The Bank manages the interest rate risk on the banking book primarily by focusing on the repricing mismatches. Gap analysis provides a static view of the maturity and repricing characteristics of the Bank's balance sheet positions. Repricing gap limits are set to control the Bank's interest rate risk.

Stress tests on the Bank's various types of interest rate risk are conducted regularly. The Asset and Liability Management Committee monitors the results of stress tests and decides remedial action if required.

Sensitivity analysis on earnings and economic value to interest rate changes is assessed through a hypothetical interest rate shock of 200 basis points across the yield curve on both sides of the balance sheet and performed on monthly basis. Sensitivity limits are set to control the Bank's interest rate risk exposure under both earnings and economic value perspectives. The results are reported to the Asset and Liability Management Committee and the Board of Directors on a regular basis.

**Sensitivity analysis on interest rate risk**

The Bank uses sensitivity analysis to measure the potential effect of changes in interest rates on our net interest income and economic value change:

	2008			2007		
	HKD	USD	CNY	HKD	USD	CNY
	HK\$ Mn					
Impact on earnings over the next 12 months if interest rates rise by 200 basis points .....	64	(26)	185	57	(112)	36
Impact on economic value if interest rates rise by 200 basis points .....	(98)	(203)	113	(180)	(273)	(56)

This sensitivity analysis, which is based on a static interest rate risk profile of assets and liabilities, is used for risk management purposes only. The analysis is based on the following assumptions:

- (i) there is a parallel shift in the yield curve and in interest rates;
- (ii) there are no other changes to the portfolio;
- (iii) no loan prepayment is assumed as the majority of loans is on a floating rate basis; and
- (iv) deposits without fixed maturity dates are assumed to be repriced on the next day.

Actual changes in the Bank's net interest income and the economic value resulting from the increases in interest rates may differ from the results of this sensitivity analysis.

The following table indicates the expected next repricing dates (or maturity dates whichever are earlier) for the interest bearing assets and liabilities at the balance sheet date:

### The Group

	2008					Total HK\$ Mn
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
<b>Assets</b>						
Cash and balances with banks and other financial institutions .....	25,610	—	—	—	2,495	28,105
Placements with banks and other financial institutions .....	82,624	13,950	—	—	—	96,574
Trade bills .....	977	137	—	—	50	1,164
Trading assets .....	406	2	81	37	2,911	3,437
Financial assets designated at fair value through profit or loss.....	1,110	595	1,987	438	—	4,130
Advances to customers .....	152,460	40,417	27,439	6,556	2,423	229,295
Other accounts .....	551	661	—	—	13,218	14,430
Available-for-sale financial assets....	8,125	5,508	2,965	953	1,009	18,560
Held-to-maturity investments .....	2,029	1,513	1,197	267	—	5,006
Non-interest bearing assets.....	—	—	—	—	14,553	14,553
<b>Total Assets.....</b>	<b>273,892</b>	<b>62,783</b>	<b>33,669</b>	<b>8,251</b>	<b>36,659</b>	<b>415,254</b>
<b>Liabilities</b>						
Deposits and balances of banks and other financial institutions...	18,091	8,671	260	10	13	27,045
Deposits from customers .....	270,892	38,309	4,354	33	10,214	323,802
Trading liabilities .....	130	200	—	—	2,516	2,846
Certificates of deposit issued .....	2,503	654	1,014	1,320	—	5,491
Loan capital.....	4,641	—	6,395	—	—	11,036
Non-interest bearing liabilities.....	—	—	—	—	12,549	12,549
<b>Total liabilities .....</b>	<b>296,257</b>	<b>47,834</b>	<b>12,023</b>	<b>1,363</b>	<b>25,292</b>	<b>382,769</b>
Interest rate sensitivity gap .....	(22,365)	14,949	21,646	6,888	—	—

## The Group

	2007					Total
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
<b>Assets</b>						
Cash and balances with banks and other financial institutions .....	12,679	—	—	—	5,174	17,853
Placements with banks and other financial institutions .....	90,578	4,126	—	—	—	94,704
Trade bills .....	687	53	—	—	72	812
Trading assets .....	815	397	—	—	3,635	4,847
Financial assets designated at fair value through profit or loss .....	5,353	446	2,845	—	14	8,658
Advances to customers .....	140,055	42,212	26,094	6,920	2,206	217,487
Other accounts .....	1,269	1,352	39	—	11,593	14,253
Available-for-sale financial assets....	7,109	1,842	807	743	1,716	12,217
Held-to-maturity investments .....	2,122	6,064	1,569	1,006	—	10,761
Non-interest bearing assets.....	—	—	—	—	12,387	12,387
<b>Total Assets.....</b>	<b>260,667</b>	<b>56,492</b>	<b>31,354</b>	<b>8,669</b>	<b>36,797</b>	<b>393,979</b>
<b>Liabilities</b>						
Deposits and balances of banks and other financial institutions...	19,327	14,414	49	10	5,260	39,060
Deposits from customers .....	249,053	22,275	3,439	378	9,041	284,186
Trading liabilities .....	1,099	—	33	—	1,240	2,372
Certificates of deposit issued .....	3,918	6,533	504	1,210	—	12,165
Loan capital.....	4,669	—	4,600	4,383	—	13,652
Non-interest bearing liabilities.....	—	—	—	—	12,098	12,098
<b>Total liabilities .....</b>	<b>278,066</b>	<b>43,222</b>	<b>8,625</b>	<b>5,981</b>	<b>27,639</b>	<b>363,533</b>
Interest rate sensitivity gap .....	(17,399)	13,270	22,729	2,688	—	—

## The Bank

	2008					Total <i>HK\$ Mn</i>
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	
<b>Assets</b>						
Cash and balances with banks and other financial institutions .....	3,619	—	—	—	1,233	4,852
Placements with banks and other financial institutions .....	78,787	13,948	—	—	—	92,735
Trade bills .....	342	129	—	—	50	521
Trading assets .....	406	2	81	37	2,388	2,914
Financial assets designated at fair value through profit or loss .....	1,110	595	1,971	438	—	4,114
Advances to customers .....	89,323	9,292	24,308	4,996	2,374	130,293
Other accounts .....	340	188	—	—	7,819	8,347
Available-for-sale financial assets....	3,821	3,803	2,522	126	713	10,985
Held-to-maturity investments .....	1,512	1,058	690	58	—	3,318
Non-interest bearing assets.....	—	—	—	—	37,140	37,140
<b>Total Assets.....</b>	<b>179,260</b>	<b>29,015</b>	<b>29,572</b>	<b>5,655</b>	<b>51,717</b>	<b>295,219</b>
<b>Liabilities</b>						
Deposits and balances of banks and other financial institutions...	1,072	8	—	—	13	1,093
Deposits from customers .....	211,740	18,398	1,057	—	8,834	240,029
Trading liabilities .....	130	200	—	—	2,219	2,549
Certificates of deposit issued .....	2,503	654	1,014	3,520	—	7,691
Loan capital.....	4,641	—	6,395	—	—	11,036
Non-interest bearing liabilities.....	—	—	—	—	5,596	5,596
<b>Total liabilities .....</b>	<b>220,086</b>	<b>19,260</b>	<b>8,466</b>	<b>3,520</b>	<b>16,662</b>	<b>267,994</b>
Interest rate sensitivity gap .....	(40,826)	9,755	21,106	2,135	—	—

## The Bank

	2007					Total <i>HK\$ Mn</i>
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	
<b>Assets</b>						
Cash and balances with banks and other financial institutions .....	2,087	—	—	—	1,046	3,133
Placements with banks and other financial institutions .....	80,493	2,630	—	—	—	83,123
Trade bills .....	375	47	—	—	48	470
Trading assets .....	815	397	—	—	3,409	4,621
Financial assets designated at fair value through profit or loss .....	5,353	446	2,828	—	14	8,641
Advances to customers .....	96,635	8,200	22,316	5,154	2,142	134,447
Other accounts .....	463	238	39	—	6,505	7,245
Available-for-sale financial assets....	7,006	1,553	653	69	1,327	10,608
Held-to-maturity investments .....	1,886	5,523	783	581	—	8,773
Non-interest bearing assets.....	—	—	—	—	37,412	37,412
<b>Total Assets.....</b>	<b>195,113</b>	<b>19,034</b>	<b>26,619</b>	<b>5,804</b>	<b>51,903</b>	<b>298,473</b>
<b>Liabilities</b>						
Deposits and balances of banks and other financial institutions...	2,284	287	—	—	10	2,581
Deposits from customers .....	213,128	9,476	2,101	378	7,505	232,588
Trading liabilities .....	1,099	—	33	—	1,043	2,175
Certificates of deposit issued .....	3,918	6,533	504	3,410	—	14,365
Loan capital.....	4,669	—	4,600	4,383	—	13,652
Non-interest bearing liabilities.....	—	—	—	—	6,931	6,931
<b>Total liabilities .....</b>	<b>225,098</b>	<b>16,296</b>	<b>7,238</b>	<b>8,171</b>	<b>15,489</b>	<b>272,292</b>
Interest rate sensitivity gap .....	(29,985)	2,738	19,381	(2,367)		

The following table summarises the range of effective average interest rates for the year ended 31st December for monetary financial instruments:

	The Group		The Bank	
	2008	2007	2008	2007
	%	%	%	%
<b>Assets</b>				
Cash and short-term funds and placements with banks and other financial institutions .....	0-10.28	0-10.00	0-10.28	0.10-8.60
Trade bills, advances to customers and advances to banks and other financial institutions .....	0.50-36.10	0-37.62	0.60-18.33	0.88-18.36
Securities (Note) .....	0.04-8.23	1.00-7.75	0.04-8.23	1.00-7.75
<b>Liabilities</b>				
Deposits and balances of banks and other financial institutions .....	0.02-13.21	0.01-8.48	0.02-13.21	0.01-7.90
Deposits from customers .....	0-9.00	0-13.33	0-9.00	0-8.75
Certificates of deposit issued and loan capital .....	0.92-10.14	2.25-10.48	0.92-10.14	2.25-10.48

*Note: Securities include certificates of deposit held, trading assets, financial assets designated at fair value through profit or loss, securities measured as loans and receivables, available-for-sale financial assets and held-to-maturity investments.*

#### (f) Strategic risk management

The objective of strategic risk management is to monitor the risk to earnings or capital arising from bad business decisions or from an improper implementation of good business decisions.

The Board of Directors reviews and approves policy for the management of the strategic risk. The Board has delegated the responsibility for ongoing strategic risk management to the Asset and Liability Management Committee. The Asset and Liability Management Committee reports to the Board of Directors via the Risk Management Committee.

#### (g) Legal risk and reputation risk management

Legal risk is the risk arising from the potential that unenforceable contracts, lawsuits or adverse judgements may disrupt or otherwise negatively affect the operations or financial condition of the Group.

Reputation risk is the risk arising from the potential that negative publicity regarding the Group's business practices, whether true or not, will cause a decline in the customer base or lead to costly litigation or revenue reductions.

The objective of managing the aforesaid risks is to identify, assess and monitor these risks and, in particular, to comply with the relevant regulatory requirements.

The Board of Directors reviews and approves policies for these risks, and it has delegated the responsibility for ongoing risk management to the Operational Risk Management Committee. The Operational Risk Management Committee reports to the Board of Directors via the Risk Management Committee.

#### (h) Capital management

The HKMA sets and monitors capital requirements for the Group as a whole. In implementing current capital requirements the HKMA requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets. The Group calculates requirements for market risk in its trading portfolios based upon the Group's VAR models and uses its internal gradings as the basis for risk weightings for credit risk. Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

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In addition to meeting the regulatory requirements, the Group's primary objectives when managing capital are to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might otherwise be possible with greater gearing and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The process of allocating capital to specific operations and activities is undertaken by Asset and Liability Management Committee and is reviewed regularly by the Board of Directors.

Consistent with industry practice, the Group monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Group's policy on the management of capital during the year, except for a change in the calculation methodology in the capital adequacy ratios.

The capital adequacy ratios as at 31st December, 2008 and 31st December, 2007 are computed on the consolidated basis of the Bank and certain of its subsidiaries as specified by the HKMA for its regulatory purposes, and are in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance which became effective on 1st January, 2007.

The Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the year ended 31st December, 2008 and 31st December, 2007 and the Group is well above the minimum required ratio set by the HKMA.

#### **40. Fair Values of Financial Instruments**

##### **(a) Estimation of fair values**

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, the most suitable measure for fair value is the quoted market price. In the absence of organised secondary markets for most financial instruments, and in particular for loans, deposits and unlisted derivatives, direct market prices are not available. The fair value of such instruments was therefore calculated on the basis of well-established valuation techniques using current market parameters. In particular, the fair value is a theoretical value applicable at a given reporting date, and hence can only be used as an indicator of value realisable in a future sale.

The Group compares valuations derived from models with quoted prices of similar financial instruments, and with actual values when realised, in order to further validate and calibrate the models. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experiences and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values. Derived fair value estimates cannot necessarily be substantiated by comparison to independent markets and, in many cases, could not be realized in an immediate sale of the instruments.

The following methods and significant assumptions have been applied in determining the fair values of financial instruments:

- (i) the fair value of demand deposits and savings accounts with no specific maturity is assumed to be the amount payable on demand at the balance sheet date;
- (ii) the fair value of variable rate financial instruments is assumed to approximate their carrying amounts and, in the case of loans and unquoted debt securities, does not, therefore, reflect changes in their credit quality, as the impact of credit risk is recognised separately by deducting the amount of the impairment allowances from both the carrying amount and fair value;

- (iii) the fair value of fixed rate loans and mortgages carried at amortized cost is estimated by comparing market interest rates when the loans were granted with current market rates offered on similar loans. Changes in the credit quality of loans within the portfolio are not taken into account in determining gross fair values, as the impact of credit risk is recognised separately by deducting the amount of the impairment loss and allowances from both the carrying amount and fair value.
- (iv) the fair value of unquoted equity investments is estimated, if possible, using applicable price/earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuers.
- (v) the fair value of unlisted open-ended investment funds are estimated using the net asset value per share as reported by the managers of such funds.
- (vi) the fair value of forward exchange contracts and interest rate swaps is estimated either using broker quotes or by discounting future cash flows. Future cash flows are estimated based on management's best estimate of the amount it would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties. The discount rate used is a market rate for a similar instrument at the balance sheet date. The fair value of an option contract is determined by applying the Black—Scholes option valuation model. Inputs are based on market related data at the balance sheet date.

**(b) Fair value**

All financial instruments are stated at fair value or carried at amounts not materially different from their fair values as at 31st December, 2008 and 2007, except for held—to—maturity investments as set out in Note 26.

**41. Off-Balance Sheet Exposures**

**(a) Contingent Liabilities and Commitments**

The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments:

	The Group		The Bank	
	2008	2007	2008	2007
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Direct credit substitutes.....	7,272	8,496	6,888	9,151
Transaction-related contingencies.....	1,771	976	1,529	707
Trade-related contingencies .....	1,045	1,493	721	1,033
Commitments that are unconditionally cancellable without prior notice .....	41,692	49,117	38,683	37,442
Other commitments .....				
- up to 1 year .....	5,651	4,510	3,049	2,062
- over 1 year .....	18,737	14,144	11,551	13,354
	76,168	78,736	62,421	63,749

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contract amounts does not represent expected future cash flows.

**(b) Derivatives**

Derivatives refer to financial contracts whose value depends on the value of one or more underlying assets or indices.

The following is a summary of the notional amounts of each significant type of derivative for the Group and the Bank:

	<b>The Group</b>					
	<b>2008</b>			<b>2007</b>		
	<b>Trading</b>	<b>Non-trading</b>	<b>Total</b>	<b>Trading</b>	<b>Non-trading</b>	<b>Total</b>
	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>
Exchange rate contracts						
Forwards and futures .....	23,860	—	23,860	14,816	22	14,838
Swaps.....	1,633	12,863	14,496	15,141	8,456	23,597
Options purchased.....	919	151	1,070	3,717	—	3,717
Options written .....	1,075	151	1,226	3,527	—	3,527
Interest rate contracts .....						
Forwards and futures .....	25	—	25	185	—	185
Swaps.....	—	44,699	44,699	1,261	26,894	28,155
Equity contracts .....						
Swaps.....	—	—	—	—	2,864	2,864
Options purchased.....	82	1,638	1,720	1,332	6,031	7,363
Options written .....	427	1,039	1,466	3,545	—	3,545
	<u>28,021</u>	<u>60,541</u>	<u>88,562</u>	<u>43,524</u>	<u>44,267</u>	<u>87,791</u>
	<b>The Bank</b>					
	<b>2008</b>			<b>2007</b>		
	<b>Trading</b>	<b>Non-trading</b>	<b>Total</b>	<b>Trading</b>	<b>Non-trading</b>	<b>Total</b>
	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>	<b>HK\$ Mn</b>
Exchange rate contracts						
Forwards and futures .....	10,842	—	10,842	12,707	—	12,707
Swaps.....	1,311	12,253	13,564	15,141	9,840	24,981
Options purchased.....	971	151	1,122	3,717	—	3,717
Options written .....	1,075	151	1,226	3,527	—	3,527
Interest rate contracts .....						
Forwards and futures .....	25	—	25	185	—	185
Swaps.....	—	42,684	42,684	1,261	24,893	26,154
Equity contracts .....						
Swaps.....	—	—	—	—	4,093	4,093
Options purchased.....	82	2,307	2,389	1,331	6,031	7,362
Options written .....	427	1,039	1,466	3,545	—	3,545
	<u>14,733</u>	<u>58,585</u>	<u>73,318</u>	<u>41,414</u>	<u>44,857</u>	<u>86,271</u>

Derivatives arise from futures, forward, swap and option transactions undertaken by the Group and the Bank in the foreign exchange, interest rate and equity markets. The notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

The fair value and credit risk weighted amounts of the aforesaid off-balance sheet exposures are as follows. These amounts do not take into account the effects of bilateral netting arrangements.

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Fair value (Note 22)				
Exchange rate contracts .....	488	235	262	172
Interest rate contracts.....	1,012	804	755	705
Options purchased				
- exchange rate contracts .....	3	—	3	—
- equity contracts .....	231	513	231	513
	<u>1,734</u>	<u>1,552</u>	<u>1,251</u>	<u>1,390</u>

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Credit risk weighted amounts*				
Contingent liabilities and commitments .....	20,642	18,725	14,002	12,305
Exchange rate contracts .....	391	130	340	131
Interest rate contracts.....	225	196	321	197
Equity contracts .....	181	75	248	99
Debt security & other commodity .....	22	—	38	—
	<u>21,461</u>	<u>19,126</u>	<u>14,949</u>	<u>12,732</u>

\* The Bank adopted the Foundation Internal Ratings Based (“IRB”) approach according to Banking (Capital) Rules for calculating the credit risk weighted amount as at 31st December, 2008.

The tables above give the contractual or notional amounts, fair value and credit risk weighted amounts of off-balance sheet transactions. The fair value is calculated for the purposes of deriving the credit risk weighted amounts. These are assessed in accordance with the Banking (Capital) Rules. Fair value represents the cost of replacing all contracts which have a positive value when marked to market.

Fair value is a close approximation of the credit risk for these contracts as at the balance sheet date. The credit risk weighted amount refers to the amount as computed in accordance with the Banking (Capital) Rules.

The following table provides an analysis of the notional amounts of derivatives of the Group by relevant maturity grouping based on the remaining periods to settlement at the balance sheet date.

	<b>The Group</b>							
	<b>Notional amounts with remaining life of</b>							
	<b>2008</b>				<b>2007</b>			
	<b>1 year or less</b>	<b>Over 1 year to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>	<b>1 years or less</b>	<b>Over 1 year to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	
Interest rate derivatives .....	26,641	14,193	3,890	44,724	10,651	13,047	4,642	28,340
Currency derivatives.....	35,145	5,507	—	40,652	40,699	4,980	—	45,679
Other derivatives.....	2,514	8	664	3,186	10,737	2,450	585	13,772
	<u>64,300</u>	<u>19,708</u>	<u>4,554</u>	<u>88,562</u>	<u>62,087</u>	<u>20,477</u>	<u>5,227</u>	<u>87,791</u>

	<b>The Bank</b>							
	<b>Notional amounts with remaining life of</b>							
	<b>2008</b>				<b>2007</b>			
	<b>1 year or less</b>	<b>Over 1 year to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>	<b>1 years or less</b>	<b>Over 1 year to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	
Interest rate derivatives .....	26,341	12,384	3,984	42,709	11,021	11,222	4,096	26,339
Currency derivatives.....	21,247	5,507	—	26,754	40,286	4,646	—	44,932
Other derivatives.....	3,183	8	664	3,855	11,137	3,278	585	15,000
	<u>50,771</u>	<u>17,899</u>	<u>4,648</u>	<u>73,318</u>	<u>62,444</u>	<u>19,146</u>	<u>4,681</u>	<u>86,271</u>

(c) Capital Commitments

Capital commitments outstanding at 31st December and not provided for in the accounts were as follows:

	<b>The Group</b>		<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Expenditure authorised and contracted for .....	1,611	1,880	608	647
Expenditure authorised but not contracted for .....	107	131	98	89
	<u>1,718</u>	<u>2,011</u>	<u>706</u>	<u>736</u>

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(d) **Operating Lease Commitments**

At 31st December, 2008, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	<b>The Group</b>		<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Properties				
Within one year.....	338	272	135	119
After one year but within five years .....	684	619	117	125
After five years .....	358	307	—	1
	<u>1,380</u>	<u>1,198</u>	<u>252</u>	<u>245</u>

	<b>The Group</b>		<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>	<i>HK\$ Mn</i>
Equipment				
Within one year.....	7	5	2	2
After one year but within five years .....	10	9	2	2
After five years .....	—	—	—	—
	<u>17</u>	<u>14</u>	<u>4</u>	<u>4</u>

The Group and the Bank lease certain properties and equipment under operating leases. The leases run for an initial period of one to twenty five years, with an option to renew the lease when all terms are renegotiated. Lease payments are usually adjusted annually to reflect market rentals. None of the leases includes contingent rentals.

## 42. Notes on Consolidated Cash Flow Statement

### (a) Purchase of Subsidiaries

	2008	2007
	HK\$ Mn	HK\$ Mn
Net assets acquired		
Cash and balances with banks and other financial institutions .....	12	2
Advances and other accounts less provisions .....	10	5
Fixed assets .....	4	—
Goodwill .....	25	—
Other accounts and provisions .....	(45)	(3)
	6	4
Goodwill arising on consolidation.....	27	36
Total purchase price.....	33	40
Less: cash and cash equivalents acquired .....	(12)	(2)
Cash flow on acquisition net of cash acquired.....	21	38

### (b) Disposal of Subsidiary

	2008	2007
	HK\$ Mn	HK\$ Mn
Advances and other accounts less provisions .....	—	53
Taxation .....	—	(3)
Other accounts and provisions .....	—	(1)
	—	49
Add: gain on disposal .....	—	406
Cash flow on disposal of subsidiary .....	—	455

### (c) Cash and Cash Equivalents

#### (i) Components of cash and cash equivalents in the consolidated cash flow statement

	2008	2007
	HK\$ Mn	HK\$ Mn
Cash and balances with banks and other financial institutions .....	20,042	14,187
Placements with banks and other financial institutions with original maturity within three months .....	70,442	87,395
Treasury bills with original maturity within three months .....	3,251	1,919
Certificates of deposit held with original maturity within three months .....	371	217
	94,106	103,718

(ii) Reconciliation with the consolidated balance sheet

	2008	2007
	HK\$ Mn	HK\$ Mn
Cash and balances with banks and other financial institutions (Note 19) .....	28,105	17,853
Placements with banks and other financial institutions (Note 20) .....	96,574	94,704
Treasury bills and certificates of deposit held		
- trading assets (Note 22) .....	400	1,195
- designated at fair value through profit or loss (Note 23) .....	—	50
- advances and other accounts (Note 24) .....	39	39
- available-for-sale (Note 25) .....	11,153	3,676
- held-to-maturity (Note 26) .....	1,897	1,692
	<u>13,489</u>	<u>6,652</u>
Amounts shown in the consolidated balance sheet .....	138,168	119,209
Less: amounts with an original maturity of beyond three months .....	(35,999)	(11,825)
cash balance with central bank subject to regulatory restriction .....	<u>(8,063)</u>	<u>(3,666)</u>
Cash and cash equivalents in the consolidated cash flow statement .....	<u>94,106</u>	<u>103,718</u>

### 43. Assets Pledged as Security

The following balances with banks have been pledged as collateral for securities borrowings and margin deposits of derivatives.

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Cash collateral for borrowed securities.....	7	—	7	—
Collateral deposit for derivatives dealing.....	<u>912</u>	<u>55</u>	<u>912</u>	<u>55</u>
	<u>919</u>	<u>55</u>	<u>919</u>	<u>55</u>

These transactions are conducted under terms that are usual and customary to standard lending and securities borrowing and lending activities.

#### 44. Loans to Officers

The aggregate of loans to officers of the Bank disclosed pursuant to Section 161B(4B) and (4C) of the Hong Kong Companies Ordinance is as follows:

	2008	2007
	<u>HK\$ Mn</u>	<u>HK\$ Mn</u>
Aggregate amount of relevant loans outstanding at 31st December		
By the Bank.....	4,169	1,432
By subsidiaries.....	1,073	625
	<u>5,242</u>	<u>2,057</u>
The maximum aggregate amount of relevant loans outstanding during the year		
By the Bank.....	4,573	1,864
By subsidiaries.....	1,492	625
	<u>6,065</u>	<u>2,489</u>

There was no interest due but unpaid nor any impairment allowance made against these loans at 31st December, 2008 and 31st December, 2007.

#### 45. Material Related Party Transactions

The Group maintains certain retirement benefit schemes for its staff as per Note 2(q)(iii). In 2008, the total amount of contributions the Group made to the schemes was HK\$107 million (2007: HK\$93 million).

The Group enters into a number of transactions with the Group's related parties, including its associates, and key management personnel and their close family members and companies controlled or significantly influenced by them. The transactions include accepting deposits from and extending credit facilities to them. Except that there is interest free shareholder's advance extended to one (2007: one) associate amounting to HK\$7 million at 31st December, 2008 (2007: HK\$7 million), all interest rates in connection with the deposits taken and credit facilities extended are under terms and conditions normally applicable to customers of comparable standing.

The interest received from and interest paid to the Group's related parties for the year, outstanding balances of amounts due from and due to at the year end, and maximum outstanding balance of amounts due from and due to them during the year are aggregated as follows:

	Key management personnel		Subsidiaries		Associates	
	2008	2007	2008	2007	2008	2007
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Interest income.....	264	155	1,079	833	8	9
Interest expense.....	88	134	148	204	—	—
Amounts due from.....	8,209	10,448	16,398	17,964	124	213
Amounts due to .....	3,696	3,961	1,994	1,634	7	10
Maximum amounts due from.....	12,429	11,361	22,072	23,699	446	422
Maximum amounts due to .....	8,527	8,593	2,850	1,894	34	62

#### 46. Equity Compensation Plans

The Bank has adopted Staff Share Option Schemes where by the Board of the Bank may at its discretion grant to any employees, including Executive Directors and Chief Executive, of the Group options to subscribe for shares of the Bank. The options may be exercised during the period beginning on the first anniversary of the Date of Grant and ending on the fifth anniversary of the Date of Grant. All options were granted for nil consideration.

##### (a) Particulars of Share Options

Date of Grant	Vesting Period	Exercise Period	Exercise Price Per Share HK\$
02/5/2003	02/5/2003 — 01/5/2004	02/5/2004 — 02/5/2008	14.90
22/4/2004	22/4/2004 — 21/4/2005	22/4/2005 — 22/4/2009	23.23
03/5/2005	03/5/2005 — 02/5/2006	03/5/2006 — 03/5/2010	22.95
03/5/2006	03/5/2006 — 02/5/2007	03/5/2007 — 03/5/2011	33.05
10/5/2007	10/5/2007 — 09/5/2008	10/5/2008 — 10/5/2012	47.13
05/5/2008	05/5/2008 — 04/5/2009	05/5/2009 — 05/5/2013	44.10

##### (b) Movement of Share Options

###### 2008

Date of Grant	Number of Share Options				Outstanding at 31/12/2008
	Outstanding at 1/1/2008	Granted	Exercised	Lapsed	
02/5/2003	2,205,000	—	2,205,000	—	Nil
22/4/2004	3,915,000	—	1,080,000	70,000	2,765,000
03/5/2005	7,230,000	—	1,125,000	—	6,105,000
03/5/2006	3,200,000	—	500,000	—	2,700,000
10/5/2007	2,750,000	—	—	—	2,750,000
05/5/2008	—	5,500,000	—	—	5,500,000
Total	<u>19,300,000</u>	<u>5,500,000</u>	<u>4,910,000</u>	<u>70,000</u>	<u>19,820,000</u>

###### 2007

Date of Grant	Number of Share Options				Outstanding at 31/12/2007
	Outstanding at 1/1/2007	Granted	Exercised	Lapsed	
18/4/2002	1,855,000	—	1,855,000	—	NIL
02/5/2003	2,895,000	—	690,000	—	2,205,000
22/4/2004	5,750,000	—	1,835,000	—	3,915,000
03/5/2005	10,310,000	—	3,080,000	—	7,230,000
03/5/2006	3,250,000	—	50,000	—	3,200,000
10/5/2007	—	2,750,000	—	—	2,750,000
Total	<u>24,060,000</u>	<u>2,750,000</u>	<u>7,510,000</u>	<u>—</u>	<u>19,300,000</u>

(c) No share options were cancelled during the years ended 31st December, 2008 and 2007.

(d) Details of Share Options Exercised

Exercise Period	Date of Grant	Number of Share Options	
		2008	2007
January .....	18/4/2002	—	20,000
	02/5/2003	1,005,000	55,000
	22/4/2004	130,000	390,000
	03/5/2005	75,000	420,000
February .....	18/4/2002	—	55,000
	02/5/2003	20,000	55,000
	22/4/2004	20,000	155,000
	03/5/2005	25,000	320,000
March .....	18/4/2002	—	930,000
	02/5/2003	1,060,000	125,000
	22/4/2004	665,000	180,000
	03/5/2005	715,000	180,000
	03/5/2006	500,000	—
April .....	18/4/2002	—	850,000
	02/5/2003	30,000	10,000
	22/4/2004	165,000	75,000
	03/5/2005	110,000	290,000
May .....	02/5/2003	90,000	210,000
	22/4/2004	20,000	155,000
	03/5/2005	75,000	390,000
June .....	02/5/2003	—	150,000
	22/4/2004	25,000	65,000
	03/5/2005	25,000	655,000
July .....	22/4/2004	5,000	75,000
	03/5/2005	55,000	145,000
	02/5/2003	—	30,000
August .....	22/4/2004	30,000	120,000
	03/5/2005	45,000	105,000
	22/4/2004	20,000	30,000
September .....	03/5/2005	—	115,000
	22/4/2004	—	180,000
October .....	03/5/2005	—	100,000
	02/5/2003	—	15,000
	22/4/2004	—	310,000
November .....	03/5/2005	—	160,000
	03/5/2006	—	50,000
	02/5/2003	—	40,000
	22/4/2004	—	100,000
December .....	03/5/2005	—	200,000
		<u>4,910,000</u>	<u>7,510,000</u>

**47. Accounting Estimates and Judgements**

The preparation of accounts requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of these accounts and the reported amounts of revenues and expenses for the years presented. Changes in assumptions may have a significant impact on the accounts in the periods where the assumptions are changed. The application of assumptions and estimates means that any selection of different assumptions would cause the Group's reporting to differ. The Group believes that the assumptions that have been made are appropriate and that the accounts therefore present the financial position and results fairly, in all material respects.

Management discussed with the Audit Committee the development, selection and disclosure of the Group's significant accounting policies and estimates and the application of these policies and estimates.

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(a) **Key Sources of Estimation Uncertainty**

Notes 29, 35 and 40 contain information about the assumptions and their risk factors relating to goodwill impairment, fair value of share options granted and fair values of financial instruments. Other key sources of estimation uncertainty are as follows:

(i) *Impairment losses*

*Loans and advances*

Loan portfolios are reviewed periodically to assess whether impairment losses exist. The Group makes judgement as to whether there is any objective evidence that a loan portfolio is impaired, i.e. whether there is a decrease in estimated future cash flows. Objective evidence for impairment includes observable data that the payment status of borrowers in a group has adversely changed. It may also include observable data that correlate with defaults on the assets in the Group. If management has determined, based on their judgement, that objective evidence for impairment exists, expected future cash flows are estimated based on historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of the current observable data. Management reviews the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

*Available-for-sale financial assets and held-to-maturity investments*

The Group determines that available-for-sale financial assets and held-to-maturity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. The determination of when a decline in fair value below its cost is not recoverable within a reasonable time period is judgmental by nature, so profit and loss could be affected by differences in this judgement.

(ii) *Valuation of financial instruments*

The Group's accounting policy for valuation of financial instruments is included in Note 2. The fair value of the financial instruments is mainly based on the quoted market price on a recognised stock exchange or a price quoted from a broker/dealer for non-exchanged traded financial instruments. The fair value of collateralised debt obligations is based on bid prices quoted by reputable brokers and has been carefully assessed for reasonableness by management. The fair value of SIV is based on their net asset values as provided by the SIV's managers.

(b) **Critical accounting judgements in applying the Group's accounting policies** Certain critical accounting judgements in applying the Group's accounting policies are described below:

(i) *Held-to-maturity investments*

The Group classifies non-derivative financial assets with fixed or determinable payments and fixed maturity and where the Group has a positive intention and ability to hold to maturity as held-to-maturity investments. In making this judgement, the Group evaluates its intention and ability to hold such investments till maturity.

If the Group fails to hold these investments to maturity other than for certain specific circumstances, the Group will have to reclassify the entire portfolio of held-to-maturity investments as available-for-sale, as such class is deemed to have been tainted.

This would result in held-to-maturity investments being measured at fair value instead of at amortised cost.

(ii) *Recognition of deferred tax assets*

The group recognises deferred tax assets only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Estimates and judgements are applied in determining the amount of future taxable profits and the probability that such future taxable profits are available in the foreseeable future to support recognition of the deferred tax assets. The group uses all readily available information, including estimates based on reasonable and supportable assumptions and projections of revenue and operating costs, in determining future taxable profits. Changes in these estimates could significantly affect the timing of deferred tax asset recognition and the amount of asset recognised.

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#### 48. Comparative Figures

The comparative figures have been restated to conform with current year's presentation.

#### 49. Proposed Impact of Amendments, New Standards and Interpretations issued but not yet effective for the Year ended 31st December, 2008

Up to the date of issue of these accounts, the HKICPA has issued a number of amendments, new standard and interpretations which are not yet effective for the accounting year ended 31st December, 2008 and which have not been adopted in these accounts.

The Group is in the process of making an assessment of what the impact of these amendments, new standards, new interpretations and additional disclosures is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Bank's results of operations and financial position.

In addition, the following developments may result in new or amended disclosures in the accounts:

	<b>Effective for accounting periods beginning on or after</b>
HK(IFRIC) 13 — Customer loyalty programmes .....	1st July 2008
HKFRS 2 — Share-based payment (Revised).....	1st January 2009
HKFRS 8 — Operating segments.....	1st January 2009
Amendment to HKAS 1, Presentation of financial statements: capital disclosures .....	1st January 2009

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**INDEPENDENT AUDITOR'S REPORT  
TO THE SHAREHOLDERS OF THE BANK OF EAST ASIA, LIMITED  
(incorporated in Hong Kong with limited liability)**

We have audited the consolidated accounts of The Bank of East Asia, Limited ("the Bank") set out on pages F-139 to F-240, which comprise the consolidated and the Bank balance sheets as at 31st December 2007, and the consolidated profit and loss account, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

**DIRECTORS' RESPONSIBILITY FOR THE ACCOUNTS**

The Directors of the Bank are responsible for the preparation and the true and fair presentation of these accounts 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 the accounts 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 accounts based on our audit. This report is made solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risk of material misstatement of the accounts, 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 accounts 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 accounts.

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 accounts give a true and fair view of the state of affairs of the Bank and of the Group as at 31st 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.

KPMG  
*Certified Public Accountants*  
8th Floor, Prince's Building  
10 Chater Road  
Central, Hong Kong

Hong Kong, 15th February 2008

**THE BANK OF EAST ASIA, LIMITED**  
**CONSOLIDATED PROFIT AND LOSS ACCOUNT**  
**FOR THE YEAR ENDED 31ST DECEMBER 2007**

		2007	2006
	Notes	HK\$'000	Restated HK\$'000
Interest income .....	4	18,309,312	14,048,544
Interest expense .....	5	(12,332,142)	(9,049,744)
Net interest income .....		<u>5,977,170</u>	<u>4,998,800</u>
Fee and commission income .....	6	2,608,047	1,898,883
Fee and commission expense .....		(471,426)	(288,145)
Net fee and commission .....		2,136,621	1,610,738
Net trading profits .....	7	1,416,837	590,646
Net result from financial instruments designated at fair value through profit or loss .....	8	(1,154,461)	110,526
Other operating income .....	9	437,346	253,602
Non-interest income .....		<u>2,836,343</u>	<u>2,565,512</u>
Operating income .....		8,813,513	7,564,312
Operating expenses .....	10	(4,691,040)	(3,465,360)
Operating profit before impairment losses .....		<u>4,122,473</u>	<u>4,098,952</u>
Impairment losses on loans and advances .....	11	(216,471)	(243,848)
(Charge for)/Write back of impairment losses on held-to-maturity investments ..	27	(41,967)	12,972
Impairment losses on available-for-sale financial assets .....		(227,701)	—
(Charge for)/Write back of impairment losses on associates .....		(41,240)	24,560
Impairment losses on goodwill .....	30(a)	—	(23,698)
Write back of impairment losses on bank premises .....	31	132,530	27,681
Impairment losses .....		<u>(394,849)</u>	<u>(202,333)</u>
Operating profit after impairment losses .....		3,727,624	3,896,619
Net loss on sale of held-to-maturity investments .....		—	(17)
Net profit on sale of available-for-sale financial assets .....	12	667,008	49,998
Net profit on sale of subsidiaries / associates .....		406,279	1,516
Net loss on sale of fixed assets .....		(570)	(8,273)
Valuation gains on investment properties .....	31	292,998	137,777
Share of profits less losses on associates .....		91,653	182,574
Profit for the year before taxation .....		5,184,992	4,260,194
Income tax .....	13	(963,843)	(774,576)
Profit for the year after taxation .....		<u>4,221,149</u>	<u>3,485,618</u>
Attributable to:			
Equity holders of the Group .....	14	4,143,604	3,434,511
Minority interests .....	39	77,545	51,107
Profit after taxation .....		<u>4,221,149</u>	<u>3,485,618</u>
Appropriations:			
Dividends attributable to the year .....	15		
Interim paid .....		753,004	661,663
Final paid in respect of previous year .....		2,864	6,342
Final proposed .....		1,857,753	1,596,646
Earnings per share		<b>HK\$</b>	<b>HK\$</b>
Basic .....	16	2.65	2.24
Diluted .....	16	2.63	2.22

The notes on pages F-145 to F-240 form part of these accounts.

**THE BANK OF EAST ASIA, LIMITED**  
**CONSOLIDATED BALANCE SHEET**  
**AS AT 31ST DECEMBER 2007**

		2007	2006
	Notes	HK\$'000	HK\$'000
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions .....	20	14,186,701	8,317,746
Placements with banks and other financial institutions .....	21	94,703,893	66,864,045
Trade bills .....	22	811,630	620,463
Trading assets .....	23	4,846,602	2,937,534
Financial assets designated at fair value through profit or loss .....	24	8,658,006	8,643,479
Advances to customers and other accounts .....	25	235,405,829	175,096,666
Available-for-sale financial assets .....	26	12,217,495	12,002,197
Held-to-maturity investments .....	27	10,761,049	10,249,359
Investments in associates .....	29	2,793,070	1,076,738
Fixed assets .....	31	6,856,413	5,749,605
- Investment properties .....		1,726,158	1,288,541
- Other property and equipment .....		5,130,255	4,461,064
Goodwill and intangible assets .....	30	2,668,102	2,605,316
Deferred tax assets .....	33(b)	69,870	39,169
<b>Total Assets .....</b>		<b><u>393,978,660</u></b>	<b><u>294,202,317</u></b>
<b>EQUITY AND LIABILITIES</b>			
Deposits and balances of banks and other financial institutions .....		39,060,256	31,959,182
Deposits from customers .....		284,185,844	209,524,220
Trading liabilities .....	34(a)	2,372,101	942,595
Certificates of deposit issued .....		12,164,901	6,998,407
- At fair value through profit or loss .....		7,659,690	1,943,951
- At amortised cost .....		4,505,211	5,054,456
Current taxation .....	33(a)	228,850	334,097
Deferred tax liabilities .....	33(b)	871,557	598,118
Other accounts and provisions .....	34(b)	10,997,020	8,046,654
Loan capital .....	35	13,652,219	8,154,315
- At fair value through profit or loss .....		8,983,045	4,288,824
- At amortised cost .....		4,669,174	3,865,491
<b>Total Liabilities .....</b>		<b><u>363,532,748</u></b>	<b><u>266,557,588</u></b>
Share capital .....	37	3,935,918	3,875,355
Reserves .....	38	26,162,850	23,387,599
<b>Total equity attributable to equity holders of the Group .....</b>		<b><u>30,098,768</u></b>	<b><u>27,262,954</u></b>
Minority interests .....	39	347,144	381,775
<b>Total Equity .....</b>		<b><u>30,445,912</u></b>	<b><u>27,644,729</u></b>
<b>Total Equity and Liabilities .....</b>		<b><u>393,978,660</u></b>	<b><u>294,202,317</u></b>

Approved and authorised for issue by the Board of Directors on 15th February 2008.

Chairman and Chief Executive  
**David LI Kwok-po**

Directors  
**LI Fook-wo**  
**WONG Chung-hin**  
**Winston LO Yau-lai**

The notes on pages F-145 to F-240 form part of these accounts.

**THE BANK OF EAST ASIA, LIMITED**  
**BALANCE SHEET**  
**AS AT 31ST DECEMBER 2007**

		2007	2006
	Notes	HK\$'000	HK\$'000
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions .....	20	3,133,147	8,072,113
Placements with banks and other financial institutions .....	21	83,122,954	66,106,221
Trade bills .....	22	469,557	620,463
Trading assets .....	23	4,620,778	2,899,883
Financial assets designated at fair value through profit or loss .....	24	8,641,353	8,614,375
Advances to customers and other accounts .....	25	141,691,784	167,694,747
Amounts due from subsidiaries .....	32(a)	17,964,169	1,934,495
Available-for-sale financial assets .....	26	10,608,024	10,101,535
Held-to-maturity investments .....	27	8,772,898	8,334,876
Investments in subsidiaries .....	28	10,604,337	2,792,703
Investments in associates .....	29	1,964,545	239,890
Fixed assets .....	31	5,407,293	5,475,115
- Investment properties .....		1,829,570	1,316,755
- Other property and equipment .....		3,577,723	4,158,360
Goodwill and intangible assets .....	30	1,460,292	1,460,292
Deferred tax assets .....	33(b)	12,349	22,905
<b>Total Assets .....</b>		<b>298,473,480</b>	<b>284,369,613</b>
<b>EQUITY AND LIABILITIES</b>			
Deposits and balances of banks and other financial institutions .....		2,580,678	31,741,621
Deposits from customers .....		232,588,289	202,463,214
Trading liabilities .....	34(a)	2,174,732	934,375
Certificates of deposit issued .....		14,364,901	9,198,407
- At fair value through profit or loss .....		7,659,690	1,943,951
- At amortised cost .....		6,705,211	7,254,456
Amounts due to subsidiaries .....	32(b)	1,634,297	1,675,643
Current taxation .....	33(a)	80,871	295,823
Deferred tax liabilities .....	33(b)	754,212	594,903
Other accounts and provisions .....	34(b)	4,461,989	4,446,064
Loan capital .....	35	13,652,219	8,154,315
- At fair value through profit or loss .....		8,983,045	4,288,824
- At amortised cost .....		4,669,174	3,865,491
<b>Total Liabilities .....</b>		<b>272,292,188</b>	<b>259,504,365</b>
Share capital .....	37	3,935,918	3,875,355
Reserves .....	38	22,245,374	20,989,893
<b>Total equity attributable to equity holders of the Bank .....</b>		<b>26,181,292</b>	<b>24,865,248</b>
<b>Total Equity and Liabilities .....</b>		<b>298,473,480</b>	<b>284,369,613</b>

Approved and authorised for issue by the Board of Directors on 15th February 2008.

Chairman and Chief Executive  
David LI Kwok-po

Directors  
LI Fook-wo  
WONG Chung-hin  
Winston LO Yau-lai

The notes on pages F-145 to F-240 form part of these accounts.

**THE BANK OF EAST ASIA, LIMITED**  
**CONSOLIDATED SUMMARY STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED 31ST DECEMBER 2007**

	Notes	2007 HK\$'000	2006 HK\$'000
Total equity as at 1st January .....		27,644,729	24,404,528
Net income recognised directly in equity			
(Recognition)/release of net deferred tax liabilities in			
- Revaluation reserve on bank premises .....	38(c)	(5,998)	(11,195)
- Investment revaluation reserve on available-for-sale financial assets ..	38(h)	16,485	(109,777)
Revaluation surplus on bank premises			
transferred to investment properties .....	38(c)	35,669	69,444
Capital reserve on share-based transactions .....	38(g)	27,310	22,067
Reversal upon disposal of available-for-sale financial assets .....	38(h)	27,037	(41,766)
Changes in fair value of available-for-sale financial assets .....	38(h)	(421,425)	653,701
Exchange and other adjustments .....	38(f), 38(h), 39	482,720	107,042
		<u>161,798</u>	<u>689,516</u>
Net profit for the year			
Attributable to:			
Equity holders of the Group .....	38(i)	4,143,604	3,434,511
Minority interests .....	39	77,545	51,107
		<u>4,221,149</u>	<u>3,485,618</u>
Total recognised income and expenses for the year			
(of which HK\$77,545,000 (2006: HK\$51,107,000))			
is attributable to minority interests) .....		4,382,947	4,175,134
Dividends declared or approved during the year .....	38(i)	(2,352,514)	(2,072,519)
Movements in shareholders' equity arising from capital transactions with			
equity holders of the Group:			
Shares issued under Staff Share Option Schemes .....	37,38(a)	154,555	415,523
Shares issued in lieu of dividends .....	38(b)	730,463	599,825
Capital fee .....	38(a)	(135)	(251)
		<u>884,883</u>	<u>1,015,097</u>
Movements in minority interests			
Sale of interests in businesses to minority interests investors .....	39	49,697	2,561
Purchase of interests in businesses from minority interests investors .....	39	(14,634)	(29,268)
Reversal upon disposal of available-for-sale financial assets .....	39	(149,196)	—
Share of revaluation surplus of available-for-sale financial assets .....	39	—	149,196
		<u>(114,133)</u>	<u>122,489</u>
Balance as at 31st December .....		<u>30,445,912</u>	<u>27,644,729</u>

The notes on pages F-145 to F-240 form part of these accounts.

**THE BANK OF EAST ASIA, LIMITED**  
**CONSOLIDATED CASH FLOW STATEMENT**  
**FOR THE YEAR ENDED 31ST DECEMBER 2007**

		2007	2006
	Notes	HK\$'000	HK\$'000
<b>OPERATING ACTIVITIES</b>			
Profit for the year before taxation .....		5,184,992	4,260,194
Adjustments for:			
Charge for impairment losses on loans and advances .....	11	216,471	243,848
Charge for/(Write back of) impairment allowances on held-to-maturity investments, available-for-sale financial assets and associates .....		310,907	(37,532)
Share of profits less losses of associates .....		(91,653)	(182,574)
Net loss on sale of held-to-maturity investments .....		—	17
Net profit on sale of available-for-sale financial assets, subsidiaries and associates .....		(1,073,287)	(51,514)
Net (profit)/loss on sale of fixed assets .....		(570)	8,273
Interest expense on loan capital, certificates of deposit and bonds issued		1,115,170	707,185
Depreciation on fixed assets .....	10, 31	326,265	299,074
Amortisation of intangible assets .....	10	2,490	2,231
Impairment losses on goodwill .....		—	23,698
Write back of impairment losses on bank premises .....		(132,530)	(27,681)
Dividend income from available-for-sale financial assets .....		(62,909)	(27,501)
Amortisation of premium/discount on certificates of deposit and loan capital issued .....		64,610	—
Revaluation gain on certificates of deposit and loan capital issued .....		85,809	16,771
Valuation gains on investment properties .....	31	(292,998)	(137,777)
Equity-settled share-based payment expenses .....		27,310	22,067
<b>OPERATING PROFIT BEFORE CHANGES IN WORKING CAPITAL</b>		<b>5,680,077</b>	<b>5,118,779</b>
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months .....		(4,255,878)	(867,011)
Trade bills .....		(191,167)	(7,833)
Trading assets .....		(2,007,592)	(688,690)
Financial assets designated at fair value through profit or loss .....		(14,527)	1,514,228
Advances to customers .....		(52,157,551)	(27,424,381)
Advances to banks and other financial institutions .....		(3,219,723)	(29,989)
Held-to-maturity debt securities .....		(278,864)	2,749,309
Available-for-sale financial assets .....		(4,809,035)	(256,245)
Intangible assets .....		—	(15,217)
Other accounts and accrued interest .....		(3,916,385)	(2,501,018)
Deferred tax assets .....		(30,701)	(700)
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions .....		7,101,074	18,172,986
Deposits from customers .....		74,661,624	33,133,134
Trading liabilities .....		1,429,506	(994,404)
Other accounts and provisions .....		2,712,332	1,132,006
Deferred tax liabilities .....		(90,185)	(206,175)
Exchange adjustments .....		496,926	(30,781)

		<u>2007</u>	<u>2006</u>
	<i>Notes</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
NET CASH INFLOW FROM OPERATIONS .....		21,109,931	28,797,998
Income tax paid			
Hong Kong profits tax paid .....		(393,828)	(459,723)
Overseas profits tax paid .....		(305,775)	(204,171)
NET CASH FLOWS GENERATED FROM OPERATING ACTIVITIES ....		<u>20,410,328</u>	<u>28,134,104</u>
INVESTING ACTIVITIES			
Dividends received from associates.....		103,320	21,897
Dividends received from available-for-sale equity securities .....		62,909	27,501
Purchase of equity securities .....		(831,759)	(1,655,473)
Proceeds from sale of equity securities .....		1,455,603	140,925
Purchase of fixed assets.....	31	(924,359)	(511,367)
Proceeds from disposal of fixed assets.....		14,793	59,966
Purchase/increase in shareholding in associates .....		(1,735,210)	(96,479)
Proceeds from disposal of associates .....		579	1,842
Purchase of subsidiaries .....	43(a)	(38,266)	(72,574)
Proceeds from sale of interests in a subsidiary .....		455,686	37
NET CASH USED IN INVESTING ACTIVITIES .....		<u>(1,436,704)</u>	<u>(2,083,725)</u>
FINANCING ACTIVITIES			
Ordinary dividends paid .....		(1,622,051)	(1,472,694)
Issue of ordinary share capital.....	37, 38(a)	154,555	415,523
Issue of loan capital .....		9,255,365	3,878,825
Redemption of loan capital.....		(3,906,775)	(4,265,690)
Capital fee paid on increase in issued share capital.....	38(a)	(135)	(251)
Issue of certificates of deposit .....		9,654,541	7,798,252
Redemption of certificates of deposit issued.....		(4,619,894)	(7,198,009)
Interest paid on loan capital .....		(655,597)	(399,797)
Interest paid on certificates of deposit issued .....		(224,252)	(381,551)
NET CASH GENERATED FROM/(USED IN)			
FINANCING ACTIVITIES.....		<u>8,035,757</u>	<u>(1,625,392)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS.....		27,009,381	24,424,987
CASH AND CASH EQUIVALENTS AT 1ST JANUARY.....	43(c)	<u>76,708,949</u>	<u>52,283,962</u>
CASH AND CASH EQUIVALENTS AT 31ST DECEMBER .....	43(c)	<u><u>103,718,330</u></u>	<u><u>76,708,949</u></u>
Cash flows from operating activities included:			
Interest received.....		17,569,798	13,861,533
Interest paid .....		11,600,649	8,917,057
Dividend received.....		100,800	44,227

The notes on pages F-145 to F-240 form part of these accounts.

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## **THE BANK OF EAST ASIA, LIMITED**

### **NOTES ON THE ACCOUNTS**

#### **1. Principal Activities**

The Bank and its subsidiaries (the “Group”) are engaged in the provision of banking and related financial services, and business, corporate and investor services.

#### **2. Significant Accounting Policies**

##### **(a) Statement of Compliance**

These accounts have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”), and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. These accounts also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Bank. The adoption of these new and revised HKFRSs did not result in significant changes to the Group’s and the Bank’s accounting policies applied in these accounts for the years presented.

##### **(b) Basis of Preparation of the Accounts**

The accounts for the year ended 31st December 2007 comprise the Group and the Group’s interest in associates.

The measurement basis used in the preparation of the accounts is historical cost except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- financial instruments classified as trading, designated at fair value through profit or loss and available-for-sale (Note 2(f)(i)); and
- investment properties (Note 2(h)(ii))

The preparation of accounts in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Details of judgements made by management in the application of HKFRSs that have significant effect on the accounts and estimates with a significant risk of material adjustment in the next year are set out in Note 50.

##### **(c) Basis of Consolidation**

###### *(i) Subsidiaries and minority interests*

The consolidated accounts include the accounts of the Bank and all its subsidiaries made up to 31st December each year. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

All material intercompany transactions and balances are eliminated on consolidation. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from or to the date of their acquisition or disposal, as appropriate.

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Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Bank, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of these interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meet the definition of a financial liability. They are presented in the consolidated balance sheet and consolidated summary statement of changes in equity within equity, separately from equity attributable to equity holders of the Group. Minority interests in the results of the Group are presented on the face of the consolidated profit and loss account as an allocation of the net profit for the year between minority interests and equity holders of the Group.

In the Bank's balance sheet, its investments in subsidiaries are stated at cost less any impairment losses (Note 2(k)).

*(ii) Associates*

An associate is a company in which the Group or the Bank has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

An investment in an associate is accounted for in the consolidated accounts under the equity method and is initially recorded at cost and adjusted thereafter for the post-acquisition change in the Group's share of the associate's net assets.

The consolidated profit and loss account reflects the Group's share of the post-acquisition, post-tax results of the associates for the year, including any impairment loss on goodwill relating to the investment in associates recognised for the year in accordance with Notes 2(j) and 2(k).

When the Group's share of losses exceeds its interest in the associates, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. For these purposes, the Group's interest in the associate is the carrying amount of the investment under equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates, except when unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

The Bank accounts for the results of associates to the extent of dividends received. Investments in associates are stated at cost less any impairment losses (Note 2(k)).

**(d) Translation of Foreign Currencies**

Transactions in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the balance sheet date. Exchange differences are dealt with in the profit and loss account.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into Hong Kong dollars using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

Exchange differences relating to investments at fair value through profit or loss and derivative financial instruments are included in gains less losses from trading securities or financial instruments designated at fair value through profit or loss. All other exchange differences relating to monetary items are presented as gains less losses from dealing in foreign currencies in the profit and loss account.

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The results of foreign operations are translated into Hong Kong dollars at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items, including goodwill arising on consolidation of foreign operations acquired on or after 1st January 2005, are translated into Hong Kong dollars at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in a separate component of equity. Goodwill arising on consolidation of a foreign operation acquired before 1st January 2005 is translated at the foreign exchange rate that applied at the date of acquisition of the foreign operation.

On disposal of a foreign enterprise, the cumulative amount of the exchange differences which relate to that foreign enterprise is included in the calculation of the profit or loss on disposal.

**(e) Revenue Recognition**

Provided it is probable that economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the profit and loss account as follows.

Interest income for all interest-bearing financial instruments, except those classified as held for trading or designated at fair value through profit or loss, are recognised as interest income in the profit and loss account on an accruals basis using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating the interest income 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. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discontinued, but any increase in the present value of impaired loans due to the passage of time is reported as interest income.

Net income from financial instruments designated at fair value through profit or loss and net trading income comprises all gains and losses from changes in fair value (net of accrued coupon) of such financial assets and financial liabilities, together with dividend income attributable to those financial instruments.

Fee and commission income is recognised in the profit and loss account when the corresponding service is provided, except where the fee is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised as income in the accounting period in which the costs or risk is incurred and is accounted for as interest income.

Origination or commitment fees received/paid by the Group which result in the creation or acquisition of a financial asset are deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the Group making a loan, the fee is recognised as revenue on a straight-line basis over the commitment period.

Finance income implicit in finance leases is recognised as interest income over the period of the lease so as to produce an approximately constant periodic rate of return of the outstanding net investment in the leases for each accounting period.

Rental income received under operating leases is recognised as other operating income in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives granted are recognised in the profit and loss account as an integral part of the aggregate net lease payments receivables. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established. Dividend income from listed investments is recognised when the share price of the investment is quoted ex-dividend.

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**(f) Financial Instruments**

*(i) Initial recognition*

The Group classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets and other financial liabilities.

Financial instruments are measured initially at fair value, which normally will be equal to the transaction price plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset or issue of the financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. A regular way purchase or sale of financial assets is recognised using trade date accounting. From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities at fair value through profit or loss are recorded.

*(ii) Categorisation*

*Fair value through profit or loss*

This category comprises financial assets and financial liabilities held for trading, and those designated at fair value through profit or loss upon initial recognition, but excludes those investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

Trading financial instruments are financial assets or financial liabilities which are acquired or incurred principally for the purpose of trading, or are 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. Non-hedging derivatives are accounted for as trading instruments.

Financial instruments are designated at fair value through profit or loss upon initial recognition when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise;
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract; or
- the separation of the embedded derivatives from the financial instrument is not prohibited.

Financial assets and financial liabilities under this category are carried at fair value. Changes in the fair value are included in the profit and loss account in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the profit and loss account.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Group intends to sell immediately or in the near term, which will be classified as held for trading; (b) those that the Group, upon initial recognition, designates as at fair value through profit or loss or as available-for-sale; or (c) those where the Group may not recover substantially all of its initial investment, other than because of credit deterioration, which will be classified as available-for-sale. Loans and receivables mainly comprise placements with banks and other financial institutions, trade bills and loans and advances to customers.

Securities classified as loans and receivables typically comprise securities issued by the same customers with whom the Group has a lending relationship in its wholesale banking business. Investment decisions for credit substitute securities are subject to the same credit approval processes as loans, and the Group bears the same customer risk as it does for loans extended to those customers. Additionally the yield and maturity terms are generally directly negotiated by the Group with the issuer. These securities include commercial paper, short term debentures and preference shares issued by the borrower.

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Loans and receivables and securities classified as loans and receivables are carried at amortised cost using the effective interest method, less impairment losses, if any (Note 2(k)).

*Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity which the Group has the positive intention and ability to hold to maturity, other than (a) those that the Group, upon initial recognition, designates as at fair value through profit or loss or available-for-sale; and (b) those that meet the definition of loans and receivables.

Held-to-maturity investments are carried at amortised cost using the effective interest method less impairment losses, if any (Note 2(k)).

*Available-for-sale financial assets*

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the other three categories above. They include financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

Available-for-sale financial assets are carried at fair value except for investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are carried at cost less impairment losses, if any (Note 2(k)). Unrealised gains and losses arising from changes in the fair value are recognised directly in the investment revaluation reserve, except for foreign exchange gains and losses on monetary items such as debt securities which are recognised in the profit and loss account.

When the available-for-sale financial assets are sold, gains or losses on disposal include the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments which are released from the investment revaluation reserve.

*Other financial liabilities*

Financial liabilities, other than trading liabilities and those designated at fair value through profit or loss, are measured at amortised cost using the effective interest method.

*(iii) Fair value measurement principles*

The fair value of financial instruments is based on their quoted market prices at the balance sheet date without any deduction for estimated future selling costs.

If there is no publicly available latest traded price nor a quoted market price on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments or if the market for it is not active, the fair value of the instrument is estimated using valuation techniques that provide a reliable estimate of prices which could be obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the balance sheet date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the balance sheet date.

*(iv) Derecognition*

The Group derecognises a financial asset when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership, have been transferred.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

The Group uses the weighted average method to determine realised gains and losses to be recognised in the profit and loss account on derecognition.

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(v) *Offsetting*

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet only where 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.

(vi) *Embedded derivatives*

An embedded derivatives is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. The embedded derivatives are separated from the host contract and accounted for as a derivative when (a) the economic characteristics and risks of the embedded derivative are not closely related to the host contract; and (b) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in the profit and loss account.

When the embedded derivative is separated, the host contract is accounted for in accordance with note (ii) above.

(g) **Hedging**

(i) *Cash flow hedges*

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction and the hedge is effective, the gain or loss on the derivative financial instrument in relation to the hedged risk is recognised directly in equity.

(ii) *Fair value hedge*

A fair value hedge seeks to offset risks of changes in the fair value of an existing asset or liability that will give rise to a gain or loss being recognised in the profit and loss account.

The hedging instrument is measured at fair value, with fair value changes recognised in the profit and loss account. The carrying amount of the hedged item is adjusted by the amount of the changes in fair value of hedging instrument attributable to the risk being hedged. This adjustment is recognised in the profit and loss account to offset the effect of the gain or loss on the hedging instrument.

The Group currently does not use hedge accounting.

(h) **Properties**

- (i) Bank premises are stated in the balance sheet at cost or at Directors' valuation, by reference to an independent professional valuation, less accumulated depreciation and accumulated impairment loss (Note 2(k)).

When a deficit arises on revaluation, it will be charged to the profit and loss account, to the extent that it exceeds the amount held in the bank premises revaluation reserve in respect of that same asset immediately prior to the revaluation; and when a surplus arises on revaluation, it will be credited to the profit and loss account, to the extent that a deficit on revaluation in respect of that same asset had previously been charged to the profit and loss account.

In preparing these accounts, advantage has been taken of the transitional provisions set out in paragraph 80A of HKAS 16 "Property, Plant and Equipment" issued by the Hong Kong Institute of Certified Public Accountants, with the effect that bank premises have not been revalued to fair value at the balance sheet date.

- (ii) Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. Investment properties are stated at fair value. Investment properties are valued annually by external independent valuation companies, having an appropriate recognised professional qualification and recent experience in the location and category of property being valued. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. No allowance has been

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made in the valuations for any charges, mortgages or amounts owing on the properties nor any expenses or taxation which may be incurred in effecting a sale.

Any gain or loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for as described in Note 2(e).

When a bank property is transferred to investment property following a change in its use, any differences arising at the date of transfer between the carrying amount of the bank property immediately prior to transfer and its fair value is recognised as a revaluation of bank premises as described in Note 2(h)(i).

If an investment property becomes owner-occupied, it is reclassified as bank premises and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes.

A property interest under an operating lease is classified and accounted for as an investment property when the Group holds it to earn rentals or for capital appreciation or both. Any such property interest under an operating lease classified as an investment property is carried at fair value. Lease payments are accounted for as described in Note 2(l).

- (iii) Profit or loss on disposal of bank premises and investment properties is determined as the difference between the net sales proceeds and the carrying amount of the asset and is recognised in the profit and loss account upon disposal. Any surplus that is included in the bank premises revaluation reserve of the related bank premises disposed is transferred to the general reserve.

**(i) Amortisation and Depreciation**

*(i) Bank premises*

Freehold land is not amortised. Leasehold land held for own use under an operating lease, the fair value of which cannot be measured separately from the fair value of a building situated thereon at the inception of the lease, is accounted for as being held under a finance lease. Leasehold land is amortised on a straight line basis over the remaining term of the lease. Buildings are depreciated on a straight line basis at rates calculated to write off the cost or valuation of each building over its estimated useful life of 50 years or the remaining lease period of the land on which it is situated, whichever is the shorter.

Investment properties are not depreciated.

*(ii) Other fixed assets*

Other fixed assets are stated in the balance sheet at cost less accumulated depreciation, which is calculated on a straight line basis to write off the assets over their estimated useful lives from 4 to 20 years.

**(j) Goodwill**

Goodwill represents the excess of the cost of a business combination or an investment in an associate over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (Note 2(k)). In respect of associates, the carrying amount of goodwill is included in the carrying amount of the interest in the associates.

Any excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate is recognised immediately in the profit and loss account.

On disposal of a cash generating unit, or an associate during the year, any attributable amount of purchased goodwill is included in the calculation of the profit and loss on disposal.

**(k) Impairment of Assets**

At each balance sheet date, the carrying amount of the Group's assets are reviewed to determine whether there is objective evidence of impairment. If internal and external sources of information indicate such evidence exists, the carrying amount is reduced to the estimated recoverable amount and an impairment loss is recognised in the profit and loss account.

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(i) *Loans and receivables*

The impairment losses of loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets.) Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for impairment losses consists of two components: individual impairment allowances, and collective impairment allowances.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The individual impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgements about the borrower's financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Group. Each impaired asset is assessed on its own merits.

In assessing the need for collective loan loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Group makes assumptions both to define the way the Group models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the impairment allowances the Group makes depends on how well the Group can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Group believes that the impairment allowances on loans and advances to customers are reasonable and supportable.

All loans and receivables are reviewed and analysed periodically. Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and will be charged or credited to the profit and loss account. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years.

Where there is no reasonable prospect of recovery, the loan and the related interest receivables are written off.

(ii) *Held-to-maturity investments*

Impairment on held-to-maturity investments is considered at both an individual and collective level. The individual impairment allowance is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at asset's original effective interest rate, where the effect of discounting is material.

All significant assets found not to be individually impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets with similar risk characteristics.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the profit and loss account. A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

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*(iii) Available-for-sale financial assets*

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in the profit and loss account. The amount of the cumulative loss that is recognised in the profit and loss account is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in the profit and loss account.

For unquoted available-for-sale equity securities that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the equity securities and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset, where the effect of discounting is material.

Impairment losses recognised in the profit and loss account in respect of available-for-sale equity securities are not reversed through profit and loss account. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the profit and loss account.

*(iv) Other assets*

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property and equipment (other than properties carried at revalued amounts);
- investments in subsidiaries and associates;
- goodwill; and
- intangible assets

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment.

*Calculation of recoverable amount*

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cashgenerating unit).

*Recognition of impairment losses*

An impairment loss is recognised in the profit and loss account whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a *pro rata* basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

*Reversals of impairment losses*

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

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Reversals of impairment losses are credited to the profit and loss account in the year in which the reversals are recognised.

*(v) Interim financial reporting and impairment*

Under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the Group is required to prepare an interim financial report in compliance with HKAS34, Interim financial reporting, in respect of the first six months of the year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the year. (Note 2(k)(i) to (iv))

Impairment losses recognised in an interim period in respect of goodwill and available-for-sale equity securities carried at cost are not reversed in a subsequent period. This is the case even if no loss, or a smaller loss, would have been recognised had the impairment been assessed only at the end of the year to which the interim period relates.

**(l) Leased Assets**

Leases of assets under which the lessee assumes substantially all the risks and benefits of ownership are classified as finance leases. Leases of assets under which the lessor has not transferred all the risks and benefits of ownership are classified as operating leases.

*(i) Assets held under finance leases*

The amounts due from lessees in respect of finance leases are recorded in the balance sheet as advances to customers at the amounts of net investment which represent the total rentals receivable under finance leases less unearned income. Revenue arising from finance leases is recognised in accordance with the Group's revenue recognition policies, as set out in Note 2(e).

*(ii) Assets held for use in operating leases*

Where the Group leases out assets under operating leases, the leased assets are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies, as set out in Note 2(i). Impairment losses are accounted for in accordance with the accounting policy as set out in Note 2(k). Revenue arising from operating leases is recognised in accordance with the Group's revenue recognition policies, as set out in Note 2(e).

*(iii) Operating lease charges*

Where the Group has the use of assets under operating leases, payments made under the leases are charged to the profit and loss account in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in the profit and loss account as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the profit and loss account in the accounting period in which they are incurred.

**(m) Repossession of Assets**

In the recovery of impaired loans and advances, the Group may take possession of the collateral assets through court proceedings or voluntary delivery of possession by the borrowers. In accordance with the Group's accounting policy set out in Note 2(k), impairment allowances for impaired loans and advances are maintained after taking into account the net realisable value of the collateral assets, usually resulting in a partial write-off of the loans and advances against impairment allowances. Repossessed assets are reported under other assets if it is highly probable that their carrying amount will be recovered through a sale transaction rather than through continuing use and the assets are available for sale in their present condition. Related loans and advances are then written off.

Repossessed assets are recorded at the lower of the amount of the related loans and advances and fair value less costs to sell at the date of exchange. They are not depreciated or amortised.

Impairment losses on initial classification and on subsequent remeasurement are recognised in the profit and loss account.

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(n) **Income Tax**

- (i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the profit and loss account except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.
- (ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.
- (iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary difference, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing deductible temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

- (iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Bank or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:
  - in the case of current tax assets and liabilities, the Bank or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
  - in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
    - the same taxable entity; or
    - different taxable entities, which in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

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**(o) Insurance Reserves and Provisions for Outstanding Claims**

Insurance reserves, except those attributable to long term business, represent the proportion of retained premiums written in the year relating to the period of risk from 1st January in the following year to the subsequent date of expiry of policies which is carried forward as a provision for unearned premiums and calculated on a daily basis.

The insurance reserve of long term business is ascertained by actuarial valuation.

Full provision is made for the estimated cost of claims notified but not settled at the balance sheet date and for the estimated cost of claims incurred but not reported by that date, after deducting the amounts due from reinsurers. Provision has also been made for the estimated cost of servicing claims notified but not settled at the balance sheet date and to meet expenses on claims incurred but not reported at the balance sheet date.

These reserves and provisions are classified as other accounts and provisions.

**(p) Provisions and Contingent Liabilities**

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Bank has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

**(q) Employee Benefits**

*(i) Salaries, bonuses and leave benefits*

Employee entitlements to salaries, annual bonuses, paid annual leave, leave passage and the cost to the Group of non-monetary benefits are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are recognised when the absences occur.

*(ii) Performance-related bonus plan*

Liabilities for performance-related bonus plan, which are due wholly within twelve months after the balance sheet date, are recognised 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.

*(iii) Retirement benefits*

Retirement benefits are provided to eligible staff of the Group. Hong Kong employees enjoy retirement benefits under either the Mandatory Provident Fund Exempted ORSO Scheme (“MPFEOS”) or the Mandatory Provident Fund Scheme (“MPFS”). Both are defined contribution schemes. The employer’s monthly contribution to both schemes are at a maximum of 10% of each employee’s monthly salary.

The pension schemes covering all the Group’s PRC and overseas employees are defined contribution schemes at various funding rates, and are in accordance with local practices and regulations.

The cost of all these schemes is charged to the profit and loss account for the period concerned and the assets of all these schemes are held separately from those of the Group. Under the MPFEOS, the employer’s contribution is not reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions. Under the MPFS, the employer’s contribution is reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

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(iv) *Share based payments*

The option exercise price is equal to the higher of:

- (a) the closing price of the Bank's shares in the Stock Exchange's daily quotations sheet on the date of grant of the relevant options;
- (b) an amount equivalent to the average closing price of the Bank's shares as stated in the Stock Exchange's daily quotation sheets for the 5 business days immediately preceding the date of grant of the relevant options; and
- (c) the nominal value of the Bank's shares.

When the options are exercised, equity is increased by the amount of the proceeds received. The fair value of share options granted to employees is recognised as an expense in the profit and loss account with a corresponding increase in a capital reserve within equity. The fair value is measured at the grant date using the trinomial model, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to those share options, the total estimated fair value of the share options is spread over the vesting period, taking into account the probability that the options will vest.

During the vesting period, the number of share options that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged or credited to the profit and loss account for the year of the review unless the original expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of share options that vest (with a corresponding adjustment to capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the Bank's shares.

The amount recognised in capital reserve is retained until either the option is exercised (when it is transferred to share premium) or the option expires (when it is released directly to retained profits).

(r) **Related Parties**

For the purposes of these accounts, a party is considered to be related to the Group if:

- (i) The party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;
- (ii) The Group and the party are subject to common control;
- (iii) The party is an associate of the Group;
- (iv) The party is a member of key management personnel of the Group, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) The party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) The party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

(s) **Segment Reporting**

A segment is a distinguishable component of the Group that is engaged either in providing services (business segment), or in providing services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

The Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment and those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between Group enterprises within a single segment. The allocation of revenue reflects the benefits of capital and other funding resources allocated to the business or geographical segments by way of internal capital allocation and fund transfer mechanisms. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets (both tangible and intangible) that are expected to be used for more than one year.

**(t) Cash and Cash Equivalents**

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including cash, balances with banks and other financial institutions, treasury bills, other eligible bills and certificates of deposit that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

**3. Changes in Presentation — Hong Kong Accounting Standard 1 “Presentation of Financial Statements”**

With effect from 2007 reporting, interest income and expense from trading financial assets and liabilities and financial instruments designated at fair value are reported under “Interest income” and “Interest expense” instead of “Net trading profits” and “Net result from financial instruments designated at fair value through profit or loss” respectively as in previous year. The change has been made principally to match the interest expense arising from non-trading liabilities that fund the trading book with the interest income from trading assets. This also facilitates the comparison of the Bank’s net interest income and net interest margin with many peer banks in Hong Kong.

Comparative figures for 2006 have been reclassified to conform with the current year’s presentation as follows:

	As previously reported	Increase/ (decrease) in the profit for the year	As restated
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Interest income .....	12,865,593	1,182,951	14,048,544
Interest expense .....	<u>7,999,958</u>	<u>1,049,786</u>	<u>9,049,744</u>
Net interest income .....	4,865,635	133,165	4,998,800
Net trading profits .....	586,160	4,486	590,646
Net result from financial instruments designated at fair value through profit or loss .....	248,177	<u>(137,651)</u>	110,526
		<u>—</u>	

The HKICPA has issued a number of new and revised HKFRSs and Interpretations that are first effective or available for early adoption for the current accounting period of the Bank and the Group.

There have been no significant changes to the accounting policies applied in these financial statements for the years presented as a result of these developments. However, as a result of the adoption of HKFRS 7, Financial instruments: Disclosures and the amendment to HKAS 1, Presentation of financial statements: Capital disclosures, there have been some additional disclosures provided as follows:

As a result of the adoption of HKFRS 7, the financial statements include expanded disclosure about the significance of the Group's financial instruments and the nature and extent of risks arising from those instruments, compared with the information previously required to be disclosed by HKAS 30, Disclosures in the financial statements of banks and similar financial institutions, and HKAS 32, Financial instruments: Disclosure and presentation. These disclosures are provided throughout these financial statements, in particular in Note 40.

The amendment to HKAS 1 introduces additional disclosure requirements to provide information about the level of capital and the Bank's and the Group's objectives, policies and processes for managing capital. These new disclosures are set out in Note 40(h).

Both HKFRS 7 and the amendment to HKAS 1 do not have any material impact on the classification, recognition and measurement of the amounts recognised in the financial statements.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (Note 51).

#### 4. Interest Income

	2007	2006
	HK\$'000	Restated HK\$'000
Listed securities classified as held-to-maturity or available-for-sale .....	154,401	120,160
Trading assets		
- listed .....	3,570	1,612
- unlisted .....	34,769	32,998
Interest rate swaps .....	769,635	656,971
Financial assets designated at fair value through profit or loss		
- listed .....	152,117	125,423
- unlisted .....	426,409	365,947
Loans, deposits with banks and financial institutions, trade bills, and other unlisted securities that are not at fair value through profit or loss .....	16,768,411	12,745,433
Total interest income .....	<u>18,309,312</u>	<u>14,048,544</u>

Included above is interest income accrued on impaired financial assets of HK\$29,473,000 (2006: HK\$37,490,000) which includes interest income on effect of discounting of HK\$7,953,000 (2006: HK\$9,248,000) (Note 25(b)) for the year ended 31st December 2007.

## 5. Interest Expense

	2007	2006
	HK\$'000	Restated HK\$'000
Customer deposits, deposits of banks and other financial institutions and certificates of deposit issued which are stated at amortised cost .....	10,432,634	7,871,506
Subordinated notes carried at amortised cost .....	264,679	126,681
Interest rate swaps .....	917,981	696,067
Financial instruments designated at fair value through profit or loss .....	712,333	353,719
Other borrowings .....	4,515	1,771
Total interest expense .....	<u>12,332,142</u>	<u>9,049,744</u>

## 6. Fee and Commission Income

Fee and commission income arises from the following services:

	2007	2006
	HK\$'000	Restated HK\$'000
Corporate services .....	753,098	597,837
Loans, overdrafts and guarantees .....	386,737	300,575
Credit cards .....	399,980	307,475
Other retail banking services .....	190,703	140,683
Trade finance .....	113,096	110,713
Securities and brokerage .....	443,710	205,594
Trust and other fiduciary activities .....	83,390	46,507
Others .....	237,333	189,499
Total fee and commission income .....	<u>2,608,047</u>	<u>1,898,883</u>

## 7. Net Trading Profits

	2007	2006
	HK\$'000	Restated HK\$'000
Profit on dealing in foreign currencies .....	173,616	146,222
Profit on trading securities .....	851,966	479,545
Profit/(loss) on other dealing activities .....	353,364	(51,643)
Dividend income from listed trading securities .....	37,891	16,522
Total net trading profits .....	<u>1,416,837</u>	<u>590,646</u>

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**8. Net Result From Financial Instruments Designated at Fair Value Through Profit or Loss**

	<u>2007</u>	<u>2006</u>
	<u>HK\$'000</u>	<u>Restated</u>
		<u>HK\$'000</u>
Net (losses)/gains .....	(1,154,461)	110,322
Dividend income from listed securities .....	—	204
	<u>(1,154,461)</u>	<u>110,526</u>

**9. Other Operating Income**

	<u>2007</u>	<u>2006</u>
	<u>HK\$'000</u>	<u>HK\$'000</u>
Dividend income from available-for-sale financial assets		
- listed .....	42,055	12,856
- unlisted .....	20,854	14,645
Rental from safe deposit boxes .....	88,023	86,293
Net revenue from insurance activities .....	138,723	51,809
Rental income on properties .....	72,640	53,553
Others .....	<u>75,051</u>	<u>34,446</u>
Total other operating income .....	<u>437,346</u>	<u>253,602</u>

## 10. Operating Expenses

	2007	2006
	<u>HK\$'000</u>	<u>HK\$'000</u>
Contributions to defined contribution plan* .....	163,807	127,460
Equity-settled share-based payment expenses .....	27,310	22,067
Salaries and other staff costs .....	<u>2,276,673</u>	<u>1,713,721</u>
Total staff costs .....	<u>2,467,790</u>	<u>1,863,248</u>
Premises and equipment expenses excluding depreciation		
- Rental of premises .....	288,093	206,425
- Maintenance, repairs and others .....	<u>342,851</u>	<u>275,489</u>
Total premises and equipment expenses excluding depreciation .....	<u>630,944</u>	<u>481,914</u>
Depreciation on fixed assets (Note 31) .....	<u>326,265</u>	<u>299,074</u>
Amortisation of intangible assets (Note 30(b)) .....	<u>2,490</u>	<u>2,231</u>
Other operating expenses		
- Communications, stationery and printing .....	233,448	183,916
- Legal and professional fees .....	165,135	122,125
- Advertising expenses .....	269,785	158,011
- Business promotions and business travel .....	81,808	59,165
- Card related expenses .....	59,687	47,949
- Stamp duty, overseas and PRC** business taxes, and value added taxes .....	217,044	100,142
- Insurance expenses .....	33,471	13,342
- Bank charges .....	4,690	3,633
- Administration expenses of secretarial business .....	21,081	14,367
- Membership fees .....	6,000	5,286
- Bank licence .....	4,716	4,974
- Audit fee .....	6,214	5,160
- Donations .....	8,129	15,915
- Others .....	<u>152,343</u>	<u>84,908</u>
Total other operating expenses .....	<u>1,263,551</u>	<u>818,893</u>
Total operating expenses*** .....	<u><u>4,691,040</u></u>	<u><u>3,465,360</u></u>

\* Forfeited contributions totalling HK\$7,138,000 (2006: HK\$6,454,000) were utilised to reduce the Group's contribution during the year. There were no forfeited contributions available for reducing future contributions at the year end (2006: Nil).

\*\* PRC denotes the People's Republic of China.

\*\*\* Included in operating expenses are direct operating expenses of HK\$21,072,000 (2006: HK\$11,949,000) in respect of investment properties which generated rental income during the year.

## 11. Impairment Losses on Loans and Advances

	2007	2006
	<u>HK\$'000</u>	<u>HK\$'000</u>
Net charge for impairment losses on loans and advances		
Individual impairment loss		
- new provisions (Note 25(b)) .....	345,896	372,819
- releases .....	(87,724)	(82,177)
- recoveries (Note 25(b)) .....	<u>(107,521)</u>	<u>(84,837)</u>
	150,651	205,805
Collective Impairment loss .....		
- new provisions (Note 25(b)) .....	68,455	38,043
- releases (Note 25(b)) .....	<u>(2,635)</u>	<u>—</u>
Net charge to profit and loss account .....	<u>216,471</u>	<u>243,848</u>

## 12. Net Profit on Sale of Available-for-sale Financial Assets

	2007	2006
	<u>HK\$'000</u>	<u>HK\$'000</u>
Net revaluation (loss)/gain transferred from reserves (Note 38(h)) .....	(27,037)	41,766
Profit arising in current year .....	<u>694,045</u>	<u>8,232</u>
	<u>667,008</u>	<u>49,998</u>

## 13. Income Tax

(a) Taxation in the consolidated profit and loss account represents:

	2007	2006
	<u>HK\$'000</u>	<u>HK\$'000</u>
Current tax - provision for Hong Kong Profits Tax		
Tax for the year (Note 33(a)) .....	265,175	508,542
Write back of over-provision in respect of prior years .....	<u>(7,641)</u>	<u>(21,687)</u>
	<u>257,534</u>	<u>486,855</u>
Current tax - overseas		
Tax for the year .....	347,647	241,627
Write back of over-provision in respect of prior years .....	<u>(16,206)</u>	<u>(12,336)</u>
	<u>331,441</u>	<u>229,291</u>
Deferred tax (Note 33(b))		
Origination and reversal of temporary differences .....	317,751	33,229
Movements in the value of investment properties .....	<u>57,117</u>	<u>25,201</u>
	<u>374,868</u>	<u>58,430</u>
	<u>963,843</u>	<u>774,576</u>

The provision for Hong Kong Profits Tax is calculated at 17.5% (2006: 17.5%) of the estimated assessable profits for the year. Taxation for overseas branches and subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

(b) Reconciliation between tax expense and accounting profit at applicable tax rates

	2007	2006
	<u>HK\$'000</u>	<u>HK\$'000</u>
Profit before tax .....	5,184,992	4,260,194
Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned .....	1,032,457	782,512
Tax effect of non-deductible expenses .....	228,336	115,371
Tax effect of non-taxable revenue .....	(239,759)	(82,690)
Tax effect of tax losses not recognised .....	11,834	24,332
Recognition of deferred tax assets on prior year tax losses .....	(7,734)	(7,283)
Write back of over-provision in respect of prior years .....	(23,847)	(34,023)
Tax benefits derived from leasing partnerships .....	(27,498)	(23,393)
Others .....	(9,946)	(250)
Actual tax expense .....	<u>963,843</u>	<u>774,576</u>

**14. Profit Attributable to Equity Holders of the Group**

The consolidated profit attributable to equity holders of the Group includes a profit of HK\$3,002,752,000 (2006: HK\$3,014,390,000) which has been dealt with in the accounts of the Bank.

Reconciliation of the above amount to the Bank's profit for the year

	2007	2006
	<u>HK\$'000</u>	<u>HK\$'000</u>
Amount of consolidated profit attributable to equity holders dealt with in the Bank's financial statements .....	2,875,196	2,892,617
Final dividends from subsidiaries and associates attributable to the profits of the previous financial year, approved and paid during the year .....	127,556	121,773
Bank's profit for the year .....	<u>3,002,752</u>	<u>3,014,390</u>

**15. Dividends**

(a) Dividends attributable to the year

	2007	2006
	<u>HK\$'000</u>	<u>HK\$'000</u>
Interim dividend declared and paid of HK\$0.48 per share on 1,568,758,481 shares (2006: HK\$0.43 per share on 1,538,750,041 shares) (Note 38(i)) .....	753,004	661,663
Final dividend paid in respect of the previous financial year on shares issued under the share option schemes subsequent to the balance sheet date and before the close of the Register of Members of the Bank, of HK\$1.03 (2006: HK\$0.93) .....	2,864	6,342
Final dividend proposed after the balance sheet date of HK\$1.18 per share on 1,574,367,205 shares (2006: HK\$1.03 per share on 1,550,142,050 shares) .....	<u>1,857,753</u>	<u>1,596,646</u>
	<u>2,613,621</u>	<u>2,264,651</u>

The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

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(b) Dividends attributable to the previous financial year, approved and paid during the year

	<u>2007</u>	<u>2006</u>
	<i>HK\$'000</i>	<i>HK\$'000</i>
Final dividend in respect of the previous financial year, approved and paid during the year, of HK\$1.03 per share on 1,550,142,050 shares (2006: HK\$0.93 per share on 1,510,229,871 shares) .....	<u>1,596,646</u>	<u>1,404,514</u>

**16. Earnings Per Share**

(a) Basic earnings per share

The calculation of basic earnings per share is based on earnings of HK\$4,143,604,000 (2006: HK\$3,434,511,000) and on the weighted average of 1,565,141,199 (2006: 1,533,741,133) ordinary shares outstanding during the year, calculated as follows:

Weighted average number of ordinary shares

	<u>2007</u>	<u>2006</u>
	<i>Number of Shares</i>	<i>Number of Shares</i>
Issued ordinary shares at 1st January .....	1,550,142,050	1,502,313,852
Effect of share options exercised and shares issued in lieu of dividends .....	<u>14,999,149</u>	<u>31,427,281</u>
Weighted average number of ordinary shares at 31st December .....	<u>1,565,141,199</u>	<u>1,533,741,133</u>

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on earnings of HK\$4,143,604,000 (2006: HK\$3,434,511,000) and on 1,574,625,151 (2006: 1,543,706,739) ordinary shares, being the weighted average number of ordinary shares outstanding during the year, adjusted for the effects of all dilutive potential shares.

Weighted average number of ordinary shares (diluted)

	<u>2007</u>	<u>2006</u>
	<i>Number of Shares</i>	<i>Number of Shares</i>
Weighted average number of ordinary shares at 31st December .....	1,565,141,199	1,533,741,133
Effect of deemed issue of ordinary shares under the Bank's share option scheme for nil consideration .....	<u>9,483,952</u>	<u>9,965,606</u>
Weighted average number of ordinary shares (diluted) at 31st December .....	<u>1,574,625,151</u>	<u>1,543,706,739</u>

## 17. Directors' Remuneration

Directors' remuneration disclosed pursuant to Section 161 of the Hong Kong Companies Ordinance is as follows:

	Directors' fees	Salaries, allowances and benefits in kind	Discretionary bonuses	Share options	Retirement scheme contributions	2007 Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Chairman and Chief Executive</b>						
Dr. The Hon. Sir David						
LI Kwok-po .....	330	7,938	15,311	9,544	732	33,855
<b>Executive Directors</b>						
Mr. Joseph PANG Yuk-wing .....	200	3,402	3,937	4,772	314	12,625
Mr. CHAN Kay-cheung .....	66	1,185	1,282	1,063	102	3,698
<b>Non-executive Directors</b>						
Dr. LI Fook-wo .....	230	—	—	—	—	230
Mr. Aubrey LI Kwok-sing .....	260	—	—	—	—	260
Dr. William MONG Man-wai ....	200	—	—	—	—	200
Tan Sri Dr. KHOO Kay-peng .....	200	—	—	—	—	200
Mr. Richard LI Tzar-kai .....	200	—	—	—	—	200
Mr. Eric LI Fook-chuen .....	280	—	—	—	—	280
Mr. Stephen Charles						
LI Kwok-sze .....	200	—	—	—	—	200
<b>Independent Non-executive Directors</b>						
Mr. WONG Chung-hin .....	260	—	—	—	—	260
Dr. LEE Shau-kee .....	230	—	—	—	—	230
Dr. Allan WONG Chi-yun .....	340	—	—	—	—	340
Mr. Winston LO Yau-lai .....	330	—	—	—	—	330
Mr. Thomas KWOK Ping-kwong	290	—	—	—	—	290
Mr. TAN Man-kou .....	260	—	—	—	—	260
Mr. Kenneth LO Chin-ming .....	260	—	—	—	—	260
	<u>4,136</u>	<u>12,525</u>	<u>20,530</u>	<u>15,379</u>	<u>1,148</u>	<u>53,718</u>

	Directors' fees	Salaries, allowances and benefits in kind	Discretionary bonuses	Share options	Retirement scheme contributions	2006 Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Chairman and Chief Executive</b>						
Dr. The Hon. Sir David LI Kwok-po .....	210	7,560	13,804	4,774	697	27,045
<b>Executive Directors</b>						
Mr. Joseph PANG Yuk-wing .....	100	3,241	3,549	2,387	299	9,576
Mr. CHAN Kay-cheung .....	100	3,240	3,549	2,387	299	9,575
<b>Non-executive Directors</b>						
Dr. LI Fook-wo .....	110	—	—	—	—	110
Dr. The Hon. Simon LI Fook-sean .....	35	—	—	—	—	35
Mr. Aubrey LI Kwok-sing .....	120	—	—	—	—	120
Dr. William MONG Man-wai ....	100	—	—	—	—	100
Tan Sri Dr. KHOO Kay-peng .....	100	—	—	—	—	100
Mr. Richard LI Tzar-kai .....	100	—	—	—	—	100
Mr. Eric LI Fook-chuen .....	115	—	—	—	—	115
Mr. Stephen Charles LI Kwok-sze .....	67	—	—	—	—	67
<b>Independent Non-executive Directors</b>						
Mr. WONG Chung-hin .....	110	—	—	—	—	110
Dr. LEE Shau-kee .....	110	—	—	—	—	110
Dr. Allan WONG Chi-yun .....	140	—	—	—	—	140
Mr. Winston LO Yau-lai .....	130	—	—	—	—	130
Mr. Thomas KWOK Ping-kwong	120	—	—	—	—	120
Mr. TAN Man-kou .....	110	—	—	—	—	110
Mr. Kenneth LO Chin-ming .....	110	—	—	—	—	110
	<u>1,987</u>	<u>14,041</u>	<u>20,902</u>	<u>9,548</u>	<u>1,295</u>	<u>47,773</u>

Included in the above remuneration, share options were granted to Executive Directors under the Bank's Staff Share Option Schemes. The details of these benefits in kind are disclosed under the paragraph "Information on Share Options" in the Report of the Directors and Note 36.

## 18. Five Top-paid Employees

	2007	2006
	HK\$'000	HK\$'000
Salaries and other emoluments .....	19,473	17,842
Performance-related bonuses .....	25,079	24,653
Share options .....	20,521	11,935
Pension contributions .....	<u>1,631</u>	<u>1,645</u>
	<u>66,704</u>	<u>56,075</u>

The remuneration of the five top-paid employees is within the following bands:

	2007	2006
	<i>Number of Employees</i>	<i>Number of Employees</i>
HK\$		
5,000,001 — 5,500,000 .....	—	2
6,000,001 — 6,500,000 .....	1	—
7,000,001 — 7,500,000 .....	2	—
9,500,001 — 10,000,000 .....	—	2
12,000,001 — 12,500,000 .....	1	—
27,000,001 — 27,500,000 .....	—	1
33,500,001 — 34,000,000 .....	1	—

Included in the emoluments of the five top-paid employees were the emoluments of 2 (2006: 3) Directors. Their respective directors' emoluments have been included in Note 17 above.

### 19. Segment Reporting

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format because this is more relevant to the Group's internal financial reporting.

#### (a) Business segments

The Group comprises the following main business segments:

Personal financial services includes branch operations, personal Internet banking, consumer finance, property loans, credit card business and private banking to personal customers.

Corporate banking business includes corporate lending and loan syndication, asset based lending, commercial lending, enterprise lending, securities lending, trust services, mandatory provident fund business and corporate Internet banking.

Investment banking business includes treasury operations, securities broking and dealing, and provision of internet security trading services.

Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.

Other businesses include bancassurance, insurance business and property-related business.

Unallocated items mainly comprise the central management unit, bank premises, and any items which cannot be reasonably allocated to specific business segments.

2007

	Personal Financial Services	Corporate Banking	Investment Banking	Corporate Services	Others	Unallocated	Inter-segment elimination	Consolidated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>The Group</b>								
Net interest income .....	1,995,869	2,970,132	980,371	1,099	30,655	(956)	—	5,977,170
Other operating income from external customers .....	1,055,931	445,808	308,100	758,393	238,623	29,488	—	2,836,343
Inter-segment income .....	—	—	—	—	—	157,540	(157,540)	—
Operating income .....	3,051,800	3,415,940	1,288,471	759,492	269,278	186,072	(157,540)	8,813,513
Operating expenses .....	(1,897,765)	(1,327,492)	(570,291)	(440,999)	(221,836)	(232,657)	—	(4,691,040)
Inter-segment expenses .....	(126,482)	(16,385)	(7,093)	—	(1,320)	(6,260)	157,540	—
Operating profit before impairment losses .....	1,027,553	2,072,063	711,087	318,493	46,122	(52,845)	—	4,122,473
(Charge for)/Write back of impairment losses on loans and advances .....	(42,747)	(172,399)	309	(4,913)	3,279	—	—	(216,471)
Write back of impairment losses on bank premises .....	—	—	—	—	—	132,530	—	132,530
Impairment losses on available-for-sale financial assets, held-to-maturity investments and associates ....	—	—	(310,908)	—	—	—	—	(310,908)
Operating profit after impairment losses .....	984,806	1,899,664	400,488	313,580	49,401	79,685	—	3,727,624
Profit on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments and subsidiaries/associates .....	—	—	1,073,162	—	125	(570)	—	1,072,717
Valuation gains on investment properties .....	—	—	—	—	292,998	—	—	292,998
Share of profits less losses of associates .....	3,058	34,419	51,606	—	2,716	(146)	—	91,653
Profit before taxation .....	987,864	1,934,083	1,525,256	313,580	345,240	78,969	—	5,184,992
Depreciation for the year .....	(128,488)	(73,555)	(26,290)	(14,108)	(8,191)	(75,633)	—	(326,265)
Segment assets .....	56,900,852	159,795,691	151,171,404	1,105,656	8,218,409	1,013,585	—	378,205,597
Investments in associates .....	54,810	2,261,030	133,111	—	343,429	689	—	2,793,069
Unallocated assets .....	—	—	—	—	—	12,979,994	—	12,979,994
Total assets .....	56,955,662	162,056,721	151,304,515	1,105,656	8,561,838	13,994,268	—	393,978,660
Segment liabilities .....	171,180,610	114,689,983	55,646,549	126,496	2,677,047	—	—	344,320,685
Unallocated liabilities .....	—	—	—	—	—	5,559,844	—	5,559,844
Loan capital .....	—	—	—	—	—	13,652,219	—	13,652,219
Total liabilities .....	171,180,610	114,689,983	55,646,549	126,496	2,677,047	19,212,063	—	363,532,748
Capital expenditure incurred during the year .....	48,365	400,157	225,953	55,421	16,963	445,311	—	1,192,170

**2006**  
**Restated**

	Personal Financial Services	Corporate Banking	Investment Banking	Corporate Services	Others	Unallocated	Inter-segment elimination	Consolidated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>The Group</b>								
Net interest income .....	2,124,203	1,940,619	920,208	459	15,000	(1,689)	—	4,998,800
Other operating income from external customers .....	686,041	347,143	814,793	598,820	101,011	17,704	—	2,565,512
Inter-segment income .....	—	—	—	—	—	149,168	(149,168)	—
Operating income .....	2,810,244	2,287,762	1,735,001	599,279	116,011	165,183	(149,168)	7,564,312
Operating expenses .....	(1,542,398)	(844,678)	(338,201)	(359,794)	(159,783)	(220,506)	—	(3,465,360)
Inter-segment expenses .....	(121,253)	(15,584)	(5,832)	—	(1,006)	(5,493)	149,168	—
Operating profit before impairment losses .....	1,146,593	1,427,500	1,390,968	239,485	(44,778)	(60,816)	—	4,098,952
(Charge for)/Write back of impairment losses on loans and advances .....	(31,052)	(212,784)	1,588	(1,789)	189	—	—	(243,848)
Write back of impairment losses on bank premises .....	—	—	—	—	—	27,681	—	27,681
Write back of impairment losses on available-for-sale financial assets, held-to-maturity investments and associates ....	—	24,560	12,972	—	—	—	—	37,532
Impairment losses on goodwill ..	—	—	—	—	(23,698)	—	—	(23,698)
Operating profit after impairment losses .....	1,115,541	1,239,276	1,405,528	237,696	(68,287)	(33,135)	—	3,896,619
Profit on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments and subsidiaries/associates .....	—	—	49,981	—	1,493	(8,250)	—	43,224
Valuation gains on investment properties .....	—	—	—	—	137,777	—	—	137,777
Share of profits less losses of associates .....	1,822	31,061	98,744	—	51,964	(1,017)	—	182,574
Profit before taxation .....	1,117,363	1,270,337	1,554,253	237,696	122,947	(42,402)	—	4,260,194
Depreciation for the year .....	(112,438)	(57,630)	(22,259)	(14,019)	(7,297)	(85,431)	—	(299,074)
Segment assets .....	54,999,355	113,727,008	109,300,351	898,940	4,982,267	1,134,481	—	285,042,402
Investments in associates .....	42,885	513,925	168,044	—	351,049	835	—	1,076,738
Unallocated assets .....	—	—	—	—	—	8,083,177	—	8,083,177
Total assets .....	55,042,240	114,240,933	109,468,395	898,940	5,333,316	9,218,493	—	294,202,317
Segment liabilities .....	143,750,674	65,775,116	41,133,198	85,386	2,168,122	—	—	252,912,496
Unallocated liabilities .....	—	—	—	—	—	5,490,777	—	5,490,777
Loan capital .....	—	—	—	—	—	8,154,315	—	8,154,315
Total liabilities .....	143,750,674	65,775,116	41,133,198	85,386	2,168,122	13,645,092	—	266,557,588
Capital expenditure incurred during the year .....	76,343	167,049	151,904	84,430	5,326	136,785	—	621,837

(b) Geographical Segments

The information concerning geographical analysis has been classified by the location of the principal operations of the subsidiaries, or in the case of the Bank itself, by the location of the branches of the Bank responsible for reporting the results or booking the assets.

	2007					
	Hong Kong	People's Republic of China	Other Asian Countries	Others	Inter-segment elimination	Consolidated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>The Group</b>						
Operating income .....	5,938,320	2,391,248	445,839	577,675	(539,569)	8,813,513
Profit before taxation .....	3,568,133	1,226,445	228,848	161,566	—	5,184,992
Total assets .....	288,114,930	111,710,551	19,471,974	29,968,188	(55,286,983)	393,978,660
Total liabilities .....	261,011,370	101,516,320	16,608,561	26,037,239	(41,640,742)	363,532,748
Contingent liabilities and commitments .....	52,062,834	14,431,120	7,045,384	5,196,962	—	78,736,300
Capital expenditure during the year .....	249,797	617,492	237,984	86,897	—	1,192,170

	2006					
	Hong Kong	People's Republic of China	Other Asian Countries	Others	Inter-segment elimination	Consolidated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>The Group</b>						
Operating income .....	5,755,931	1,289,963	363,274	621,172	(466,028)	7,564,312
Profit before taxation .....	3,069,261	721,226	237,587	232,120	—	4,260,194
Total assets .....	236,848,380	64,224,867	20,502,975	23,972,200	(51,346,105)	294,202,317
Total liabilities .....	209,971,501	63,287,825	19,620,135	20,252,609	(46,574,482)	266,557,588
Contingent liabilities and commitments .....	41,683,215	9,775,953	6,509,521	4,256,031	—	62,224,720
Capital expenditure during the year .....	311,143	180,747	31,605	98,342	—	621,837

20. Cash and Balances with Banks and Other Financial Institutions (Note 43(c))

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cash in hand .....	824,377	605,104	632,373	584,536
Balances with central banks .....	6,938,702	2,133,118	128,477	2,049,110
Balances with banks and other financial institutions .....	6,423,622	5,579,524	2,372,297	5,438,467
	<u>14,186,701</u>	<u>8,317,746</u>	<u>3,133,147</u>	<u>8,072,113</u>

## 21. Placements with Banks and Other Financial Institutions

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Placements with banks and authorised institutions .....	92,929,703	65,753,545	82,966,941	64,995,721
Placements with other financial institutions .....	1,774,190	1,110,500	156,013	1,110,500
	<u>94,703,893</u>	<u>66,864,045</u>	<u>83,122,954</u>	<u>66,106,221</u>
Maturing				
- within one month .....	65,361,139	49,407,915	56,568,807	48,858,054
- between one month and one year .....	29,342,754	17,456,130	26,554,147	17,248,167
	<u>94,703,893</u>	<u>66,864,045</u>	<u>83,122,954</u>	<u>66,106,221</u>

## 22. Trade Bills

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Gross trade bills .....	<u>811,630</u>	<u>620,463</u>	<u>469,557</u>	<u>620,463</u>

There was no movement of impairment allowances for 2007.

Movement of impairment allowances for 2006

	The Group		The Bank	
	Individual	Collective	Individual	Collective
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January .....	—	43	—	43
Provisions released back to profit and loss account .....	(1,094)	(45)	(1,094)	(45)
Recoveries (Note 11) .....	1,094	—	1,094	—
Exchange adjustments .....	—	2	—	2
At 31st December .....	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>

## 23. Trading Assets

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Treasury bills (including Exchange Fund Bills) .....	1,194,530	497,915	1,194,530	497,915
Debt securities .....	17,598	161,153	17,598	161,153
Equity securities .....	1,808,604	1,350,059	1,744,460	1,321,766
Investment funds .....	274,137	265,990	274,137	265,990
Trading securities .....	3,294,869	2,275,117	3,230,725	2,246,824
Positive fair values of derivatives (Note 42(b)) .....	1,551,733	662,417	1,390,053	653,059
	<u>4,846,602</u>	<u>2,937,534</u>	<u>4,620,778</u>	<u>2,899,883</u>
Issued by:				
Central governments and central banks .....	1,194,530	497,915	1,194,530	497,915
Public sector entities .....	18,746	161,153	18,746	161,153
Banks and other financial institutions .....	545,990	700,158	533,068	698,366
Corporate entities .....	1,524,270	901,673	1,473,048	875,172
Other entities .....	11,333	14,218	11,333	14,218
	<u>3,294,869</u>	<u>2,275,117</u>	<u>3,230,725</u>	<u>2,246,824</u>
Analysed by place of listing:				
Listed in Hong Kong .....	1,626,429	1,177,448	1,562,284	1,149,155
Listed outside Hong Kong .....	211,106	201,555	211,106	201,555
	1,837,535	1,379,003	1,773,390	1,350,710
Unlisted .....	1,457,334	896,114	1,457,335	896,114
	<u>3,294,869</u>	<u>2,275,117</u>	<u>3,230,725</u>	<u>2,246,824</u>

## 24. Financial Assets Designated at Fair Value Through Profit or Loss

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Certificates of deposit held .....	49,600	95,685	49,600	95,685
Debt securities .....	8,608,406	8,546,958	8,591,753	8,517,854
Equity securities .....	—	836	—	836
	<u>8,658,006</u>	<u>8,643,479</u>	<u>8,641,353</u>	<u>8,614,375</u>
Issued by:				
Central governments and central banks .....	—	39,123	—	39,123
Public sector entities .....	184,082	134,845	184,082	134,845
Banks and other financial institutions .....	1,096,044	1,149,969	1,087,630	1,129,002
Corporate entities .....	7,377,880	7,319,542	7,369,641	7,311,405
	<u>8,658,006</u>	<u>8,643,479</u>	<u>8,641,353</u>	<u>8,614,375</u>
Analysed by place of listing:				
Listed in Hong Kong .....	1,754,988	1,364,389	1,754,988	1,364,389
Listed outside Hong Kong .....	796,090	1,408,981	779,437	1,383,725
	2,551,078	2,773,370	2,534,425	2,748,114
Unlisted .....	6,106,928	5,870,109	6,106,928	5,866,261
	<u>8,658,006</u>	<u>8,643,479</u>	<u>8,641,353</u>	<u>8,614,375</u>

## 25. Advances to Customers and Other Accounts

### (a) Advances to customers and other accounts

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
(i) Advances to customers .....	218,183,900	166,178,102	134,858,062	160,163,418
Less: Impairment allowances				
- Individual .....	(263,649)	(254,014)	(78,948)	(160,096)
- Collective .....	(432,791)	(443,874)	(331,995)	(431,676)
	<u>217,487,460</u>	<u>165,480,214</u>	<u>134,447,119</u>	<u>159,571,646</u>
(ii) Other accounts				
Advances to banks and other financial institutions* ..	5,673,832	2,454,109	209,163	2,454,109
Notes and bonds .....	262,351	344,076	257,982	339,720
Certificates of deposit held .....	39,003	38,890	39,003	38,890
Accrued interest .....	1,912,092	1,172,578	1,413,304	1,112,116
Bankers acceptances .....	1,425,323	422,022	309,190	417,057
Other accounts .....	8,637,260	5,219,124	5,016,023	3,761,209
	<u>17,949,861</u>	<u>9,650,799</u>	<u>7,244,665</u>	<u>8,123,101</u>
Less: Impairment allowances				
- Individual .....	(24,969)	(26,118)	—	—
- Collective .....	(6,523)	(8,229)	—	—
	<u>17,918,369</u>	<u>9,616,452</u>	<u>7,244,665</u>	<u>8,123,101</u>
	<u>235,405,829</u>	<u>175,096,666</u>	<u>141,691,784</u>	<u>167,694,747</u>

\* The above advances to banks and other financial institutions include:-

- (a) Receivables from reverse repurchase agreements under which the Group and the Bank obtain securities on terms which permit them to re-pledge or resell securities to others in the absence of default. At 31st December 2007, the fair value of financial assets accepted as collateral that the Group is permitted to sell or re-pledge under such terms is HK\$1,274,722,000 (2006: HK\$483,339,000).
- (b) Statutory reserve deposits with a central bank of HK\$3,666,160,000 (2006: HK\$548,944,000).

(b) Impairment allowances against advances and other accounts for 2007

	The Group					
	Advances to customers		Other Accounts		Total	
	Individual	Collective	Individual	Collective	Individual	Collective
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
At 1st January .....	254,014	443,874	26,118	8,229	280,132	452,103
New provisions charged to profit and loss account (Note 11) .....	335,527	68,455	10,369	—	345,896	68,455
Net provisions released back to profit and loss account (Note 11)	(182,894)	—	(4,398)	(2,635)	(187,292)	(2,635)
Amounts written off .....	(246,465)	(86,917)	(7,504)	—	(253,969)	(86,917)
Recoveries (Note 11) .....	107,255	—	266	—	107,521	—
Additions through acquisition of subsidiaries .....	—	—	—	837	—	837
Effect of discounting (Note 4) .....	(7,953)	—	—	—	(7,953)	—
Exchange adjustments .....	4,165	7,379	118	92	4,283	7,471
At 31st December .....	<u>263,649</u>	<u>432,791</u>	<u>24,969</u>	<u>6,523</u>	<u>288,618</u>	<u>439,314</u>

	The Bank					
	Advances to customers		Other Accounts		Total	
	Individual	Collective	Individual	Collective	Individual	Collective
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
At 1st January .....	160,096	431,676	—	—	160,096	431,676
New provisions charged to profit and loss account .....	251,310	102,121	—	—	251,310	102,121
Net provisions released back to profit and loss account .....	(153,285)	—	—	—	(153,285)	—
Amounts written off .....	(241,151)	(83,660)	—	—	(241,151)	(83,660)
Recoveries .....	80,052	—	—	—	80,052	—
Transfer to The Bank of East Asia (China) Limited .....	(17,147)	(121,612)	—	—	(17,147)	(121,612)
Effect of discounting .....	(4,922)	—	—	—	(4,922)	—
Exchange adjustments .....	3,995	3,470	—	—	3,995	3,470
At 31st December .....	<u>78,948</u>	<u>331,995</u>	<u>—</u>	<u>—</u>	<u>78,948</u>	<u>331,995</u>

(b) Impairment allowances against advances and other accounts for 2006

	The Group					
	Advances to customers		Other Accounts		Total	
	Individual	Collective	Individual	Collective	Individual	Collective
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January .....	295,575	478,995	28,570	9,943	324,145	488,938
New provisions charged to profit and loss account (Note 11) .....	366,669	39,926	6,150	—	372,819	39,926
Net provisions released back to profit and loss account (Note 11) .....	(153,220)	—	(3,452)	(1,838)	(156,672)	(1,838)
Amounts written off .....	(337,840)	(80,059)	(5,580)	—	(343,420)	(80,059)
Recoveries (Note 11) .....	83,539	—	204	—	83,743	—
Additions through acquisition of subsidiaries	—	—	92	—	92	—
Effect of discounting (Note 4) .....	(9,248)	—	—	—	(9,248)	—
Exchange adjustments .....	8,539	5,012	134	124	8,673	5,136
At 31st December .....	<u>254,014</u>	<u>443,874</u>	<u>26,118</u>	<u>8,229</u>	<u>280,132</u>	<u>452,103</u>

	The Bank					
	Advances to customers		Other Accounts		Total	
	Individual	Collective	Individual	Collective	Individual	Collective
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January .....	204,122	471,854	—	—	204,122	471,854
New provisions charged to profit and loss account ....	361,822	34,818	—	—	361,822	34,818
Net provisions released back to profit and loss account	(151,384)	—	—	—	(151,384)	—
Amounts written off .....	(336,735)	(80,058)	—	—	(336,735)	(80,058)
Recoveries .....	82,809	—	—	—	82,809	—
Effect of discounting .....	(9,100)	—	—	—	(9,100)	—
Exchange adjustments .....	8,562	5,062	—	—	8,562	5,062
At 31st December .....	<u>160,096</u>	<u>431,676</u>	<u>—</u>	<u>—</u>	<u>160,096</u>	<u>431,676</u>

(c) **Advances to customers — by industry sectors**

The analysis of gross advances to customers and the percentage of secured advances by industry sector is based on the categories and definitions used by the Hong Kong Monetary Authority.

	2007		2006	
	Gross Advances	% of secured advances	Gross Advances	% of secured advances
	HK\$'000	%	HK\$'000	%
<b>The Group</b>				
Loans for use in Hong Kong Industrial, commercial and financial				
- Property development .....	9,079,949	66.41	6,422,770	45.69
- Property investment .....	26,023,323	87.04	20,464,978	96.48
- Financial concerns .....	1,931,675	76.71	1,865,472	82.54
- Stockbrokers .....	659,071	99.60	258,562	77.62
- Wholesale and retail trade .....	1,469,007	50.12	1,322,504	47.75
- Manufacturing .....	1,934,455	48.35	1,884,745	51.30
- Transport and transport equipment .....	4,344,681	70.36	4,118,384	73.72
- Recreational activities .....	285,273	90.81	316,426	88.17
- Information technology .....	4,608	38.89	3,321	0.00
- Others .....	9,672,652	72.40	6,711,510	64.02
- Sub-total .....	<u>55,404,694</u>	77.27	<u>43,368,672</u>	77.54
<b>Individuals</b>				
- Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme .....	1,040,884	100.00	1,117,688	100.00
- Loans for the purchase of other residential properties ...	36,245,144	99.68	36,956,206	99.52
- Credit card advances .....	2,619,066	0.00	2,409,027	0.00
- Others .....	5,449,772	70.57	4,728,035	70.37
- Sub-total .....	<u>45,354,866</u>	90.43	<u>45,210,956</u>	91.18
Total loans for use in Hong Kong .....	100,759,560	83.20	88,579,628	84.50
Trade finance .....	3,713,849	57.09	3,464,619	58.44
Loans for use outside Hong Kong* .....	<u>113,710,491</u>	72.67	<u>74,133,855</u>	66.08
Total advances to customers .....	<u>218,183,900</u>	77.27	<u>166,178,102</u>	75.74

\* Loans for use outside Hong Kong includes the following loans for use in the PRC.

	2007		2006	
	Gross Advances	% of secured advances	Gross Advances	% of secured advances
	HK\$'000	%	HK\$'000	%
Property development .....	11,399,331	72.07	4,915,208	49.61
Property investment .....	22,048,674	92.58	14,640,487	90.51
Wholesale and retail trade .....	11,275,846	84.46	3,977,583	73.58
Manufacturing .....	7,417,408	47.35	6,019,503	38.22
Others .....	27,173,366	59.45	16,603,585	57.16
	<u>79,314,625</u>	72.90	<u>46,156,366</u>	65.88
<b>The Bank</b>				
Loans for use in Hong Kong Industrial, commercial and financial				
- Property development .....	8,967,432	67.25	6,285,172	46.69
- Property investment .....	25,939,167	87.00	20,464,979	96.48
- Financial concerns .....	1,931,275	76.73	1,734,376	81.25
- Stockbrokers .....	659,071	99.60	258,562	77.62
- Wholesale and retail trade .....	1,457,111	49.72	1,322,504	47.75
- Manufacturing .....	1,934,455	48.35	1,884,745	51.30
- Transport and transport equipment .....	4,344,681	70.36	4,118,384	73.72
- Recreational activities .....	285,273	90.81	316,426	88.17
- Information technology .....	4,608	38.89	3,322	0.00
- Others .....	9,454,248	71.76	6,711,508	64.02
- Sub-total .....	<u>54,977,321</u>	77.30	<u>43,099,978</u>	77.72
<b>Individuals</b>				
- Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme .....	1,040,885	100.00	1,117,688	100.00
- Loans for the purchase of other residential properties ...	36,220,418	99.68	36,956,206	99.52
- Credit card advances .....	2,619,066	0.00	2,409,027	0.00
- Others .....	5,317,777	71.35	4,717,943	70.52
- Sub-total .....	<u>45,198,146</u>	90.58	<u>45,200,864</u>	91.20
Total loans for use in Hong Kong .....	100,175,467	83.29	88,300,842	84.62
Trade finance .....	3,353,034	54.92	3,325,615	56.91
Loans for use outside Hong Kong* .....	<u>31,329,561</u>	58.35	<u>68,536,961</u>	63.47
Total advances to customers .....	<u>134,858,062</u>	76.79	<u>160,163,418</u>	75.00

\* Loans for use outside Hong Kong includes the following loans for use in the PRC.

	2007		2006	
	Gross Advances	% of secured advances	Gross Advances	% of secured advances
	HK\$'000	%	HK\$'000	%
Property development .....	1,381,023	9.95	4,915,208	49.61
Property investment .....	824,008	96.36	14,640,487	90.51
Wholesale and retail trade .....	—	0.00	3,977,583	73.58
Manufacturing .....	672,629	13.92	6,019,503	38.22
Others .....	1,869,645	0.00	16,603,585	57.16
	<u>4,747,305</u>	21.59	<u>46,156,366</u>	65.88

Individually impaired loans and individual and collective impairment allowances in respect of industry sectors which constitute 10% or more of total advances to customers are as follows:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
(i) Property development				
a. Individually impaired loans .....	305,029	232,655	181,235	95,058
b. Individual impairment allowance .....	90,493	92,249	—	54
c. Collective impairment allowance .....	34,771	29,180	22,914	28,457
d. Provision charged to profit and loss .....	47	47,797	47	47,797
e. Written off .....	—	45,785	—	45,785
(ii) Property investment				
a. Individually impaired loans .....	23,173	55,307	12,616	37,551
b. Individual impairment allowance .....	173	170	59	170
c. Collective impairment allowance .....	88,967	94,971	58,977	88,148
d. Provision charged to profit and loss .....	366	3,806	59	3,806
e. Written off .....	318	3,373	—	3,373
(iii) Loans for purchase of residential properties				
a. Individually impaired loans .....	188,831	254,380	165,805	254,380
b. Individual impairment allowance .....	6,184	14,267	6,065	14,267
c. Collective impairment allowance .....	25,016	33,121	18,132	31,528
d. Provision charged to profit and loss .....	6,965	9,281	6,766	9,220
e. Written off .....	6,323	11,563	6,323	11,534

(d) **Advances to customers — by geographical areas**

The information concerning the breakdown of the gross amount of advances to customers by countries or geographical areas 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.

	<b>The Group</b>				
	<b>2007</b>				
	<b>Total advances to customers</b>	<b>Advances overdue for over three months</b>	<b>Impaired advances to customers</b>	<b>Individual impairment allowance</b>	<b>Collective impairment allowance</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
Hong Kong .....	123,538,991	296,281	622,504	147,893	264,981
People's Republic of China .....	62,517,654	113,790	333,820	86,789	83,517
Other Asian Countries .....	10,339,650	56,330	89,668	27,893	60,438
Others .....	21,787,605	1,251	195,895	1,074	23,855
Total .....	<u>218,183,900</u>	<u>467,652</u>	<u>1,241,887</u>	<u>263,649</u>	<u>432,791</u>
% of total advances to customers .....			<u>0.57%</u>		
Market value of security held against impaired advances to customers .....			<u>3,647,073</u>		

	<b>The Group</b>				
	<b>2006</b>				
	<b>Total advances to customers</b>	<b>Advances overdue for over three months</b>	<b>Impaired advances to customers</b>	<b>Individual impairment allowance</b>	<b>Collective impairment allowance</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
Hong Kong .....	105,270,368	361,260	786,086	171,264	272,508
People's Republic of China .....	35,322,858	57,202	275,942	10,749	81,187
Other Asian Countries .....	9,090,413	103,149	198,818	70,278	59,639
Others .....	<u>16,494,463</u>	<u>1,690</u>	<u>33,342</u>	<u>1,723</u>	<u>30,540</u>
Total .....	<u>166,178,102</u>	<u>523,301</u>	<u>1,294,188</u>	<u>254,014</u>	<u>443,874</u>
% of total advances to customers .....			<u>0.78%</u>		
Market value of security held against impaired advances to customers .....			<u>2,340,517</u>		

<b>The Bank</b>					
<b>2007</b>					
	<b>Total advances to customers</b>	<b>Advances overdue for over three months</b>	<b>Impaired advances to customers</b>	<b>Individual impairment allowance</b>	<b>Collective impairment allowance</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Hong Kong .....	104,081,610	205,721	442,514	49,628	236,955
People's Republic of China .....	8,521,325	2,069	188,739	1,427	23,205
Other Asian Countries .....	9,510,687	56,079	89,417	27,893	59,512
Others .....	<u>12,744,440</u>	<u>156</u>	<u>176,804</u>	<u>—</u>	<u>12,323</u>
<b>Total .....</b>	<b><u>134,858,062</u></b>	<b><u>264,025</u></b>	<b><u>897,474</u></b>	<b><u>78,948</u></b>	<b><u>331,995</u></b>
% of total advances to customers .....			<u>0.67%</u>		
Market value of security held against impaired advances to customers .....			<u>2,281,988</u>		

<b>The Bank</b>					
<b>2006</b>					
	<b>Total advances to customers</b>	<b>Advances overdue for over three months</b>	<b>Impaired advances to customers</b>	<b>Individual impairment allowance</b>	<b>Collective impairment allowance</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Hong Kong .....	104,955,072	361,260	648,489	79,069	272,230
People's Republic of China .....	35,316,294	57,202	275,942	10,749	81,187
Other Asian Countries .....	9,090,413	103,149	198,818	70,278	59,639
Others .....	<u>10,801,639</u>	<u>509</u>	<u>5,009</u>	<u>—</u>	<u>18,620</u>
<b>Total .....</b>	<b><u>160,163,418</u></b>	<b><u>522,120</u></b>	<b><u>1,128,258</u></b>	<b><u>160,096</u></b>	<b><u>431,676</u></b>
% of total advances to customers .....			<u>0.70%</u>		
Market value of security held against impaired advances to customers .....			<u>2,309,813</u>		

Impaired loans and advances are individually assessed loans with objective evidence of impairment on an individual basis. The above information by countries or geographical areas are derived according to the location of the counterparties after taking into account any transfer of risk.

There were no impaired advances to banks and other financial institutions as at 31st December 2007 and 31st December 2006, nor were there any individual impairment allowances made for them on these two dates.

(e) **Advances to customers — Net investment in finance leases**

Advances to customers include net investment in equipment leased under finance leases. The total minimum lease payments receivable under finance leases and their present values at the year end are as follows:

	The Group and The Bank					
	2007			2006		
	Present value of the minimum lease payments	Interest income relating to future periods	Total minimum lease payments	Present value of the minimum lease payments	Interest income relating to future periods	Total minimum lease payments
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Amounts receivable:						
Within one year .....	1,086,905	202,657	1,289,562	981,767	222,438	1,204,205
After one year but within five years .....	1,433,710	400,942	1,834,652	1,281,289	494,641	1,775,930
After five years .....	1,900,091	631,882	2,531,973	1,920,007	848,158	2,768,165
	4,420,706	<u>1,235,481</u>	<u>5,656,187</u>	4,183,063	<u>1,565,237</u>	<u>5,748,300</u>
Less: Individual impairment allowances .....	<u>(3,591)</u>			<u>(3,867)</u>		
Net investment in finance leases .....	<u>4,417,115</u>			<u>4,179,196</u>		

The net investment in finance leases is carried on the balance sheet as a receivable. No accrual is made for the interest income relating to future periods.

## 26. Available-for-Sale Financial Assets

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Treasury bills (including Exchange Fund Bills) .....	2,868,626	4,221,416	2,837,560	4,190,581
Certificates of deposit held .....	807,061	943,306	765,536	934,346
Debt securities .....	6,797,749	3,274,524	5,682,244	2,711,545
Equity securities .....	1,601,851	3,398,552	1,248,204	2,231,997
Investment funds .....	142,208	164,399	74,480	33,066
	<u>12,217,495</u>	<u>12,002,197</u>	<u>10,608,024</u>	<u>10,101,535</u>
Issued by:				
Central governments and central banks .....	2,914,152	4,344,171	2,857,703	4,280,311
Public sector entities .....	2,336,964	220,749	2,297,332	163,881
Banks and other financial institutions .....	4,076,627	5,058,286	3,616,244	3,944,250
Corporate entities .....	2,586,100	2,214,163	1,601,267	1,680,027
Other entities .....	303,652	164,828	235,478	33,066
	<u>12,217,495</u>	<u>12,002,197</u>	<u>10,608,024</u>	<u>10,101,535</u>
Analysed by place of listing:				
Listed in Hong Kong .....	1,024,760	2,771,512	760,222	1,556,460
Listed outside Hong Kong .....	2,548,630	1,949,661	1,618,961	1,462,927
	3,573,390	4,721,173	2,379,183	3,019,387
Unlisted .....	8,644,105	7,281,024	8,228,841	7,082,148
	<u>12,217,495</u>	<u>12,002,197</u>	<u>10,608,024</u>	<u>10,101,535</u>

## 27. Held-to-Maturity Investments

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Treasury bills (including Exchange Fund Bills) .....	66,793	84,044	66,793	38,069
Certificates of deposit held .....	1,625,065	1,614,028	701,688	867,558
Debt securities .....	9,111,158	8,551,287	8,046,384	7,429,249
	<u>10,803,016</u>	<u>10,249,359</u>	<u>8,814,865</u>	<u>8,334,876</u>
Less: Impairment allowances .....	(41,967)	—	(41,967)	—
	<u>10,761,049</u>	<u>10,249,359</u>	<u>8,772,898</u>	<u>8,334,876</u>
Issued by:				
Central governments and central banks .....	5,411,301	5,417,161	5,407,422	5,351,748
Public sector entities .....	664,054	746,137	544,159	625,158
Banks and other financial institutions .....	3,507,330	2,881,767	2,050,808	1,587,625
Corporate entities .....	1,178,364	1,204,294	770,509	770,345
	<u>10,761,049</u>	<u>10,249,359</u>	<u>8,772,898</u>	<u>8,334,876</u>
Analysed by place of listing:				
Listed in Hong Kong .....	193,792	80,663	174,123	52,819
Listed outside Hong Kong .....	2,129,581	1,773,409	1,695,566	1,312,375
	<u>2,323,373</u>	<u>1,854,072</u>	<u>1,869,689</u>	<u>1,365,194</u>
Unlisted .....	8,437,676	8,395,287	6,903,209	6,969,682
	<u>10,761,049</u>	<u>10,249,359</u>	<u>8,772,898</u>	<u>8,334,876</u>
Market value:				
Listed securities .....	2,330,403	1,847,348	1,881,528	1,365,449
Unlisted securities .....	8,462,504	8,269,760	6,914,067	6,830,620
	<u>10,792,907</u>	<u>10,117,108</u>	<u>8,795,595</u>	<u>8,196,069</u>

### Movement of impairment allowances

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January .....	—	30,887	—	30,887
Charge for/(Write back) to profit and loss .....	41,967	(12,972)	41,967	(12,972)
Write off .....	—	(20,178)	—	(20,178)
Exchange adjustments .....	—	2,263	—	2,263
At 31st December .....	<u>41,967</u>	<u>—</u>	<u>41,967</u>	<u>—</u>

## 28. Investments in Subsidiaries

	The Bank	
	2007	2006
	HK\$'000	HK\$'000
Unlisted shares, at cost .....	10,774,187	2,962,553
Less: impairment allowances .....	<u>(169,850)</u>	<u>(169,850)</u>
	<u>10,604,337</u>	<u>2,792,703</u>

The following list contains only the particulars of subsidiaries which principally affected the results, assets or liabilities of the Group. The class of shares held is ordinary.

Details of these companies are as follows:

Name of company	Place of incorporation and operation	Issued and paid-up capital	% Held by		Nature of business
			The Bank	The Group	
Bank of East Asia (Trustees) Limited	Hong Kong	HK\$ 150,000,000	100%		Trustee
BEA Life Limited	Hong Kong	HK\$ 500,000,000	100%		Life Insurance
BEA Pacific Asia Limited	Hong Kong	US\$ 13,000,000		100%	Investment holding
BEA Pacific Holding Company Limited	Bermuda	HK\$1,248,000,000	100%		Investment holding
BEA Pacific (Vanuatu) Limited	Vanuatu	US\$ 100,000	100%		Holding of a single outstanding deposit
Blue Cross (Asia-Pacific) Insurance Limited	Hong Kong	HK\$ 300,000,000	100%		Insurance
BEA Union Investment Management Limited (formerly East Asia Asset Management Company Limited)	Hong Kong	HK\$ 10,000,000	51%		Asset management
East Asia Corporate Services (BVI) Limited	BVI	US\$ 250,000		75.6%	Registered agent and trustee services
East Asia Financial Services (BVI) Ltd.	BVI	US\$ 24,096,000	100%		Investment holding
East Asia Futures Limited	Hong Kong	HK\$ 7,000,000	100%		Futures and options trading
* East Asia Holding Company, Inc.	U.S.A.	US\$ 5	100%		Bank holding company
East Asia Indonesian Holdings Limited	Seychelles	US\$ 100,000		100%	Investment holding
East Asia Investment Holdings Limited	Hong Kong	HK\$ 100,000,000	100%		Securities trading
East Asia Investments Holdings (BVI) Ltd.	BVI	HK\$ 186,038,725	100%		Investment holding
* East Asia Properties (US), Inc.	U.S.A.	US\$ 5		100%	Property holding
East Asia Secretaries (BVI) Limited	BVI	HK\$ 300,000,000		75.6%	Investment holding
East Asia Securities Company Limited	Hong Kong	HK\$ 25,000,000	100%		Securities broking
East Asia Strategic Holdings Limited	BVI	US\$ 50,000,000	100%		Investment holding
Flowers World Corporation	BVI	US\$ 1		75.6%	Holding company
The Bank of East Asia (Canada)	Canada	C\$ 38,000,000	100%		Banking services
The Bank of East Asia (China) Limited (Note 1)	PRC	CNY\$8,000,000,000	100%		Banking and related financial services
* The Bank of East Asia (U.S.A.) N.A.	U.S.A.	US\$ 4,500		100%	Banking
Tricolor Consultancy (Beijing) Limited (Note 1)	PRC	US\$ 1,500,000		75.6%	Business consultancy

Name of company	Place of incorporation and operation	Issued and paid-up capital	% Held by		Nature of business
			The Bank	The Group	
Tricor Holdings Limited	BVI	US\$7,001		75.6%	Investment holding
Tricor Holdings Pte. Ltd.	Singapore	S\$ 2		75.6%	Investment holding
Tricor Investor Services Limited	Hong Kong	HK\$ 2		75.6%	Investor services
Tricor Services Limited	Hong Kong	HK\$ 2		75.6%	Business, corporate and investor services
Tricor Singapore Pte. Ltd.	Singapore	S\$ 1		75.6%	Business management and consultancy services, and employment agency
Vitaway (Mauritius) Limited	Mauritius	US\$ 1		75.6%	Regional treasurer

*Notes:*

1. Represents a wholly foreign owned enterprise.
2. BVI denotes the British Virgin Islands and PRC denotes the People's Republic of China.
3. In April 2007, The Bank of East Asia (China) Limited, the Bank's wholly owned subsidiary incorporated in Mainland, was established to take over all assets and liabilities of the Bank's mainland branches except those retained in a booking branch in Shanghai.

\* Companies not audited by KPMG. The accounts of the subsidiaries not audited by KPMG reflect total net assets and total income constituting approximately 1.7% and 1.5% respectively of the related consolidated totals.

## 29. Investments In Associates

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Listed shares, at cost .....	—	—	1,725,234	—
Unlisted shares, at cost .....	—	—	332,749	358,851
Share of net assets .....	2,607,126	1,076,731	—	—
Goodwill .....	227,246	69	—	—
	2,834,372	1,076,800	2,057,983	358,851
Less: impairment allowances .....	(41,302)	(62)	(93,438)	(118,961)
	<u>2,793,070</u>	<u>1,076,738</u>	<u>1,964,545</u>	<u>239,890</u>

Loans to associates amounting to HK\$101,972,000 (2006: HK\$121,155,000) are included under advances to customers.

Share of associates' taxation for the year amounted to HK\$21,608,000 (2006: HK\$43,570,000).

The following list contains only the particulars of associates which principally affected the results or assets of the Group:

Name of company	Place of incorporation and operation	% of ordinary shares held by		Nature of business
		The Bank	The Group	
<b>Listed</b>				
Affin Holdings Berhad	Malaysia	20.39%		Investment holding
<b>Unlisted</b>				
Mercedes-Benz Financial Services Hong Kong Limited (formerly DaimlerChrysler Financial Services China Limited)	Hong Kong		20%	Financing, leasing and insurance services
Mercedes-Benz Financial Services Korea Limited (formerly DaimlerChrysler Financial Services Korea Limited) Mercedes-Benz Financial Services Korea Limited (DaimlerChrysler Financial Services Korea Limited)	Republic of Korea		20%	Financial services
East Asia GE Commercial Finance Limited	Hong Kong	50%		Factoring
ICEA Finance Holdings Limited	BVI	25%		Investment holding
Platinum Holdings Company Limited	Cayman Islands	30%		Investment holding
PT. Bank Resona Perdania	Indonesia		30%	Banking and related financial services
Sunfire Enterprises Limited	BVI		20%	Property development
TCL Finance Co., Ltd.	PRC	20%		Financial services and cash management
Trans-Ocean Insurance Company, Limited	Hong Kong	48.7%		Insurance

Summary financial information on associates

	Assets	Liabilities	Equity	Revenues	Profit
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>2007</b>					
100 per cent .....	105,537,038	92,272,635	13,264,403	1,098,448	355,973
Group's effective interest .....	<u>22,248,206</u>	<u>19,641,080</u>	<u>2,607,126</u>	<u>295,427</u>	<u>91,653</u>
<b>2006</b>					
100 per cent .....	15,438,203	12,179,373	3,258,830	1,354,722	621,178
Group's effective interest .....	<u>4,190,955</u>	<u>3,114,224</u>	<u>1,076,731</u>	<u>359,415</u>	<u>182,574</u>

### 30. Goodwill And Intangible Assets

Goodwill and intangible assets includes goodwill arising on business combinations and acquired intangible assets. Acquired intangible assets comprise core deposits which are amortised over their estimated economic useful life of ten years.

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Goodwill .....	2,656,719	2,592,330	1,460,292	1,460,292
Acquired intangible assets .....	11,383	12,986	—	—
	<u>2,668,102</u>	<u>2,605,316</u>	<u>1,460,292</u>	<u>1,460,292</u>

#### (a) Goodwill

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January .....	2,592,330	2,494,950	1,460,292	1,460,292
Additions through acquisition of subsidiaries .....	39,785	95,251	—	—
Impairment loss .....	—	(23,698)	—	—
Exchange adjustments .....	24,604	25,827	—	—
At 31st December .....	<u>2,656,719</u>	<u>2,592,330</u>	<u>1,460,292</u>	<u>1,460,292</u>

#### *Impairment tests for cash-generating units containing goodwill*

Goodwill is allocated to the Group's cash-generating units (CGU) identified according to business segment as follows:

	2007	2006
	HK\$'000	HK\$'000
Personal Financial Services .....	849,637	849,637
Corporate Banking .....	453,007	453,007
Investment Banking .....	157,648	157,648
Corporate Services .....	1,027,155	962,867
Others .....	169,272	169,171
	<u>2,656,719</u>	<u>2,592,330</u>

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated rates stated below. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

The pre-tax discount rate used for value-in-use calculations is 10.88% (2006: 11.74%) and the long-term growth rate is 5% (2006: 5%).

Management determined the budgeted net profit based on past performance and its expectation for market development. The weighted average growth rates used are consistent with the forecasts included in industry reports.

(b) **Intangible assets (Other than goodwill)**

Intangible assets include acquired core deposits. Intangible assets are stated at cost less accumulated amortisation and impairment loss (Note 2(k)(iv)).

Amortisation of intangible assets with finite useful lives is charged to the profit and loss account on a diminishing basis over the assets' estimated useful lives. The following intangible assets with finite useful lives are amortised from the date they are available to use and their estimated useful lives are as follows:

Acquired core deposits 10 years

Both the period and method of amortisation are reviewed annually.

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cost				
At 1st January .....	15,219	—	—	—
Additions through acquisition of subsidiaries .....	—	15,219	—	—
Formation of a new subsidiary .....	849	—	—	—
Exchange adjustments .....	45	—	—	—
At 31st December .....	<u>16,113</u>	<u>15,219</u>	<u>—</u>	<u>—</u>
Accumulated amortisation and impairment losses				
At 1st January .....	(2,233)	—	—	—
Amortisation charge for the year (Note 10) .....	(2,490)	(2,231)	—	—
Exchange adjustments .....	(7)	(2)	—	—
At 31st December .....	<u>(4,730)</u>	<u>(2,233)</u>	<u>—</u>	<u>—</u>
Carrying amount at 31st December .....	<u>11,383</u>	<u>12,986</u>	<u>—</u>	<u>—</u>

### 31. Fixed Assets

	2007				
	The Group				
	Investment Properties	Bank Premises	Furniture, Fixtures and Equipment	Sub-total	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cost or valuation					
At 1st January 2007 .....	1,288,541	4,230,569	2,255,097	6,485,666	7,774,207
Additions .....	182	442,043	482,134	924,177	924,359
Additions through acquisition .....	—	—	1,287	1,287	1,287
Revaluation surplus .....	292,998	—	—	—	292,998
Revaluation of bank premises transferred to investment properties ..	—	20,860	—	20,860	20,860
Transfer from bank premises to investment properties .....	142,581	(142,581)	—	(142,581)	—
Disposals .....	—	(13,413)	(47,999)	(61,412)	(61,412)
Exchange adjustments .....	1,856	71,411	20,369	91,780	93,636
At 31st December 2007 .....	<u>1,726,158</u>	<u>4,608,889</u>	<u>2,710,888</u>	<u>7,319,777</u>	<u>9,045,935</u>
Accumulated depreciation and amortisation					
At 1st January 2007 .....	—	683,568	1,341,034	2,024,602	2,024,602
Additions through acquisition .....	—	—	717	717	717
Charge for the year (Note 10) .....	—	68,286	257,979	326,265	326,265
Revaluation of bank premises transferred to investment properties ..	—	(14,809)	—	(14,809)	(14,809)
Impairment loss .....	—	(132,530)	—	(132,530)	(132,530)
Written back on disposals .....	—	(6,983)	(40,206)	(47,189)	(47,189)
Exchange adjustments .....	—	19,460	13,006	32,466	32,466
At 31st December 2007 .....	<u>—</u>	<u>616,992</u>	<u>1,572,530</u>	<u>2,189,522</u>	<u>2,189,522</u>
Net book value at 31st December 2007 ....	<u>1,726,158</u>	<u>3,991,897</u>	<u>1,138,358</u>	<u>5,130,255</u>	<u>6,856,413</u>
The gross amounts of the above assets are stated:					
At cost .....	—	3,774,540	2,710,888	6,485,428	6,485,428
At Directors' valuation					
— 1989 .....	—	834,349	—	834,349	834,349
At professional valuation					
— 2007 .....	<u>1,726,158</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,726,158</u>
	<u>1,726,158</u>	<u>4,608,889</u>	<u>2,710,888</u>	<u>7,319,777</u>	<u>9,045,935</u>

	2007				
	The Bank				
	Investment Properties	Bank Premises	Furniture, Fixtures and Equipment	Sub-total	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cost or valuation					
At 1st January 2007 .....	1,316,755	3,976,454	1,937,162	5,913,616	7,230,371
Additions .....	182	228,095	205,718	433,813	433,995
Revaluation surplus .....	326,384	—	—	—	326,384
Revaluation loss on bank premises .....	—	(2,670)	—	(2,670)	(2,670)
Revaluation of bank premises transferred to investment properties ..	—	20,860	—	20,860	20,860
Transfer to The Bank of East Asia (China) Ltd. ....	(10,555)	(835,824)	(258,853)	(1,094,677)	(1,105,232)
Transfer from bank premises to investment properties .....	196,804	(196,804)	—	(196,804)	—
Disposals .....	—	(91)	(29,547)	(29,638)	(29,638)
Exchange adjustments .....	—	1,523	3,367	4,890	4,890
At 31st December 2007 .....	<u>1,829,570</u>	<u>3,191,543</u>	<u>1,857,847</u>	<u>5,049,390</u>	<u>6,878,960</u>
Accumulated depreciation and amortisation					
At 1st January 2007 .....	—	600,473	1,154,783	1,755,256	1,755,256
Charge for the year .....	—	50,050	183,899	233,949	233,949
Revaluation of bank premises transferred to investment properties ..	—	(14,809)	—	(14,809)	(14,809)
Transfer to The Bank of East Asia (China) Ltd. ....	—	(200,192)	(147,495)	(347,687)	(347,687)
Impairment loss .....	—	(132,530)	—	(132,530)	(132,530)
Written back on disposals .....	—	—	(26,131)	(26,131)	(26,131)
Exchange adjustments .....	—	847	2,772	3,619	3,619
At 31st December 2007 .....	<u>—</u>	<u>303,839</u>	<u>1,167,828</u>	<u>1,471,667</u>	<u>1,471,667</u>
Net book value at 31st December 2007 ....	<u><u>1,829,570</u></u>	<u><u>2,887,704</u></u>	<u><u>690,019</u></u>	<u><u>3,577,723</u></u>	<u><u>5,407,293</u></u>
The gross amounts of the above assets are stated:					
At cost .....	—	2,357,194	1,857,847	4,215,041	4,215,041
At Directors' valuation					
— 1989 .....	—	834,349	—	834,349	834,349
At professional valuation					
— 2007 .....	<u>1,829,570</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,829,570</u>
	<u><u>1,829,570</u></u>	<u><u>3,191,543</u></u>	<u><u>1,857,847</u></u>	<u><u>5,049,390</u></u>	<u><u>6,878,960</u></u>

	2006				
	The Group				
	Investment Properties	Bank Premises	Furniture, Fixtures and Equipment	Sub-total	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cost or valuation					
At 1st January 2006 .....	950,586	4,304,481	1,999,250	6,303,731	7,254,317
Additions .....	—	133,493	377,874	511,367	511,367
Additions through acquisition .....	—	—	6,071	6,071	6,071
Revaluation surplus .....	137,777	—	—	—	137,777
Revaluation of bank premises transferred to investment properties ..	—	35,054	—	35,054	35,054
Transfer from bank premises to investment properties .....	231,068	(231,068)	—	(231,068)	—
Disposals .....	(39,400)	(13,977)	(139,610)	(153,587)	(192,987)
Exchange adjustments .....	8,510	2,586	11,512	14,098	22,608
At 31st December 2006 .....	<u>1,288,541</u>	<u>4,230,569</u>	<u>2,255,097</u>	<u>6,485,666</u>	<u>7,774,207</u>
Accumulated depreciation and amortisation					
At 1st January 2006 .....	—	671,201	1,227,217	1,898,418	1,898,418
Additions through acquisition .....	—	—	3,698	3,698	3,698
Charge for the year (Note 10) .....	—	78,709	220,365	299,074	299,074
Revaluation of bank premises transferred to investment properties ..	—	(34,390)	—	(34,390)	(34,390)
Impairment loss .....	—	(27,681)	—	(27,681)	(27,681)
Written back on disposals .....	—	(5,403)	(119,345)	(124,748)	(124,748)
Exchange adjustments .....	—	1,132	9,099	10,231	10,231
At 31st December 2006 .....	<u>—</u>	<u>683,568</u>	<u>1,341,034</u>	<u>2,024,602</u>	<u>2,024,602</u>
Net book value at 31st December 2006 ....	<u>1,288,541</u>	<u>3,547,001</u>	<u>914,063</u>	<u>4,461,064</u>	<u>5,749,605</u>
The gross amounts of the above assets are stated:					
At cost .....	—	3,389,480	2,255,097	5,644,577	5,644,577
At Directors' valuation					
— 1989 .....	—	841,089	—	841,089	841,089
At professional valuation					
— 2006 .....	<u>1,288,541</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,288,541</u>
	<u>1,288,541</u>	<u>4,230,569</u>	<u>2,255,097</u>	<u>6,485,666</u>	<u>7,774,207</u>

	2006				
	The Bank				
	Investment Properties	Bank Premises	Furniture, Fixtures and Equipment	Sub-total	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cost or valuation					
At 1st January 2006 .....	979,680	4,061,867	1,735,978	5,797,845	6,777,525
Additions .....	—	133,032	302,152	435,184	435,184
Revaluation surplus .....	134,707	—	—	—	134,707
Revaluation of bank premises transferred to investment properties ..	—	35,054	—	35,054	35,054
Transfer from bank premises to investment properties .....	241,768	(241,768)	—	(241,768)	—
Disposals .....	(39,400)	(13,976)	(110,903)	(124,879)	(164,279)
Exchange adjustments .....	—	2,245	9,935	12,180	12,180
At 31st December 2006 .....	<u>1,316,755</u>	<u>3,976,454</u>	<u>1,937,162</u>	<u>5,913,616</u>	<u>7,230,371</u>
Accumulated depreciation and amortisation					
At 1st January 2006 .....	—	593,225	1,062,702	1,655,927	1,655,927
Charge for the year .....	—	73,686	180,333	254,019	254,019
Revaluation of bank premises transferred to investment properties ..	—	(34,390)	—	(34,390)	(34,390)
Impairment loss .....	—	(27,681)	—	(27,681)	(27,681)
Written back on disposals .....	—	(5,402)	(96,580)	(101,982)	(101,982)
Exchange adjustments .....	—	1,035	8,328	9,363	9,363
At 31st December 2006 .....	<u>—</u>	<u>600,473</u>	<u>1,154,783</u>	<u>1,755,256</u>	<u>1,755,256</u>
Net book value at 31st December 2006 ....	<u>1,316,755</u>	<u>3,375,981</u>	<u>782,379</u>	<u>4,158,360</u>	<u>5,475,115</u>
The gross amounts of the above assets are stated:					
At cost .....	—	3,135,365	1,937,162	5,072,527	5,072,527
At Directors' valuation					
— 1989 .....	—	841,089	—	841,089	841,089
At professional valuation					
— 2006 .....	<u>1,316,755</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,316,755</u>
	<u>1,316,755</u>	<u>3,976,454</u>	<u>1,937,162</u>	<u>5,913,616</u>	<u>7,230,371</u>

The net book value of bank premises and investment properties comprises:

	<b>The Group</b>			
	<b>2007</b>		<b>2006</b>	
	<b>Investment Properties</b>	<b>Bank Premises</b>	<b>Investment Properties</b>	<b>Bank Premises</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
Freeholds				
Held outside Hong Kong .....	113,679	407,812	108,686	163,688
Leaseholds				
Held in Hong Kong				
On long lease (over 50 years) .....	1,247,520	1,477,167	879,700	1,455,520
On medium-term lease (10 - 50 years) .....	352,300	1,386,905	289,600	1,402,823
Held outside Hong Kong				
On long lease (over 50 years) .....	—	175,017	—	176,954
On medium-term lease (10 - 50 years) .....	12,659	544,996	10,555	348,016
	<u>1,726,158</u>	<u>3,991,897</u>	<u>1,288,541</u>	<u>3,547,001</u>
	<b>The Bank</b>			
	<b>2007</b>		<b>2006</b>	
	<b>Investment Properties</b>	<b>Bank Premises</b>	<b>Investment Properties</b>	<b>Bank Premises</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
Freeholds				
Held outside Hong Kong .....	—	152,832	—	79,895
Leaseholds				
Held in Hong Kong				
On long lease (over 50 years) .....	1,315,100	1,420,764	879,700	1,455,520
On medium-term lease (10 - 50 years) .....	514,470	1,301,618	426,500	1,315,596
Held outside Hong Kong				
On long lease (over 50 years) .....	—	11,355	—	176,954
On medium-term lease (10 - 50 years) .....	—	1,135	10,555	348,016
	<u>1,829,570</u>	<u>2,887,704</u>	<u>1,316,755</u>	<u>3,375,981</u>

The carrying amount of the bank premises of the Group and the Bank would have been HK\$2,937,224,000 (2006: HK\$2,531,195,000) and HK\$2,776,576,000 (2006: HK\$2,376,387,000) respectively had they been stated at cost less accumulated depreciation.

Investment properties were valued by independent valuers. Investment properties in Hong Kong were valued at HK\$1,599,820,000 as at 31st December 2007 by an independent valuer, Savills Valuation and Professional Services Limited, Chartered Surveyors, who has among their staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of property being valued. The valuation has been incorporated in the accounts as at 31st December 2007 and it was performed on an open market value basis.

The Group leases out investment properties under operating leases. The leases typically run for an initial period from 1 to 10 years, with an option to renew the leases after that date at which time all terms are renegotiated. None of the leases includes contingent rentals.

Rental income receivable from investment properties held for use under operating leases amounted to HK\$72,640,000 in 2007 (2006: HK\$53,553,000). There was no contingent rental recognised during the year 2007 (2006: Nil).

The total future minimum lease payments of bank premises and investment properties held for use under non-cancellable operating leases are receivable as follows:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Within one year .....	62,318	55,549	56,140	54,143
After one year but within five years .....	70,494	59,021	35,614	50,605
After five years .....	—	1,081	—	—
	<u>132,812</u>	<u>115,651</u>	<u>91,754</u>	<u>104,748</u>

### 32. Amounts Due from and Due to Subsidiaries

During the year, the Bank entered into transactions with certain subsidiaries in the ordinary course of its banking business. Details of the amounts due from and due to subsidiaries are as follows:

#### (a) Amounts Due from Subsidiaries

	The Bank	
	2007	2006
	HK\$'000	HK\$'000
Financial institutions .....	16,316,298	8,938
Others .....	<u>1,647,871</u>	<u>1,925,557</u>
	<u>17,964,169</u>	<u>1,934,495</u>

#### (b) Amounts Due to Subsidiaries

	The Bank	
	2007	2006
	HK\$'000	HK\$'000
Financial institutions .....	53,464	228,040
Others .....	<u>1,580,833</u>	<u>1,447,603</u>
	<u>1,634,297</u>	<u>1,675,643</u>

### 33. Income Tax in the Balance Sheet

#### (a) Current Taxation in the Balance Sheet Represents:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Provision for Hong Kong Profits Tax for the year (Note 13(a)) .....	265,175	508,542	152,613	443,087
Provisional Profits Tax paid .....	(188,958)	(299,011)	(133,642)	(254,605)
	76,217	209,531	18,971	188,482
Balance of Profits Tax provision relating to prior years .....	14,522	17,478	10,442	5,000
Overseas taxation .....	138,111	107,088	51,458	102,341
	<u>228,850</u>	<u>334,097</u>	<u>80,871</u>	<u>295,823</u>

#### (b) Deferred Tax Assets and Liabilities Recognised

The components of deferred tax (assets)/liabilities recognised in the consolidated balance sheet and the movements during the year are as follows:

	The Group						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available-for-sale securities	Tax losses	Others	Total
<i>Deferred tax arising from:</i>	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January 2007 .....	277,331	210,910	(17,813)	109,777	(23,503)	2,247	558,949
Write off against investment .....	—	—	—	—	—	(120,886)	(120,886)
Charged/(credited) to profit and loss account (Note 13(a)) .....	44,669	57,117	76,305	—	(35,288)	232,065	374,868
Credited to reserves (Note 38(c) and (h)) .....	—	5,998	—	(16,485)	—	—	(10,487)
Additions through acquisition of subsidiary .....	22	—	—	—	—	—	22
Exchange and other adjustments .....	(429)	—	(324)	—	(463)	437	(779)
At 31st December 2007 .....	<u>321,593</u>	<u>274,025</u>	<u>58,168</u>	<u>93,292</u>	<u>(59,254)</u>	<u>113,863</u>	<u>801,687</u>

	The Group						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available-for-sale securities	Tax losses	Others	Total
<i>Deferred tax arising from:</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
At 1st January 2006 .....	276,111	174,514	(49,124)	—	(25,512)	213,027	589,016
Write off against investment .....	—	—	—	—	—	(206,875)	(206,875)
Charged/(credited) to profit and loss account (Note 13(a)) .....	1,112	25,201	31,512	—	4,470	(3,865)	58,430
Charged to reserves (Note 38(c) and (h)) .....	—	11,195	—	109,777	—	—	120,972
Addition through acquisition of subsidiary .....	54	—	—	—	—	—	54
Exchange and other adjustments .....	54	—	(201)	—	(2,461)	(40)	(2,648)
At 31st December 2006 .....	<u>277,331</u>	<u>210,910</u>	<u>(17,813)</u>	<u>109,777</u>	<u>(23,503)</u>	<u>2,247</u>	<u>558,949</u>

	The Bank						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available-for-sale securities	Tax losses	Others	Total
<i>Deferred tax arising from:</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
At 1st January 2007 .....	274,965	210,910	(11,857)	109,841	(22,652)	10,791	571,998
Write off against investment .....	—	—	—	—	—	(120,886)	(120,886)
Charged to profit and loss account ...	38,147	57,117	2,607	—	9,677	223,373	330,921
Credited to reserves (Note 38 (c) and (h)) .....	—	5,998	—	(16,550)	—	—	(10,552)
Transfer to The Bank of East Asia (China) Ltd. ....	—	—	(33,846)	—	4,747	—	(29,099)
Exchange and other adjustments .....	—	—	(46)	—	(468)	(5)	(519)
At 31st December 2007 .....	<u>313,112</u>	<u>274,025</u>	<u>(43,142)</u>	<u>93,291</u>	<u>(8,696)</u>	<u>113,273</u>	<u>741,863</u>

	The Bank						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available-for-sale securities	Tax losses	Others	Total
<i>Deferred tax arising from:</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
At 1st January 2006 .....	275,004	174,514	(46,814)	—	(22,923)	216,879	596,660
Write off against investment .....	—	—	—	—	—	(206,875)	(206,875)
Charged/(credited) to profit and loss account .....	(39)	25,201	35,178	—	2,733	790	63,863
Charged to reserves (Note 38 (c) and (h)) .....	—	11,195	—	109,841	—	—	121,036
Exchange and other adjustments .....	—	—	(221)	—	(2,462)	(3)	(2,686)
At 31st December 2006 .....	<u>274,965</u>	<u>210,910</u>	<u>(11,857)</u>	<u>109,841</u>	<u>(22,652)</u>	<u>10,791</u>	<u>571,998</u>

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Net deferred tax assets recognised on the balance sheet .....	(69,870)	(39,169)	(12,349)	(22,905)
Net deferred tax liabilities recognised on the balance sheet .	871,557	598,118	754,212	594,903
	<u>801,687</u>	<u>558,949</u>	<u>741,863</u>	<u>571,998</u>

**(c) Deferred Tax Assets Not Recognised**

The Group has not recognised deferred tax assets in respect of cumulative tax losses of HK\$674,027,000 (2006: HK\$631,769,000) as it is not probable that future taxable profits against which the losses can be utilized will be available in the relevant tax jurisdiction and entity. Under the current tax legislation, the expiry dates of the tax losses were as follows:

	2007	2006
	HK\$'000	HK\$'000
Expiring within 5 years .....	94,780	76,667
Expiring more than 5 years .....	8,029	10,801
No expiry date .....	571,218	544,301
	<u>674,027</u>	<u>631,769</u>

**34. Other Liabilities**

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
(a) Trading Liabilities				
Exchange fund bills sold .....	1,098,512	199,800	1,098,512	199,800
Exchange fund notes sold .....	32,986	33,459	32,986	33,459
Short positions in securities .....	—	8,060	—	8,060
	1,131,498	241,319	1,131,498	241,319
Negative fair value of derivatives .....	1,240,603	701,276	1,043,234	693,056
	<u>2,372,101</u>	<u>942,595</u>	<u>2,174,732</u>	<u>934,375</u>
(b) Other Accounts and Provisions				
Accrued interest payable .....	1,586,355	854,862	1,185,801	784,977
Bankers acceptances .....	1,425,323	422,022	309,190	417,057
Other accounts .....	7,985,342	6,769,770	2,966,998	3,244,030
	<u>10,997,020</u>	<u>8,046,654</u>	<u>4,461,989</u>	<u>4,446,064</u>

### 35. Loan Capital

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
US\$550 million 5.625% subordinated notes, measured at fair value through profit or loss .....	4,382,815	4,288,824	4,382,815	4,288,824
US\$500 million floating rate subordinated notes, measured at amortised cost .....	—	3,865,491	—	3,865,491
GBP300 million 6.125% step-up perpetual subordinated notes, measured at fair value through profit or loss .....	4,600,230	—	4,600,230	—
USD600 million floating rate step-up subordinated notes, measured at amortised cost .....	4,669,174	—	4,669,174	—
	<u>13,652,219</u>	<u>8,154,315</u>	<u>13,652,219</u>	<u>8,154,315</u>

Loan capital of face value of HK\$4,290,358,000 (US\$550,000,000) and carrying amount of HK\$4,382,815,000 represents 5.625% subordinated notes qualifying as tier 2 capital which were issued on 13th December 2005 by the Bank. The notes are listed on The Stock Exchange of Hong Kong Limited and will mature on 13th December 2015.

On 20th March 2007, the Bank issued 6.125% step-up perpetual subordinated notes qualifying as tier 2 capital with face value of HK\$4,675,710,000 (GBP300,000,000). The carrying amount of the notes as at 31st December 2007 was HK\$4,600,230,000. The notes are listed on the Singapore Exchange Securities Trading Limited.

On 21st June 2007, the Bank issued floating rate step-up subordinated notes qualifying as tier 2 capital with face value of HK\$4,680,390,000 (US\$600,000,000). The carrying amount of the notes as at 31st December 2007 was HK\$4,669,174,000. The notes are listed on the Singapore Exchange Securities Trading Limited and will mature on 22nd June 2017.

On 27th June 2007, the Bank redeemed the floating rate subordinated notes with face value of HK\$3,909,000,000 (US\$500,000,000) which was issued on 27th June 2006 by the Bank.

### 36. Equity Settled Share-Based Transactions

The Bank has adopted Staff Share Option Schemes whereby the Board of the Bank may at its discretion grant to any employees, including Executive Directors and Chief Executive, of the Group options to subscribe for shares of the Bank. The options may be exercised during the period beginning on the first anniversary of the Date of Grant and ending on the fifth anniversary of the Date of Grant. All options were granted for nil consideration.

#### (a) Particulars of share options

Date of Grant	Vesting Period	Exercise Period	Exercise Price Per Share HK\$
18/4/2002 .....	18/4/2002-17/4/2003	18/4/2003-18/4/2007	15.80
02/5/2003 .....	02/5/2003-01/5/2004	02/5/2004-02/5/2008	14.90
22/4/2004 .....	22/4/2004-21/4/2005	22/4/2005-22/4/2009	23.23
03/5/2005 .....	03/5/2005-02/5/2006	03/5/2006-03/5/2010	22.95
03/5/2006 .....	03/5/2006-02/5/2007	03/5/2007-03/5/2011	33.05
10/5/2007 .....	10/5/2007-09/5/2008	10/5/2008-10/5/2012	47.13

#### (b) The number and weighted average exercise prices of share options are as follows:

	2007		2006	
	Weighted average exercise price HK\$	Number of options 000	Weighted average exercise price HK\$	Number of options 000
Outstanding at the beginning of the year .....	22.86	24,060	21.12	40,910
Exercised during the year .....	20.58	(7,510)	20.94	(19,845)
Granted during the year .....	47.13	2,750	33.05	3,250
Lapsed during the year .....	—	—	23.00	(255)
Outstanding at the end of the year .....	27.21	<u>19,300</u>	22.86	<u>24,060</u>
Exercisable at the end of the year .....	23.90	16,550	21.27	20,810

The weighted average share price at the date of exercise for shares options exercised during the year was HK\$46.16 (2006: HK\$32.40).

The options outstanding at 31st December 2007 had an exercise price from HK\$14.90 to HK\$47.13 (2006: from HK\$14.90 to HK\$33.05) and a weighted average remaining contractual life of 2.35 years (2006: 2.76 years).

(c) **Fair value of share options and assumptions**

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the share option granted is measured based on a trinomial lattice model. The contractual life of the option is used as an input into this model.

	2007	2006
Fair value at measurement date .....	HK\$11.13	HK\$6.38
Share price .....	HK\$47.00	HK\$33.05
Exercise price .....	HK\$47.13	HK\$33.05
Expected volatility (expressed as weighted average volatility used in the modelling under trinomial lattice model) .....	30.92%	23.27%
Option life .....	5 years	5 years
Expected dividends .....	4.82%	4.45%
Risk-free interest rate (based on Exchange Fund Notes) .....	4.10%	4.63%

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility based on publicly available information. Expected dividends are based on historical dividends. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. There were no market conditions associated with the share option grants.

### 37. Share Capital

	2007		2006	
	No. of shares	Nominal value	No. of shares	Nominal value
	<u>HK\$'000</u>	<u>HK\$'000</u>	<u>HK\$'000</u>	<u>HK\$'000</u>
Authorised:				
Ordinary shares of HK\$2.50 each .....	2,600,000	6,500,000	2,600,000	6,500,000
Issued and fully paid:				
At 1st January .....	1,550,142	3,875,355	1,510,229	3,775,575
Shares issued under Staff Share Option Schemes .....	7,510	18,775	19,845	49,612
Shares issued in lieu of dividends .....	16,715	41,788	20,068	50,168
At 31st December .....	<u>1,574,367</u>	<u>3,935,918</u>	<u>1,550,142</u>	<u>3,875,355</u>

Pursuant to the approved Staff Share Option Schemes (the "Schemes"), options to purchase ordinary shares in the Bank were granted to eligible employees. The option price of the Schemes equals the fair value of the underlying shares at the date of grant. The options granted under the Schemes will be exercisable between the first and the fifth anniversaries of the date of grant.

(a) **Shares Issued under Staff Share Option Scheme**

During the year, options were exercised to subscribe for 7,510,000 ordinary shares in the Bank at a consideration of HK\$154,555,000 of which HK\$18,775,000 was credited to share capital and the balance of HK\$135,780,000 was credited to the share premium account (Note 38). HK\$11,937,000 has been transferred from the capital reserve to the share premium account in accordance with policy set out in Note 2(q)(iv).

(b) Terms of Unexpired and Unexercised Share Options at Balance Sheet Date

<i>Date of options granted</i>	<i>Option price</i>	<u>2007</u>	<u>2006</u>
		<i>No. of shares</i>	<i>No. of shares</i>
18/4/2002 .....	HK\$15.80	—	1,855,000
02/5/2003 .....	HK\$14.90	2,205,000	2,895,000
22/4/2004 .....	HK\$23.23	3,915,000	5,750,000
03/5/2005 .....	HK\$22.95	7,230,000	10,310,000
03/5/2006 .....	HK\$33.05	3,200,000	3,250,000
10/5/2007 .....	HK\$47.13	2,750,000	—
		<u>19,300,000</u>	<u>24,060,000</u>

**38. Reserves**

	<u>2007</u>	
	<u>The Group</u>	<u>The Bank</u>
	<i>HK\$'000</i>	<i>HK\$'000</i>
(a) Share Premium (undistributable)		
At 1st January .....	1,012,138	1,012,138
Net premium on shares issued under Staff Share Option Schemes .....	135,780	135,780
Transfer of the fair value of options from capital reserve — share options issued .....	11,937	11,937
Shares issued in lieu of dividends .....	(41,788)	(41,788)
Capital fee .....	(135)	(135)
As 31st December .....	<u>1,117,932</u>	<u>1,117,932</u>
(b) General Reserve		
At 1st January .....	13,256,982	13,026,347
Transfer from retained profits .....	17,007	—
Shares issued in lieu of dividends .....	730,463	730,463
At 31st December .....	<u>14,004,452</u>	<u>13,756,810</u>
(c) Revaluation Reserve on Bank Premises (undistributable)		
At 1st January .....	835,829	837,935
Recognition of net deferred tax liabilities (Note 33(b)) .....	(5,998)	(5,998)
Revaluation surplus on bank premises transferred to investment properties .....	35,669	35,669
Transfer to The Bank of East Asia (China) Ltd. ....	—	(13,935)
At 31st December .....	<u>865,500</u>	<u>853,671</u>
(d) Statutory Reserves (undistributable) At 1st January and 31st December .....	<u>(14)</u>	<u>—</u>
(e) Capital Reserve (undistributable) At 1st January and 31st December .....	<u>86,436</u>	<u>—</u>

		2007	
		The Group	The Bank
		HK\$'000	HK\$'000
(f)	Exchange Revaluation Reserve (undistributable)		
	At 1st January .....	184,293	125,701
	Exchange adjustments .....	487,786	(45,030)
	At 31st December .....	<u>672,079</u>	<u>80,671</u>
(g)	Capital Reserve — Staff Share Options issued (undistributable)		
	At 1st January .....	51,256	51,256
	Transfer of the fair value of options to share premium .....	(11,937)	(11,937)
	Addition .....	27,310	27,310
	At 31st December .....	<u>66,629</u>	<u>66,629</u>
(h)	Investment Revaluation Reserve (undistributable)		
	At 1st January .....	861,188	641,954
	Changes in fair value of securities .....	(421,425)	(323,376)
	Reversal upon disposal (Note 12) .....	27,037	99,415
	Recognition of deferred tax liabilities (Note 33(b)) .....	16,485	16,550
	Exchange adjustments .....	(7,023)	(11,127)
	At 31st December .....	<u>476,262</u>	<u>423,416</u>
(i)	Retained Profits		
	At 1st January .....	7,099,491	5,294,562
	Net profit for the year .....	4,143,604	3,004,197
	Transfer to general reserve .....	(17,007)	—
	Dividends (Note 15)		
	- Interim dividend .....	(753,004)	(753,004)
	- Final dividend in respect of previous year .....	(1,599,510)	(1,599,510)
	At 31st December .....	<u>8,873,574</u>	<u>5,946,245</u>
(j)	Total Reserves .....	<u>26,162,850</u>	<u>22,245,374</u>

	2006	
	The Group	The Bank
	HK\$'000	HK\$'000
(a) Share Premium (undistributable)		
At 1st January .....	656,429	656,429
Net premium on shares issued under Staff Share Option Schemes .....	365,911	365,911
Transfer of the fair value of options from capital reserve — share options issued .....	40,217	40,217
Shares issued in lieu of dividends .....	(50,168)	(50,168)
Capital fee .....	(251)	(251)
As 31st December .....	<u>1,012,138</u>	<u>1,012,138</u>
(b) General Reserve		
At 1st January .....	12,643,214	12,425,169
Transfer from retained profits .....	12,590	—
Realised surplus on disposals transferred from revaluation reserve .....	1,353	1,353
Shares issued in lieu of dividends .....	599,825	599,825
At 31st December .....	<u>13,256,982</u>	<u>13,026,347</u>
(c) Revaluation Reserve on Bank Premises (undistributable)		
At 1st January .....	778,933	781,039
Recognition of net deferred tax liabilities (Note 33(b)) .....	(11,195)	(11,195)
Revaluation surplus on bank premises transferred to investment properties .....	69,444	69,444
Realised surplus on disposals transferred to general reserve .....	(1,353)	(1,353)
At 31st December .....	<u>835,829</u>	<u>837,935</u>
(d) Statutory Reserves (undistributable) At 1st January and 31st December .....	<u>(14)</u>	<u>—</u>
(e) Capital Reserve (undistributable) At 1st January and 31st December .....	<u>86,436</u>	<u>—</u>
(f) Exchange Revaluation Reserve (undistributable)		
At 1st January .....	78,568	46,658
Exchange adjustments .....	105,725	79,043
At 31st December .....	<u>184,293</u>	<u>125,701</u>
(g) Capital Reserve — Staff Share Options issued (undistributable)		
At 1st January .....	69,806	69,806
Transfer of the fair value of options to share premium .....	(40,217)	(40,217)
Forfeited options transferred to retained profits .....	(400)	(400)
Addition .....	22,067	22,067
At 31st December .....	<u>51,256</u>	<u>51,256</u>

	2006	
	The Group	The Bank
	HK\$'000	HK\$'000
(h) Investment Revaluation Reserve (undistributable)		
At 1st January .....	358,729	345,273
Changes in fair value of securities .....	653,701	440,584
Reversal upon disposal (Note 12) .....	(41,766)	(33,716)
Recognition of deferred tax liabilities (Note 33(b)) .....	(109,777)	(109,841)
Exchange adjustments .....	301	(346)
At 31st December .....	<u>861,188</u>	<u>641,954</u>
(i) Retained Profits		
At 1st January .....	5,749,689	4,348,064
Net profit for the year .....	3,434,511	3,018,617
Transfer to general reserve .....	(12,590)	—
Transfer in respect of forfeited options .....	400	400
Dividends (Note 15)		
- Interim dividend .....	(661,663)	(661,663)
- Final dividend in respect of previous year .....	<u>(1,410,856)</u>	<u>(1,410,856)</u>
At 31st December .....	<u>7,099,491</u>	<u>5,294,562</u>
(j) Total Reserves .....	<u>23,387,599</u>	<u>20,989,893</u>

The application of the share premium account is governed by Section 48B of the Hong Kong Companies Ordinance.

General reserve was set up from the transfer of retained earnings, the realised revaluation surplus on disposal of properties and the value of shares issued in lieu of dividend.

Revaluation reserve on bank premises and exchange revaluation reserve have been set up and are dealt with in accordance with the accounting policies adopted for the revaluation of bank premises and foreign currency translation.

Statutory reserves are set up to supplement the paid-up capital until the sum of paid-up capital and the statutory reserves is equal to the registered capital for certain associates.

Capital reserve represents the capitalization of subsidiaries' reserves.

Capital reserve — staff share options issued comprises the fair value of the actual or estimated number of unexercised share options granted to employees of the Bank recognised in accordance with the accounting policy adopted for share based payment in Note 2(q)(iv).

Investment revaluation reserve comprises the cumulative net change in the fair value of available-for-sale securities held until the securities are derecognised and is dealt with in accordance with the accounting policies in Notes 2(f) and (k).

A regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purposes by earmarking amounts in respect of losses which the Bank will or may incur on loans and advances and investments in addition to impairment losses recognised. Movements in the reserve are earmarked directly through retained earnings and in consultation with the Hong Kong Monetary Authority. As at 31st December 2007, HK\$2,100,000,000 (2006: HK\$606,000,000) was included in the retained profits in this respect which was distributable to equity holders of the Group subject to consultation with the Hong Kong Monetary Authority.

At 31st December 2007, the aggregate amount of reserves available for distribution to equity holders of the Bank was HK\$19,703,055,000 (2006: HK\$18,320,909,000). After the balance sheet date the directors proposed a final dividend of HK\$1.18 per ordinary share (2006: HK\$1.03 per share), amounting to HK\$1,857,753,000 (2006: HK\$1,596,646,000). The dividend has not been recognised as a liability at the balance sheet date.

### 39. Minority Interests

	2007	2006
	HK\$'000	HK\$'000
At 1st January .....	381,775	207,163
- sale of interests in businesses to minority interests investors .....	49,697	2,561
- purchase of interests in businesses from minority interests investors .....	(14,634)	(29,268)
- reversal upon disposal of available-for-sale financial assets .....	(149,196)	—
- share of revaluation surplus of available-for-sale financial assets .....	—	149,196
- exchange adjustments .....	1,957	1,016
Profit for the year .....	<u>77,545</u>	<u>51,107</u>
At 31st December .....	<u>347,144</u>	<u>381,775</u>

### 40. Financial Risk Management

This section presents information on the Group's management of principal risks.

The Group has in place a risk management system to identify, measure, monitor and control the various types of risk that the Group faces and, where appropriate, to set strategy and allocate capital against those risks. The risk management policies covering credit risk, market risk, operational risk, liquidity risk, interest rate risk and foreign exchange risk of the Group are reviewed regularly by the Management and specialized risk management committees, and recommendations are made by the Risk Management Committee, which comprises the Group's Chairman and Chief Executive, Executive Director and Deputy Chief Executive, General Manager and Head of Investment Banking Division, General Manager and Head of Strategic Planning & Control Division who is also Group Chief Financial Officer and Chief Compliance Officer, Head of Operations Support Division and Chief Risk Officer, for the approval of the Board of Directors. There is an independent centralized risk management function responsible for monitoring the activities relating to these principal risks. The internal auditors also perform regular audits on business units to check compliance with policies and procedures.

#### (a) Credit Risk Management

Credit risk arises from the possibility that a customer or counterparty in a transaction may default. Such risk may arise from counterparty risks from loan and advances, issuer risks from the securities business and counterparty risks from trading activities.

The Board of Directors has delegated authority to the Credit Committee to oversee management of the Group's credit risk, independent of the business units. The Credit Committee reports to the Board of Directors via the Risk Management Committee, which deals with all risk management related issues of the Group. Credit risk control limits are set at different levels and dimensions. The Board of Directors approves the core control limits and delegates the Credit Committee to approve the detailed control limits. Risk, return and market situations are considered in the limits setting. Active limit monitoring process is undertaken.

The Credit Committee is responsible for all credit risk related issues of the Group. The Group identifies and manages credit risk through target market definitions, formulation of credit policies, credit approval process and monitoring of asset quality.

In evaluating the credit risk associated with an individual customer or counterparty, financial strength and repayment ability are always the primary considerations. Credit risk may be mitigated by obtaining collateral from the customer or counterparty.

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The Group has established policies, procedures and rating systems to identify, measure, monitor and control credit risk. In this connection, guidelines for management of credit risk have been laid down in the Group's Credit Manual. These guidelines stipulate delegated lending authorities, credit extension criteria, credit monitoring process, internal rating structure, credit recovery and provisioning policy. They are reviewed and enhanced on an on-going basis to cater for the market change, statutory requirement and best practice risk management processes. The independent centralized risk management function of the Group is responsible for monitoring activities relating to credit risk.

The Group's credit risk management for the major types of credit risk is depicted as follows:

*(i) Corporate and bank credit risk*

The Group has laid down policies and procedures to evaluate the potential credit risk of a particular counterparty or transaction and to approve the transaction. For corporate and bank customers, the Group has different internal rating systems that are applied to each counterparty. For exposure classified as Specialized Lending in particular, supervisory slotting criteria are used. To monitor concentration risk, the Group has preset limits for exposures to individual industries and for borrowers and groups of borrowers. The Group also has a review process to ensure that the level of review and approval is proper and will depend on the size of the facility and rating of the credit.

The Group undertakes on-going credit analysis and monitoring at several levels. The policies are designed to promote early detection of counterparty, industry or product exposures that require special monitoring. The overall portfolio risk as well as individual impaired loans and potential impaired loans are monitored on a regular basis.

*(ii) Retail credit risk*

The Group's retail credit policy and approval process are designed for the fact that there are high volumes of relatively homogeneous and small value transactions in each retail loan category. The design of internal rating system and formulation of credit policies are primarily based on the demographic factors and the loss experience of the loan portfolios. The Group monitors its own and industry experience to determine and periodically revise product terms and desired customer profiles.

*(iii) Credit for treasury transactions*

The credit risk of the Group's treasury transactions is managed in the same way as the Group manages its corporate lending risk. The Group applies an internal rating system to its counterparties and sets individual counterparty limits.

*(iv) Credit—related commitment*

The risks involved in credit-related commitments and contingencies are essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans.

*(v) Concentrations of credit risk*

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio of financial instruments is diversified along geographic, industry and product sectors.

The Group monitors its concentration risk by adopting appropriate risk control measures, such as setting limits on exposures to different industries and loan portfolios.

(vi) *Credit quality of loans and advances*

Loans and advances to banks are only made to banks with good credit standing. At 31st December 2007 and 2006, no loans and advances to bank are impaired. The credit quality of loans and advances to customers can be analysed as follows:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Gross loans and advances to customers				
- neither past due nor impaired .....	216,484,581	164,732,996	133,851,900	158,884,346
- past due but not impaired .....	457,432	150,918	108,688	150,814
- impaired .....	1,241,887	1,294,188	897,474	1,128,258
	<u>218,183,900</u>	<u>166,178,102</u>	<u>134,858,062</u>	<u>160,163,418</u>

Of which:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Gross loans and advances to customers that are neither past due nor impaired				
- Pass .....	214,475,800	162,966,063	132,487,966	157,244,900
- Special mention .....	2,008,781	1,766,933	1,363,934	1,639,446
	<u>216,484,581</u>	<u>164,732,996</u>	<u>133,851,900</u>	<u>158,884,346</u>

The Group classifies the loans and advances in accordance with the loan classification system required to be adopted for reporting to the HKMA.

The ageing analysis of loans and advances to customers that are past due but not impaired is as follows:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Gross loans and advances to customers that are past due but not impaired				
- Overdue 3 months or less .....	409,373	150,131	108,688	150,027
- 6 months or less but over 3 months .....	16,020	787	—	787
- 1 year or less but over 6 months .....	32,039	—	—	—
- Over 1 year .....	—	—	—	—
	<u>457,432</u>	<u>150,918</u>	<u>108,688</u>	<u>150,814</u>

Loans and advances that would be past due or impaired had the terms not been renegotiated amounted to HK\$282,888,000 as at 31st December 2007 (2006: HK\$291,246,000).

(vii) *Credit quality of financial assets other than loans and advances*

Credit risk of treasury transactions is managed in the same way as the Group manages its corporate lending risk and risk gradings are applied to the counterparties with individual counterparty limits set.

At the balance sheet date, the credit quality of investment in debt securities analysed by designation of external credit assessment institution, Moody's Investor Services, or equivalent, is as follow:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Aaa .....	9,982,578	6,994,302	9,868,839	6,681,537
Aa1 to Aa3 .....	4,524,407	3,708,021	3,355,469	2,899,891
A1 to A3 .....	1,919,099	1,716,656	1,412,930	1,276,005
Lower than A3 .....	5,319,124	5,273,245	4,911,038	5,189,468
	21,745,208	17,692,224	19,548,276	16,046,901
Unrated .....	2,747,736	2,841,698	2,747,736	2,772,900
Total .....	<u>24,492,944</u>	<u>20,533,922</u>	<u>22,296,012</u>	<u>18,819,801</u>

The collateralized debt obligations ("CDOs") and special investment vehicle ("SIVs") held by the Bank were purchased according to the Bank's investment guidelines. As at 31st December 2007, CDOs and SIVs amounted to HK\$4,695,008,000 and HK\$252,975,000 respectively. Since 31st December 2007, the uncertainties in the credit and capital market for the CDOs and SIVs continue, and the fair value of the CDOs and SIVs held by the Bank further decreased by HK\$480,161,000 in January 2008.

(viii) *Collateral and other credit enhancements*

The Group holds collateral against loans and advances to customers in the forms of mortgages over property, other registered securities over assets, cash deposits and guarantees. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collaterals held as security for financial assets other than loans and advances is determined by the nature of the instrument.

Debt securities, treasury and other eligible bills are generally unsecured with the exception of asset-based securities and similar instruments, which are secured by pools of financial assets. The Group entered into the ISDA Master Agreement which contractually binds both parties to apply close-out netting arrangement across outstanding derivatives.

The lower of gross loan amount and the estimate of the fair value of collateral and other credit enhancements held against financial assets is as follows:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Fair value of collateral and other credit enhancements held against financial assets that are:				
- neither past due nor impaired .....	167,369,772	124,908,986	102,776,915	119,187,049
- past due but not impaired .....	359,878	140,696	85,777	140,696
	<u>167,729,650</u>	<u>125,049,682</u>	<u>102,862,692</u>	<u>119,327,745</u>

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**(b) Market risk management**

Market risk arises from all market risk sensitive financial instruments, including debt securities, foreign exchange contracts, equity and derivative instruments, as well as from balance sheet or structural positions. The objective of market risk management is to reduce the Group's exposure to the volatility inherent in financial instruments.

The Board of Directors reviews and approves policies for the management of the market risks. The Board has delegated the responsibility for ongoing market risk management to the Asset and Liability Management Committee. The Asset and Liability Management Committee reports to the Board of Directors via the Risk Management Committee.

The Asset and Liability Management Committee deals with all market risk and liquidity risk related issues of the Group. It is also responsible for deciding the future business strategy with respect to interest rates trend review.

The use of derivatives for proprietary trading and their sale to customers as risk management products is an integral part of the Group's business activities. These instruments are also used to manage the Group's own exposures to market risk, as part of its asset and liability management process. The principal derivatives instruments used by the Group are interest rate, foreign exchange and equity related contracts, in the form of both over-the-counter derivatives and exchange traded derivatives. Most of the Group's derivatives positions have been entered into to meet customer demand and to manage the risk of these and other trading positions.

*(i) Currency risk*

The Group's foreign currency positions arise from foreign exchange dealing, commercial banking operations and structural foreign currency exposures. All foreign currency positions are managed within limits approved by the Board.

Structural foreign currency positions, which arise mainly from foreign currency investments in the Group's branches, subsidiaries and associated companies, are excluded from VaR measurements, as related gains or losses are taken to reserves. Such foreign currency positions are managed with the principal objective of ensuring that the Group's reserves are protected from exchange rate fluctuations. The Group seeks to match closely its foreign currency denominated assets with corresponding liabilities in the same currencies.

The following table indicates the concentration of currency risk at the balance sheet date:

The Group

	2007				2006			
	USD	CNY	Other Foreign currencies	Total	USD	CNY	Other Foreign currencies	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Assets</b>								
Cash and balances with banks and other financial institutions .....	1,330,897	11,132,602	870,029	13,333,528	1,637,240	2,656,355	2,655,722	6,949,317
Placements with banks and other financial institutions .....	36,794,309	2,178,679	19,554,095	58,527,083	25,836,121	—	16,830,116	42,666,237
Trade bills .....	563,925	198,004	31,497	793,426	569,059	—	29,835	598,894
Trading assets .....	792,053	—	191,905	983,958	549,298	—	23,243	572,541
Financial assets designated at fair value through profit or loss ...	6,278,557	—	315,768	6,594,325	6,478,579	—	363,766	6,842,345
Advances to customers and other accounts .....	38,065,897	61,918,887	18,670,493	118,655,277	30,939,797	25,986,629	13,462,897	70,389,323
Available-for-sale financial assets	2,427,045	118,504	2,587,655	5,133,204	2,093,595	—	1,824,624	3,918,219
Held-to-maturity investments .....	7,786,595	—	1,539,738	9,326,333	8,032,353	—	786,697	8,819,050
Investment in associates .....	326,453	—	—	326,453	299,061	—	99,761	398,822
Fixed assets .....	187,859	53,699	302,176	543,734	145,519	—	185,432	330,951
Goodwill and intangible assets ...	249,331	849	331,156	581,336	205,443	—	301,405	506,848
Deferred tax assets .....	56,240	—	10,286	66,526	14,747	—	23,277	38,024
Spot assets .....	<u>94,859,161</u>	<u>75,601,224</u>	<u>44,404,798</u>	<u>214,865,183</u>	<u>76,800,812</u>	<u>28,642,984</u>	<u>36,586,775</u>	<u>142,030,571</u>
<b>Liabilities</b>								
Deposits and balances of banks and other financial institutions .....	(742,045)	(35,964,730)	(2,174,122)	(38,880,897)	(2,516,000)	(21,776,110)	(5,250,376)	(29,542,486)
Deposits from customers .....	(69,467,118)	(33,681,107)	(37,958,672)	(141,106,897)	(58,328,752)	(5,118,680)	(30,526,587)	(93,974,019)
Trading liabilities .....	(316,735)	—	(140,914)	(457,649)	(341,909)	—	(24,305)	(366,214)
Certificates of deposit issued .....	(1,497,143)	—	(552,805)	(2,049,948)	(1,246,096)	—	(751,747)	(1,997,843)
Current taxation .....	(14,192)	(68,537)	(52,519)	(135,248)	(22,275)	—	(85,562)	(107,837)
Deferred tax liabilities .....	(3,549)	—	(422)	(3,971)	—	—	(65)	(65)
Other accounts and provisions ...	(1,494,438)	(668,581)	(1,640,385)	(3,803,404)	(2,067,863)	(107,425)	271,650	(1,903,638)
Loan capital .....	(9,051,989)	—	(4,600,230)	(13,652,219)	(8,154,315)	—	—	(8,154,315)
Spot liabilities .....	<u>(82,587,209)</u>	<u>(70,382,955)</u>	<u>(47,120,069)</u>	<u>(200,090,233)</u>	<u>(72,677,210)</u>	<u>(27,002,215)</u>	<u>(36,366,992)</u>	<u>(136,046,417)</u>
Forward purchases .....	36,089,303	3,398,749	15,231,011	54,719,063	20,344,824	19,395	5,761,707	26,125,926
Forward sales .....	(45,223,767)	(4,418,210)	(11,368,977)	(61,010,954)	(23,720,263)	(23,766)	(5,431,750)	(29,175,779)
Net option position .....	(10,140)	—	21,989	11,849	(8,787)	—	33,038	24,251
Net long non-structural position	<u>3,127,348</u>	<u>4,198,808</u>	<u>1,168,752</u>	<u>8,494,908</u>	<u>739,376</u>	<u>1,636,398</u>	<u>582,778</u>	<u>2,958,552</u>
Net structural position .....	<u>1,792,305</u>	<u>4,770,667</u>	<u>890,790</u>	<u>7,453,762</u>	<u>1,779,312</u>	<u>1,344,884</u>	<u>658,586</u>	<u>3,782,782</u>

## The Bank

	2007				2006			
	USD	CNY	Other Foreign currencies	Total	USD	CNY	Other Foreign currencies	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Assets</b>								
Cash and balances with banks and other financial institutions .....	556,915	1,374,811	680,416	2,612,142	1,498,074	2,656,355	2,572,734	6,727,163
Placements with banks and other financial institutions .....	29,405,449	—	19,228,115	48,633,564	25,087,102	—	16,391,163	41,478,265
Trade bills .....	424,951	—	26,403	451,354	569,059	—	29,835	598,894
Trading assets .....	777,662	—	44,616	822,278	539,942	—	23,242	563,184
Financial assets designated at fair value through profit or loss ...	6,261,904	—	315,768	6,577,672	6,449,475	—	363,766	6,813,241
Advances to customers and other accounts .....	17,531,821	6,703	14,810,117	32,348,641	25,440,563	25,961,866	11,358,710	62,761,139
Available-for-sale financial assets	1,305,383	118,504	2,486,256	3,910,143	1,556,585	—	1,820,864	3,377,449
Amounts due from subsidiaries ..	205,607	—	634,086	839,693	399,687	—	445,083	844,770
Held-to-maturity investments .....	6,823,059	—	1,383,540	8,206,599	7,179,749	—	665,506	7,845,255
Investment in subsidiaries and associates .....	1,232,920	—	208,666	1,441,586	1,377,658	—	208,666	1,586,324
Fixed assets .....	6,886	—	188,932	195,818	7,329	—	74,130	81,459
Deferred tax assets .....	5,921	—	6,428	12,349	3,713	—	19,192	22,905
Spot assets .....	<u>64,538,478</u>	<u>1,500,018</u>	<u>40,013,343</u>	<u>106,051,839</u>	<u>70,108,936</u>	<u>28,618,221</u>	<u>33,972,891</u>	<u>132,700,048</u>
<b>Liabilities</b>								
Deposits and balances of banks and other financial institutions .....	(646,556)	—	(1,755,290)	(2,401,846)	(2,388,519)	(21,776,150)	(5,160,256)	(29,324,925)
Deposits from customers .....	(52,751,196)	(1,476,563)	(36,323,017)	(90,550,776)	(50,927,325)	(5,118,680)	(28,540,005)	(84,586,010)
Trading liabilities .....	(207,470)	—	(52,809)	(260,279)	(333,703)	—	(24,305)	(358,008)
Certificates of deposit issued .....	(1,497,143)	—	(552,805)	(2,049,948)	(1,246,096)	—	(751,747)	(1,997,843)
Amounts due to subsidiaries .....	(1,111,003)	—	(2,013)	(1,113,016)	(924,774)	—	(227,190)	(1,151,964)
Current taxation .....	(5,120)	—	(46,338)	(51,458)	(12,667)	—	(86,924)	(99,591)
Other accounts and provisions ...	(926,476)	(2,539)	(745,288)	(1,674,303)	(1,886,061)	(107,425)	356,471	(1,637,015)
Loan capital .....	<u>(9,051,989)</u>	<u>—</u>	<u>(4,600,230)</u>	<u>(13,652,219)</u>	<u>(8,154,315)</u>	<u>—</u>	<u>—</u>	<u>(8,154,315)</u>
Spot liabilities .....	<u>(66,196,953)</u>	<u>(1,479,102)</u>	<u>(44,077,790)</u>	<u>(111,753,845)</u>	<u>(65,873,460)</u>	<u>(27,002,255)</u>	<u>(34,433,956)</u>	<u>(127,309,671)</u>
Forward purchases .....	33,069,414	216,572	14,799,081	48,085,067	20,219,638	19,395	5,750,564	25,989,597
Forward sales .....	(43,247,506)	(371,027)	(10,749,074)	(54,367,607)	(23,709,253)	(23,766)	(5,306,564)	(29,039,583)
Net option position .....	<u>(10,140)</u>	<u>—</u>	<u>21,989</u>	<u>11,849</u>	<u>(8,787)</u>	<u>—</u>	<u>33,038</u>	<u>24,251</u>
Net long/(short) non-structural position .....	<u>(11,846,707)</u>	<u>(133,539)</u>	<u>7,549</u>	<u>(11,972,697)</u>	<u>737,074</u>	<u>1,611,595</u>	<u>15,973</u>	<u>2,364,642</u>
Net structural position .....	<u>1,792,305</u>	<u>4,770,667</u>	<u>890,790</u>	<u>7,453,762</u>	<u>1,779,312</u>	<u>1,344,884</u>	<u>658,586</u>	<u>3,782,782</u>

(ii) *Interest rate risk*

The Group's interest rate positions arise from treasury and commercial banking activities. Interest rate risk arises in both trading portfolios and non-trading portfolios. Interest rate risk primarily results from the timing differences in the repricing of interest-bearing assets, liabilities and commitments. It also relates to positions from non-interest bearing liabilities including shareholders' funds and current accounts, as well as from certain fixed rate loans and liabilities. Interest rate risk is managed daily by the Treasury Department within the limits approved by the Board of Directors. The instruments used to manage interest rate risk include interest rate swaps and other derivatives.

Market risk control limits are set at different levels and dimensions. The Board of Directors approves the core control limits and delegates the Asset and Liability Management Committee to approve the detailed control limits. Risk, return and risk capital are considered in the limits setting. Active limit monitoring process is undertaken.

The independent centralized risk management function of the Group monitors the risk-taking activities of the Group. It 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 frequent basis to ensure that they are within established control limits.

The Group quantifies the market risk of the underlying trading portfolio by means of value-at-risk ("VaR"). VaR is a statistical estimate that measures the potential losses in market value of a portfolio as a result of unfavourable movements in market rates and prices, if positions are held unchanged over a certain horizon time period.

The Group estimates VaR for the Group's trading portfolio by the Parametric Approach, where the VaR computes from the underlying variances and covariances of the constituents of a portfolio. This methodology uses historical movements in market rates and prices, a 99% confidence level, a one-day holding period, a one-year historical observation period with higher weights being assigned to more recent observations, and takes into account correlations between different markets and rates.

Structural foreign exchange positions arising from net investments in branches and subsidiaries are not included in the VaR for foreign exchange trading position.

In addition to the listed shares, the book value of private equity funds and unlisted equities (excluding credit-related unlisted securities) (collectively the "Unlisted Securities") is limited and is monitored by the management of the Bank. The Unlisted Securities and listed non-trading equities are not included in the VaR for equity trading position and are managed through the delegated limits. The limits are subject to regular review by the Board.

Value-at-risk statistics

	2007			
	At 31st December	Maximum	Minimum	Mean
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
VaR for total trading activities .....	62,156	97,545	21,639	54,127
VaR for foreign exchange trading positions* .....	1,412	8,809	590	1,460
VaR for interest rate trading positions .....	798	1,015	83	379
VaR for equity trading positions .....	<u>60,779</u>	<u>95,427</u>	<u>21,481</u>	<u>52,931</u>

	2006			
	At 31st			
	December	Maximum	Minimum	Mean
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
VaR for total trading activities .....	25,561	29,720	11,663	18,578
VaR for foreign exchange trading positions* .....	1,043	2,167	528	1,042
VaR for interest rate trading positions .....	98	3,366	55	1,029
VaR for equity trading positions .....	<u>25,423</u>	<u>29,551</u>	<u>10,527</u>	<u>17,464</u>

\* Included all foreign exchange positions but excluded structured foreign exchange positions.

**(c) Operational risk management**

Operational risk is the risk arising from the potential loss due to inadequate or failed internal processes, people and systems or from external events.

The objective of operational risk management is to identify, assess and monitor operational risk and, in particular, to comply with the relevant regulatory requirements.

The Group has implemented a centralized risk management framework since January 2006. The Board of Directors reviews and approves the policies for operational risk management, and it has delegated the responsibility for ongoing operational risk management to the Operational & Other Risks Management Committee. The Operational & Other Risks Management Committee regularly reports status of operational risk management to the Board of Directors via the Risk Management Committee. The independent centralized risk management function of the Group is responsible for monitoring activities relating to operational risk.

Operational risk management tools adopted include operational risk incidents reporting, control self-assessment, key risk indicators, operation manuals, insurance policies, business continuity planning, etc.

Furthermore, the independent centralized risk management function of the Group has also performed self-assessments on the Group's compliance with the requirements of HKMA Supervisory Policy Manual on Operational Risk Management and Banking (Capital) Rules (the "Capital Rules"), with satisfactory result which has been reviewed independently by the Internal Audit Department.

**(d) Liquidity risk management**

The purpose of liquidity management is to ensure sufficient cash flows to meet all financial commitment and to capitalize on opportunities for business expansion. This includes the Group's ability to meet deposit withdrawals either on demand or at contractual maturity, to repay borrowings as they mature, to comply with the statutory liquidity ratio, and to make new loans and investments as opportunities arise.

The management of the Bank's liquidity risk is governed by the Liquidity Risk Management Policy, endorsed by the Risk Management Committee and approved by the Board of Directors. The Asset and Liability Management Committee is delegated by the Board of Directors to oversee the Bank's liquidity risk management, set the strategy and policy for managing liquidity risk and the means for ensuring that such strategy and policy are implemented. Liquidity risk is managed on a daily basis by the Treasury Department within the limits approved by the Board of Directors. The independent centralized risk management function of the Group is responsible for monitoring the activities of the Treasury Department in compliance with the Liquidity Risk Management Manual and Policy. The Internal Audit Department performs periodic reviews to make sure the liquidity risk management functions are carried out effectively.

The Group manages liquidity risk by holding sufficient liquid assets (e.g. cash and short term funds and securities) of appropriate quality to ensure that short term funding requirements are covered within prudent limits. Adequate standby facilities are maintained to provide strategic liquidity to meet unexpected and material cash outflows in the ordinary course of business.

The Group conducts stress testing regularly to analyze liquidity risk and has formulated a contingency plan that sets out a strategy for dealing with a liquidity problem and the procedures for making up cash flow deficits in emergency situations.

In addition to observing the statutory liquidity ratio, the Bank also monitors the loan to deposit ratio and maturity mismatch between assets and liabilities to control the Bank's liquidity risk.

Analysis of assets and liabilities by remaining maturity:

### The Group

	2007						Total
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	
<b>Assets</b>							
Cash and balances with banks and other financial institutions .	13,583,109	62,400	—	—	—	541,192	14,186,701
Placements with banks and other financial institutions .....	—	90,574,292	4,129,601	—	—	—	94,703,893
Trade bills .....	57,279	624,275	91,625	—	—	38,451	811,630
Trading assets .....	—	797,857	396,673	—	17,598	3,634,474	4,846,602
Financial assets designated at fair value through profit or loss .....	—	154,749	522,699	7,980,558	—	—	8,658,006
Advances to customers and other accounts ..	4,211,222	36,839,812	34,528,649	83,439,606	61,708,576	14,677,964	235,405,829
Available-for-sale financial assets .....	—	1,922,511	4,681,603	2,898,681	970,641	1,744,059	12,217,495
Held-to-maturity investments .....	—	970,156	6,096,029	2,606,799	1,088,065	—	10,761,049
Undated assets .....	—	—	—	—	—	12,387,455	12,387,455
<b>Total assets .....</b>	<b>17,851,610</b>	<b>131,946,052</b>	<b>50,446,879</b>	<b>96,925,644</b>	<b>63,784,880</b>	<b>33,023,595</b>	<b>393,978,660</b>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .	3,722,566	17,591,509	17,685,372	49,261	9,946	1,602	39,060,256
Deposits from customers .....	81,227,431	178,156,451	17,106,985	7,659,059	35,918	—	284,185,844
- Demand deposits and current accounts .....	29,989,672	—	—	—	—	—	29,989,672
- Savings deposit .....	49,216,282	—	—	—	—	—	49,216,282
- Time, call and notice deposits .....	2,021,477	178,156,451	17,106,985	7,659,059	35,918	—	204,979,890
Trading liabilities .....	—	1,098,512	—	32,885	101	1,240,603	2,372,101
Certificates of deposit issued .....	—	288,420	9,662,609	1,326,263	887,609	—	12,164,901
Current taxation .....	—	—	228,850	—	—	—	228,850
Loan capital .....	—	—	—	9,269,404	4,382,815	—	13,652,219
Undated liabilities .....	—	—	—	—	—	11,868,577	11,868,577
<b>Total liabilities .....</b>	<b>84,949,997</b>	<b>197,134,892</b>	<b>44,683,816</b>	<b>18,336,872</b>	<b>5,316,389</b>	<b>13,110,782</b>	<b>363,532,748</b>
<b>Net gap .....</b>	<b>(67,098,387)</b>	<b>(65,188,840)</b>	<b>5,763,063</b>	<b>78,588,772</b>	<b>58,468,491</b>		

## The Group

	2006						
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Assets</b>							
Cash and balances with banks and other financial institutions .	8,317,746	—	—	—	—	—	8,317,746
Placements with banks and other financial institutions .....	—	64,315,952	1,717,526	830,567	—	—	66,864,045
Trade bills .....	31,258	439,366	104,631	—	—	45,208	620,463
Trading assets .....	387	516,124	134,770	13,043	31,485	2,241,725	2,937,534
Financial assets designated at fair value through profit or loss .....	—	197,519	375,619	7,928,462	141,043	836	8,643,479
Advances to customers and other accounts ..	4,099,733	30,736,093	23,224,513	54,944,952	52,686,001	9,405,374	175,096,666
Available-for-sale financial assets .....	—	4,371,077	1,370,320	2,096,336	608,292	3,556,172	12,002,197
Held-to-maturity investments .....	—	848,234	842,936	7,268,993	1,260,134	29,062	10,249,359
Undated assets .....	—	—	—	—	—	9,470,828	9,470,828
<b>Total assets .....</b>	<b>12,449,124</b>	<b>101,424,365</b>	<b>27,770,315</b>	<b>73,082,353</b>	<b>54,726,955</b>	<b>24,749,205</b>	<b>294,202,317</b>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .	4,512,307	11,312,398	14,202,290	821,476	1,039,047	71,664	31,959,182
Deposits from customers .....	59,423,997	134,799,884	10,812,037	4,463,928	—	24,374	209,524,220
- Demand deposits and current accounts .....	15,130,231	—	—	—	—	—	15,130,231
- Savings deposit .....	43,644,321	—	—	—	—	—	43,644,321
- Time, call and notice deposits .....	649,445	134,799,884	10,812,037	4,463,928	—	24,374	150,749,668
Trading liabilities .....	386	216,675	9,033	63,430	3,004	650,067	942,595
Certificates of deposit issued .....	—	3,033,404	964,439	3,000,564	—	—	6,998,407
Current taxation .....	—	—	334,097	—	—	—	334,097
Loan capital .....	—	—	—	3,865,491	4,288,824	—	8,154,315
Undated liabilities .....	—	—	—	—	—	8,644,772	8,644,772
<b>Total liabilities .....</b>	<b>63,936,690</b>	<b>149,362,361</b>	<b>26,321,896</b>	<b>12,214,889</b>	<b>5,330,875</b>	<b>9,390,877</b>	<b>266,557,588</b>
<b>Net gap .....</b>	<b>(51,487,566)</b>	<b>(47,937,996)</b>	<b>1,448,419</b>	<b>60,867,464</b>	<b>49,396,080</b>		

## The Bank

	2007						
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Assets</b>							
Cash and balances with banks and other financial institutions .	2,721,253	—	—	—	—	411,894	3,133,147
Placements with banks and other financial institutions .....	—	80,492,807	2,630,147	—	—	—	83,122,954
Trade bills .....	33,934	311,605	85,567	—	—	38,451	469,557
Trading assets .....	—	797,857	396,673	—	17,598	3,408,650	4,620,778
Financial assets designated at fair value through profit or loss .....	—	154,749	522,699	7,963,905	—	—	8,641,353
Advances to customers and other accounts ..	3,862,117	23,246,131	12,885,687	52,567,238	42,388,245	6,742,366	141,691,784
Available-for-sale financial assets .....	—	1,903,056	4,392,898	2,745,202	244,184	1,322,684	10,608,024
Held-to-maturity investments .....	—	734,643	5,554,559	1,820,348	663,348	—	8,772,898
Undated assets .....	—	—	—	—	—	37,412,985	37,412,985
<b>Total assets .....</b>	<b>6,617,304</b>	<b>107,640,848</b>	<b>26,468,230</b>	<b>65,096,693</b>	<b>43,313,375</b>	<b>49,337,030</b>	<b>298,473,480</b>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .	369,105	1,923,311	286,660	—	—	1,602	2,580,678
Deposits from customers .....	56,357,730	164,306,521	9,444,618	2,479,420	—	—	232,588,289
- Demand deposits and current accounts deposits ...	10,144,175	—	—	—	—	—	10,144,175
- Savings deposit .....	46,188,530	—	—	—	—	—	46,188,530
- Time, call and notice deposits .....	25,025	164,306,521	9,444,618	2,479,420	—	—	176,255,584
Trading liabilities .....	—	1,098,512	—	32,885	101	1,043,234	2,174,732
Certificates of deposit issued .....	—	288,420	9,662,609	1,326,263	3,087,609	—	14,364,901
Current taxation .....	—	—	80,871	—	—	—	80,871
Loan capital .....	—	—	—	9,269,404	4,382,815	—	13,652,219
Undated liabilities .....	—	—	—	—	—	6,850,498	6,850,498
<b>Total liabilities .....</b>	<b>56,726,835</b>	<b>167,616,764</b>	<b>19,474,758</b>	<b>13,107,972</b>	<b>7,470,525</b>	<b>7,895,334</b>	<b>272,292,188</b>
<b>Net gap .....</b>	<b>(50,109,531)</b>	<b>(59,975,916)</b>	<b>6,993,472</b>	<b>51,988,721</b>	<b>35,842,850</b>		

## The Bank

	2006						
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated or overdue	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Assets</b>							
Cash and balances with banks and other financial institutions .	8,072,113	—	—	—	—	—	8,072,113
Placements with banks and other financial institutions .....	—	63,688,406	1,587,248	830,567	—	—	66,106,221
Trade bills .....	31,258	439,366	104,631	—	—	45,208	620,463
Trading assets .....	387	515,976	134,770	6,188	29,130	2,213,432	2,899,883
Financial assets designated at fair value through profit or loss .....	—	193,671	375,619	7,928,462	115,787	836	8,614,375
Advances to customers and other accounts ..	3,477,395	29,832,312	22,958,197	54,024,867	49,586,381	7,815,595	167,694,747
Available-for-sale financial assets .....	—	4,351,760	1,134,652	1,937,533	419,307	2,258,283	10,101,535
Held-to-maturity investments .....	—	714,541	436,236	6,409,880	745,156	29,063	8,334,876
Undated assets .....	—	—	—	—	—	11,925,400	11,925,400
<b>Total assets .....</b>	<b>11,581,153</b>	<b>99,736,032</b>	<b>26,731,353</b>	<b>71,137,497</b>	<b>50,895,761</b>	<b>24,287,817</b>	<b>284,369,613</b>
<b>Liabilities</b>							
Deposits and balances of banks and other financial institutions .	4,512,307	11,203,262	14,176,739	738,602	1,039,047	71,664	31,741,621
Deposits from customers .....	57,386,698	132,211,103	8,580,336	4,260,703	—	24,374	202,463,214
- Demand deposits and current accounts .....	13,485,262	—	—	—	—	—	13,485,262
- Savings deposit .....	43,251,991	—	—	—	—	—	43,251,991
- Time, call and notice deposits .....	649,445	132,211,103	8,580,336	4,260,703	—	24,374	145,725,961
Trading liabilities .....	386	216,501	9,033	58,112	276	650,067	934,375
Certificates of deposit issued .....	—	3,033,404	964,439	5,200,564	—	—	9,198,407
Current taxation .....	—	—	295,823	—	—	—	295,823
Loan capital .....	—	—	—	3,865,491	4,288,824	—	8,154,315
Undated liabilities .....	—	—	—	—	—	6,716,610	6,716,610
<b>Total liabilities .....</b>	<b>61,899,391</b>	<b>146,664,270</b>	<b>24,026,370</b>	<b>14,123,472</b>	<b>5,328,147</b>	<b>7,462,715</b>	<b>259,504,365</b>
<b>Net gap .....</b>	<b>(50,318,238)</b>	<b>(46,928,238)</b>	<b>2,704,983</b>	<b>57,014,025</b>	<b>45,567,614</b>		

As the trading and available-for-sale portfolios may be sold before maturity or deposits from customers may mature without being withdrawn, the contractual maturity dates do not represent expected dates of future cash flows.

The following tables provide an analysis of the residual contractual maturities of non-derivatives financial liabilities of the Group at the balance sheet date.

## The Group

2007								
	Carrying Amount	Gross cash outflow	Repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	Undated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Deposits and balances of banks and other financial institutions	39,060,256	39,649,036	3,740,859	17,784,501	18,062,750	49,378	9,946	1,602
Deposits from customers	284,185,844	286,298,036	81,231,830	179,299,062	17,674,385	8,053,456	39,303	—
- Demand deposits and current accounts	29,989,672	29,989,672	29,989,672	—	—	—	—	—
- Savings deposit	49,216,282	49,216,282	49,216,282	—	—	—	—	—
- Time, call and notice deposits	204,979,890	207,092,082	2,025,876	179,299,062	17,674,385	8,053,456	39,303	—
Trading liabilities	2,372,101	2,376,644	—	1,098,515	2,254	35,164	108	1,240,603
Certificates of deposit issued	12,164,901	12,634,963	—	364,803	9,994,662	1,387,889	887,609	—
Current taxation	228,850	228,850	—	—	228,850	—	—	—
Loan capital	13,652,219	16,861,073	—	210,565	583,852	11,683,841	4,382,815	—
Interest rate swaps	2,246,651	2,246,651	72,469	150,245	365,684	1,448,660	209,593	—
Other liabilities	11,868,577	11,868,577	—	—	—	—	—	11,868,577
Total	365,779,399	372,163,830	85,045,158	198,907,691	46,912,437	22,658,388	5,529,374	13,110,782

2006								
	Carrying Amount	Gross cash outflow	Repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	Undated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Deposits and balances of banks and other financial institutions	31,959,182	32,376,484	4,512,523	11,393,353	14,329,013	903,688	1,166,243	71,664
Deposits from customers	209,524,220	210,784,654	59,424,412	135,602,704	11,186,240	4,546,924	—	24,374
- Demand deposits and current accounts	15,130,231	15,130,231	15,130,231	—	—	—	—	—
- Savings deposit	43,644,321	43,644,321	43,644,321	—	—	—	—	—
- Time, call and notice deposits	150,749,668	152,010,102	649,860	135,602,704	11,186,240	4,546,924	—	24,374
Trading liabilities	942,595	949,357	386	216,678	11,274	67,937	3,015	650,067
Certificates of deposit issued	6,998,407	7,314,778	—	3,108,626	1,056,169	3,149,983	—	—
Current taxation	334,097	334,097	—	—	334,097	—	—	—
Loan capital	8,154,315	9,253,255	—	68,209	308,840	4,587,382	4,288,824	—
Interest rate swaps	785,664	785,664	—	65,104	59,596	484,014	176,950	—
Other liabilities	8,644,772	8,644,772	—	—	—	—	—	8,644,772
Total	267,343,252	270,443,061	63,937,321	150,454,674	27,285,229	13,739,928	5,635,032	9,390,877

## The Bank

2007

	Carrying Amount	Gross cash outflow	Repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	Undated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Deposits and balances of banks and other financial institutions	2,580,678	2,597,060	369,105	1,937,215	289,138	—	—	1,602
Deposits from customers	232,588,289	233,974,780	56,358,123	165,342,030	9,772,390	2,502,237	—	—
- Demand deposits and current accounts	10,144,175	10,144,175	10,144,175	—	—	—	—	—
- Savings deposit	46,188,530	46,188,530	46,188,530	—	—	—	—	—
- Time, call and notice deposits	176,255,584	177,642,075	25,418	165,342,030	9,772,390	2,502,237	—	—
Trading liabilities	2,174,732	2,179,275	—	1,098,515	2,254	35,164	108	1,043,234
Certificates of deposit issued	14,364,901	14,834,963	—	364,803	9,994,662	1,387,889	3,087,609	—
Current taxation	80,871	80,871	—	—	80,871	—	—	—
Loan capital	13,652,219	16,861,073	—	210,565	583,852	11,683,841	4,382,815	—
Interest rate swaps	2,246,651	2,246,651	72,469	150,245	365,684	1,448,660	209,593	—
Other liabilities	6,850,498	6,856,631	1,861	4,097	175	—	—	6,850,498
Total	274,538,839	279,631,304	56,801,558	169,107,470	21,089,026	17,057,791	7,680,125	7,895,334

2006

	Carrying Amount	Gross cash outflow	Repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	Undated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Deposits and balances of banks and other financial institutions	31,741,621	32,158,668	4,512,523	11,283,962	14,303,462	820,814	1,166,243	71,664
Deposits from customers	202,463,214	203,615,957	57,387,113	132,991,472	8,883,726	4,329,272	—	24,374
- Demand deposits and current accounts	13,485,262	13,485,262	13,485,262	—	—	—	—	—
- Savings deposit	43,251,991	43,251,991	43,251,991	—	—	—	—	—
- Time, call and notice deposits	145,725,961	146,878,704	649,860	132,991,472	8,883,726	4,329,272	—	24,374
Trading liabilities	934,375	941,137	386	216,504	11,274	62,619	287	650,067
Certificates of deposit issued	9,198,407	9,514,778	—	3,108,626	1,056,169	5,349,983	—	—
Current taxation	295,823	295,823	—	—	295,823	—	—	—
Loan capital	8,154,315	9,253,255	—	68,209	308,840	4,587,382	4,288,824	—
Interest rate swaps	785,664	785,664	—	65,104	59,596	484,014	176,950	—
Other liabilities	6,716,610	6,717,710	—	1,100	—	—	—	6,716,610
Total	260,290,029	263,282,992	61,900,022	147,734,977	24,918,890	15,634,084	5,632,304	7,462,715

(e) **Interest rate risk management**

The management of the Bank's interest rate risk is governed by the Interest Rate Risk Management Policy, endorsed by Risk Management Committee and approved by the Board of Directors. The Asset and Liability Management Committee is delegated by the Board of Directors to oversee the Bank's interest rate risk management, set the strategy and policy for managing interest rate risk and the means for ensuring that such strategy and policy are implemented. Interest rate risk is managed on a daily basis by the Treasury Department within the limits approved by the Board of Directors. The independent centralized risk management function of the Group is responsible for monitoring the activities of the Treasury Department in compliance with the Interest Rate Risk Management Manual and Policy. The Internal Audit Department performs periodic reviews to make sure the interest rate risk management functions are carried out effectively.

The Bank manages the interest rate risk on the banking book primarily by focusing on the repricing mismatches. Gap analysis provides a static view of the maturity and repricing characteristics of the Bank's balance sheet positions. Repricing gap limits are set to control the Bank's interest rate risk.

Stress tests on the Bank's various types of interest rate risk are conducted regularly. The Asset and Liability Management Committee monitors the results of stress tests and decides remedial action if required.

Sensitivity analysis on earnings and economic value to interest rate changes is assessed through a hypothetical interest rate shock of 200 basis points across the yield curve on both sides of the balance sheet and performed on monthly basis. Sensitivity limits are set to control the Bank's interest rate risk exposure under both earnings and economic value perspectives. The results are reported to the Asset and Liability Management Committee and the Board of Directors on a regular basis.

**Sensitivity analysis on banking book interest rate risk**

The Bank uses sensitivity analysis to measure the potential effect of changes in interest rates on our net interest income and economic value change:—

	2007		2006	
	HKD	USD	HKD	USD
	HK'000	HK'000	HK'000	HK'000
Impact on earnings over the next 12 months if interest rates rise by 200 basis points .....	57,327	(111,706)	180,448	(133,756)
Impact on economic value if interest rates rise by 200 basis points .....	(180,188)	(273,099)	(120,020)	(246,704)

This sensitivity analysis, which is based on a static interest rate risk profile of assets and liabilities, is used for risk management purposes only. The analysis is based on the following assumptions:

- (i) there is a parallel shift in the yield curve and in interest rates;
- (ii) there are no other changes to the portfolio;
- (iii) no loan prepayment is assumed as the majority of loans is on floating rate base; and
- (iv) deposits without fixed maturity dates are assumed to be repriced on next day.

Actual changes in the Bank's net interest income and the economic value resulting from the increases in interest rates may differ from the results of this sensitivity analysis.

The following table indicates the expected next repricing dates (or maturity dates whichever are earlier) for the interest bearing assets and liabilities at the balance sheet date.

## The Group

	2007					
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Assets</b>						
Cash and balances with banks and other financial institutions .....	12,678,618	—	—	—	1,508,083	14,186,701
Placements with banks and other financial institutions .....	90,578,316	4,125,577	—	—	—	94,703,893
Trade bills .....	686,671	53,288	—	—	71,671	811,630
Trading assets .....	815,455	396,673	—	—	3,634,474	4,846,602
Financial assets designated at fair value through profit or loss .....	5,352,769	446,281	2,845,285	—	13,671	8,658,006
Advances to customers .....	140,055,461	42,211,792	26,094,084	6,919,633	2,206,490	217,487,460
Other accounts .....	1,268,816	1,352,099	39,003	—	15,258,451	17,918,369
Available-for-sale financial assets ..	7,108,981	1,841,633	806,644	743,913	1,716,324	12,217,495
Held-to-maturity investments .....	2,121,945	6,064,246	1,569,423	1,005,435	—	10,761,049
Non-interest bearing assets .....	—	—	—	—	12,387,455	12,387,455
<b>Total Assets .....</b>	<b>260,667,032</b>	<b>56,491,589</b>	<b>31,354,439</b>	<b>8,668,981</b>	<b>36,796,619</b>	<b>393,978,660</b>
<b>Liabilities</b>						
Deposits and balances of banks and other financial institutions .	19,327,207	14,414,250	49,261	9,946	5,259,592	39,060,256
Deposits from customers .....	249,053,238	22,274,935	3,438,605	377,957	9,041,109	284,185,844
Trading liabilities .....	1,098,512	—	32,885	101	1,240,603	2,372,101
Certificates of deposit issued .....	3,918,263	6,532,766	503,700	1,210,172	—	12,164,901
Loan capital .....	4,669,174	—	4,600,230	4,382,815	—	13,652,219
Non-interest bearing liabilities .....	—	—	—	—	12,097,427	12,097,427
<b>Total liabilities .....</b>	<b>278,066,394</b>	<b>43,221,951</b>	<b>8,624,681</b>	<b>5,980,991</b>	<b>27,638,731</b>	<b>363,532,748</b>
Interest rate sensitivity gap .....	(17,399,362)	13,269,638	22,729,758	2,687,990	—	—

## The Group

	2006					
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Assets</b>						
Cash and balances with banks and other financial institutions .....	6,848,009	—	—	—	1,469,737	8,317,746
Placements with banks and other financial institutions .....	64,315,952	2,548,093	—	—	—	66,864,045
Trade bills .....	519,097	38,795	—	—	62,571	620,463
Trading assets .....	507,272	132,754	2,267	28,945	2,266,296	2,937,534
Financial assets designated at fair value through profit or loss .....	324,615	721,641	7,458,909	115,786	22,528	8,643,479
Advances to customers .....	112,017,825	26,276,107	19,601,784	5,158,092	2,426,406	165,480,214
Other accounts .....	1,822,209	1,091,033	126,218	—	6,576,992	9,616,452
Available-for-sale financial assets ..	4,397,360	1,521,793	1,911,622	638,242	3,533,180	12,002,197
Held-to-maturity investments .....	1,137,134	931,836	6,920,478	1,259,667	244	10,249,359
Non-interest bearing assets .....	—	—	—	—	9,470,828	9,470,828
<b>Total Assets .....</b>	<b>191,889,473</b>	<b>33,262,052</b>	<b>36,021,278</b>	<b>7,200,732</b>	<b>25,828,782</b>	<b>294,202,317</b>
<b>Liabilities</b>						
Deposits and balances of banks and other financial institutions .	15,074,659	14,328,509	1,503,779	946,399	105,836	31,959,182
Deposits from customers .....	185,194,140	12,341,018	4,167,681	386,586	7,434,795	209,524,220
Trading liabilities .....	207,472	1,756	33,842	99	699,426	942,595
Certificates of deposit issued .....	3,033,404	357,975	3,607,028	—	—	6,998,407
Loan capital .....	—	3,865,491	—	4,288,824	—	8,154,315
Non-interest bearing liabilities .....	—	—	—	—	8,978,869	8,978,869
<b>Total liabilities .....</b>	<b>203,509,675</b>	<b>30,894,749</b>	<b>9,312,330</b>	<b>5,621,908</b>	<b>17,218,926</b>	<b>266,557,588</b>
Interest rate sensitivity gap .....	(11,620,202)	2,367,303	26,708,948	1,578,824	—	—

## The Bank

	2007					
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Assets</b>						
Cash and balances with banks and other financial institutions .....	2,087,374	—	—	—	1,045,773	3,133,147
Placements with banks and other financial institutions .....	80,492,807	2,630,147	—	—	—	83,122,954
Trade bills .....	374,783	47,229	—	—	47,545	469,557
Trading assets .....	815,455	396,673	—	—	3,408,650	4,620,778
Financial assets designated at fair value through profit or loss .....	5,352,769	446,281	2,828,632	—	13,671	8,641,353
Advances to customers .....	96,635,214	8,199,526	22,315,916	5,154,281	2,142,182	134,447,119
Other accounts .....	462,303	238,227	39,003	—	6,505,132	7,244,665
Available-for-sale financial assets ..	7,005,779	1,552,928	653,165	69,468	1,326,684	10,608,024
Held-to-maturity investments .....	1,886,432	5,522,776	782,504	581,186	—	8,772,898
Non-interest bearing assets .....	—	—	—	—	37,412,985	37,412,985
<b>Total Assets .....</b>	<b>195,112,916</b>	<b>19,033,787</b>	<b>26,619,220</b>	<b>5,804,935</b>	<b>51,902,622</b>	<b>298,473,480</b>
<b>Liabilities</b>						
Deposits and balances of banks and other financial institutions .	2,284,231	286,660	—	—	9,787	2,580,678
Deposits from customers .....	213,127,612	9,476,122	2,101,463	377,957	7,505,135	232,588,289
Trading liabilities .....	1,098,512	—	32,885	101	1,043,234	2,174,732
Certificates of deposit issued .....	3,918,263	6,532,766	503,700	3,410,172	—	14,364,901
Loan capital .....	4,669,174	—	4,600,230	4,382,815	—	13,652,219
Non-interest bearing liabilities .....	—	—	—	—	6,931,369	6,931,369
<b>Total liabilities .....</b>	<b>225,097,792</b>	<b>16,295,548</b>	<b>7,238,278</b>	<b>8,171,045</b>	<b>15,489,525</b>	<b>272,292,188</b>
Interest rate sensitivity gap .....	(29,984,876)	2,738,239	19,380,942	(2,366,110)		

## The Bank

	2006					
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Assets</b>						
Cash and balances with banks and other financial institutions .....	6,757,117	—	—	—	1,314,996	8,072,113
Placements with banks and other financial institutions .....	63,688,406	2,417,815	—	—	—	66,106,221
Trade bills .....	519,097	38,795	—	—	62,571	620,463
Trading assets .....	497,914	132,754	2,267	28,945	2,238,003	2,899,883
Financial assets designated at fair value through profit or loss .....	320,767	721,641	7,433,653	115,786	22,528	8,614,375
Advances to customers .....	109,151,089	25,600,695	17,674,698	4,775,372	2,369,792	159,571,646
Other accounts .....	1,768,900	1,090,567	126,218	—	5,137,416	8,123,101
Available-for-sale financial assets ..	4,351,760	1,286,826	1,774,579	419,307	2,269,063	10,101,535
Held-to-maturity investments .....	995,342	532,770	6,061,364	745,156	244	8,334,876
Non-interest bearing assets .....	—	—	—	—	11,925,400	11,925,400
<b>Total Assets .....</b>	<b>188,050,392</b>	<b>31,821,863</b>	<b>33,072,779</b>	<b>6,084,566</b>	<b>25,340,013</b>	<b>284,369,613</b>
<b>Liabilities</b>						
Deposits and balances of banks and other financial institutions .	14,857,098	14,328,509	1,503,779	946,399	105,836	31,741,621
Deposits from customers .....	180,823,605	10,109,318	3,964,247	386,586	7,179,458	202,463,214
Trading liabilities .....	199,799	1,334	33,842	99	699,301	934,375
Certificates of deposit issued .....	3,033,404	357,975	3,607,028	2,200,000	—	9,198,407
Loan capital .....	—	3,865,491	—	4,288,824	—	8,154,315
Non-interest bearing liabilities .....	—	—	—	—	7,012,433	7,012,433
<b>Total liabilities .....</b>	<b>198,913,906</b>	<b>28,662,627</b>	<b>9,108,896</b>	<b>7,821,908</b>	<b>14,997,028</b>	<b>259,504,365</b>
Interest rate sensitivity gap .....	(10,863,514)	3,159,236	23,963,883	(1,737,342)		

The following table summarises the range of effective average interest rates for the year ended 31st December for monetary financial instruments:

	The Group		The Bank	
	2007	2006	2007	2006
	%	%	%	%
<b>Assets</b>				
Cash and short-term funds and placements with banks and other financial institutions .....	0-10.00	0-8.50	0.10-8.60	0-8.50
Trade bills, advances to customers and advances to banks and other financial institutions .....	0-37.62	1.02-45.00	0.88-18.36	1.02-18.59
Securities (Note) .....	1.00-7.75	1.00-7.55	1.00-7.75	1.00-7.55
<b>Liabilities</b>				
Deposits and balances of banks and other financial institutions .....	0.01-8.48	0-7.24	0.01-7.90	0-7.24
Deposits from customers .....	0-13.33	0-15.00	0-8.75	0-15.00
Certificates of deposit issued and loan capital .....	2.25-10.48	1.43-6.31	2.25-10.48	1.43-6.31

Note: Securities include certificates of deposit held, trading assets, financial assets designated at fair value through profit or loss, securities measured as loans and receivables, available-for-sale financial assets and held-to-maturity investments.

#### (f) Strategic risk management

The objective of strategic risk management is to monitor the risk to earnings or capital arising from bad business decisions or from an improper implementation of good business decisions.

The Board of Directors reviews and approves policy for the management of the strategic risk. The Board has delegated the responsibility for ongoing strategic risk management to the Asset and Liability Management Committee. The Asset and Liability Management Committee reports to the Board of Directors via the Risk Management Committee.

#### (g) Legal risk and reputation risk management

Legal risk is the risk arising from the potential that unenforceable contracts, lawsuits or adverse judgements may disrupt or otherwise negatively affect the operations or financial condition of the Group.

Reputation risk is the risk arising from the potential that negative publicity regarding the Group's business practices, whether true or not, will cause a decline in the customer base or lead to costly litigation or revenue reductions.

The objective of managing the aforesaid risks is to identify, assess and monitor these risks and, in particular, to comply with the relevant regulatory requirements.

The Board of Directors reviews and approves policies for these risks, and it has delegated the responsibility for ongoing risk management to the Operational and Other Risks Management Committee. The Operational and Other Risks Management Committee reports to the Board of Directors via the Risk Management Committee.

#### (h) Capital management

The HKMA sets and monitors capital requirements for the Group as a whole. In implementing current capital requirements the HKMA requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets. The Group calculates requirements for market risk in its trading portfolios based upon the Group's VAR models and uses its internal gradings as the basis for risk weightings for credit risk. Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

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In addition to meeting the regulatory requirements, the Group's primary objectives when managing capital are to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might otherwise be possible with greater gearing and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The process of allocating capital to specific operations and activities is undertaken by Asset and Liability Committee and is reviewed regularly by the Board of Directors.

Consistent with industry practice, the Group monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Group's policy on the management of capital during the year, except for a change in the calculation methodology in the capital adequacy ratios.

The capital adequacy ratios as at 31st December 2007 are computed on the consolidated basis of the Bank and certain of its subsidiaries as specified by the HKMA for its regulatory purposes, and are in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance which became effective on 1st January 2007. The capital adequacy ratios as at 31st December 2006 were computed in accordance with the Third Schedule to the Hong Kong Banking Ordinance and adjusted in accordance with the guideline on "Maintenance of Adequate Capital Against Market Risks" issued by the HKMA. Accordingly, the capital adequacy ratios of the two years are not directly comparable.

The Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the year ended 31st December 2007 and 2006 and are well above the minimum required ratio set by the HKMA.

#### **41. Fair Values Of Financial Instruments**

##### **(a) Estimation of fair values**

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, the most suitable measure for fair value is the quoted market price. In the absence of organised secondary markets for most financial instruments, and in particular for loans, deposits and unlisted derivatives, direct market prices are not available. The fair value of such instruments was therefore calculated on the basis of well-established valuation techniques using current market parameters. In particular, the fair value is a theoretical value applicable at a given reporting date, and hence can only be used as an indicator of value realisable in a future sale.

The Group compares valuations derived from models with quoted prices of similar financial instruments, and with actual values when realised, in order to further validate and calibrate the models. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experiences and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values. Derived fair value estimates cannot necessarily be substantiated by comparison to independent markets and, in many cases, could not be realized in an immediate sale of the instruments.

The following methods and significant assumptions have been applied in determining the fair values of financial instruments:

- (i) the fair value of demand deposits and savings accounts with no specific maturity is assumed to be the amount payable on demand at the balance sheet date;
- (ii) the fair value of variable rate financial instruments is assumed to approximate their carrying amounts and, in the case of loans and unquoted debt securities, does not, therefore, reflect changes in their credit quality, as the impact of credit risk is recognised separately by deducting the amount of the impairment allowances from both the carrying amount and fair value;

- (iii) the fair value of fixed rate loans and mortgages carried at amortized cost is estimated by comparing market interest rates when the loans were granted with current market rates offered on similar loans. Changes in the credit quality of loans within the portfolio are not taken into account in determining gross fair values, as the impact of credit risk is recognised separately by deducting the amount of the impairment loss and allowances from both the carrying amount and fair value.
- (iv) the fair value of unquoted equity investments is estimated, if possible, using applicable price/earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuers.
- (v) the fair value of unlisted open-ended investment funds are estimated using the net asset value per share as reported by the managers of such funds.
- (vi) the fair value of forward exchange contracts and interest rate swaps is estimated either using broker quotes or by discounting future cash flows. Future cash flows are estimated based on management's best estimate of the amount it would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties. The discount rate used is a market rate for a similar instrument at the balance sheet date. The fair value of an option contract is determined by applying the Black-Scholes option valuation model. Inputs are based on market related data at the balance sheet date.

**(b) Fair value**

All financial instruments are stated at fair value or carried at amounts not materially different from their fair values as at 31st December 2007 and 2006, except for held-to-maturity investments as set out in Note 27.

**42. Off-Balance Sheet Exposures**

**(a) Contingent Liabilities and Commitments**

The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Direct credit substitutes .....	8,496,462	5,214,804	9,151,298	5,199,789
Transaction-related contingencies .....	976,037	740,121	707,068	740,121
Trade-related contingencies .....	1,492,668	1,835,733	1,032,553	1,782,712
Commitments that are unconditionally cancellable without prior notice .....	49,117,152	36,724,889	37,442,191	35,869,667
Other commitments				
- up to 1 year .....	4,510,116	3,022,549	2,062,476	3,022,549
- over 1 year .....	14,143,865	14,686,624	13,353,609	14,567,457
	<u>78,736,300</u>	<u>62,224,720</u>	<u>63,749,195</u>	<u>61,182,295</u>

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contract amounts do not represent expected future cash flows.

**(b) Derivatives**

Derivatives refer to financial contracts whose value depends on the value of one or more underlying assets or indices.

The following is a summary of the notional amounts of each significant type of derivative for the Group and the Bank:

	<b>The Group</b>					
	<b>2007</b>			<b>2006</b>		
	<b>Trading</b>	<b>Non-trading</b>	<b>Total</b>	<b>Trading</b>	<b>Non-trading</b>	<b>Total</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
Exchange rate contracts						
Forwards and futures .....	14,816,422	22,025	14,838,447	4,954,231	14,384	4,968,615
Swaps .....	15,141,206	8,456,003	23,597,209	8,101,973	1,847,039	9,949,012
Options purchased .....	3,716,793	—	3,716,793	1,780,330	—	1,780,330
Options written .....	3,526,541	—	3,526,541	1,568,681	—	1,568,681
Interest rate contracts						
Forwards and futures .....	185,000	—	185,000	—	—	—
Swaps .....	1,260,944	26,894,520	28,155,464	388,192	20,750,718	21,138,910
Options purchased .....	—	—	—	—	116,669	116,669
Equity contracts						
Swaps .....	—	2,864,172	2,864,172	—	—	—
Options purchased .....	1,331,547	6,030,647	7,362,194	766,431	33,108	799,539
Options written .....	3,545,259	—	3,545,259	1,743,595	33,108	1,776,703
	<u>43,523,712</u>	<u>44,267,367</u>	<u>87,791,079</u>	<u>19,303,433</u>	<u>22,795,026</u>	<u>42,098,459</u>
	<b>The Bank</b>					
	<b>2007</b>			<b>2006</b>		
	<b>Trading</b>	<b>Non-trading</b>	<b>Total</b>	<b>Trading</b>	<b>Non-trading</b>	<b>Total</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
Exchange rate contracts						
Forwards and futures .....	12,707,029	—	12,707,029	4,955,396	—	4,955,396
Swaps .....	15,141,206	9,840,123	24,981,329	8,101,974	1,725,095	9,827,069
Options purchased .....	3,716,793	—	3,716,793	1,780,330	—	1,780,330
Options written .....	3,526,541	—	3,526,541	1,568,681	—	1,568,681
Interest rate contracts						
Forwards and futures .....	185,000	—	185,000	—	—	—
Swaps .....	1,260,944	24,893,104	26,154,048	388,191	19,557,436	19,945,627
Equity contracts						
Swaps .....	—	4,093,192	4,093,192	—	—	—
Options purchased .....	1,331,547	6,030,647	7,362,194	766,431	33,108	799,539
Options written .....	3,545,259	—	3,545,259	2,024,395	33,108	2,057,503
	<u>41,414,319</u>	<u>44,857,066</u>	<u>86,271,385</u>	<u>19,585,398</u>	<u>21,348,747</u>	<u>40,934,145</u>

Derivatives arise from futures, forward, swap and option transactions undertaken by the Group and the Bank in the foreign exchange, interest rate and equity markets. The notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

The fair value and credit risk weighted amounts of the aforesaid off-balance sheet exposures are as follows. These amounts do not take into account the effects of bilateral netting arrangements.

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Fair value (Note 23)				
Exchange rate contracts .....	234,691	106,586	171,783	105,907
Interest rate contracts .....	803,765	545,055	704,994	536,376
Options purchased				
- exchange rate contracts .....	—	2,223	—	2,223
- equity contracts .....	513,276	8,553	513,276	8,553
	<u>1,551,732</u>	<u>662,417</u>	<u>1,390,053</u>	<u>653,059</u>

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Credit risk weighted amounts*				
Contingent liabilities and commitments .....	18,725,103	12,018,280	12,304,493	11,995,146
Exchange rate contracts .....	129,966	92,695	131,367	91,964
Interest rate contracts .....	195,964	219,415	197,109	219,868
Equity contracts .....	74,678	25,852	99,208	25,852
	<u>19,125,711</u>	<u>12,356,242</u>	<u>12,732,177</u>	<u>12,332,830</u>

\* The Bank adopted the Foundation Internal Ratings Based (“IRB”) approach according to Banking (Capital) Rules for calculating the credit risk weighted amount as at 31st December 2007. The amounts as at 31st December 2006 were compiled in accordance with the then Third Schedule of Hong Kong Banking Ordinance under Basel I capital accord.

The tables above give the contractual or notional amounts, fair value and credit risk weighted amounts of off-balance sheet transactions. The fair value is calculated for the purposes of deriving the credit risk weighted amounts. These are assessed in accordance with the Banking (Capital) Rules. Fair value represents the cost of replacing all contracts which have a positive value when marked to market.

Fair value is a close approximation of the credit risk for these contracts as at the balance sheet date. The credit risk weighted amount refers to the amount as computed in accordance with the Banking (Capital) Rules.

The following table provides an analysis of the notional amounts of derivatives of the Group by relevant maturity grouping based on the remaining periods to settlement at the balance sheet date.

The Group								
Notional amounts with remaining life of								
2007					2006			
	1 years or less	Over 1 year to 5 years	Over 5 years	Total	1 year or less	Over 1 year to 5 years	Over 5 years	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Interest rate derivatives .....	10,651,886	13,046,923	4,641,655	28,340,464	2,929,898	17,025,629	1,300,052	21,255,579
Currency derivatives	40,699,387	4,979,603	—	45,678,990	17,824,374	442,264	—	18,266,638
Other derivatives ....	10,736,251	2,450,326	585,048	13,771,625	2,295,442	—	280,800	2,576,242
	<u>62,087,524</u>	<u>20,476,852</u>	<u>5,226,703</u>	<u>87,791,079</u>	<u>23,049,714</u>	<u>17,467,893</u>	<u>1,580,852</u>	<u>42,098,459</u>

The Bank								
Notional amounts with remaining life of								
2007					2006			
	1 years or less	Over 1 year to 5 years	Over 5 years	Total	1 year or less	Over 1 year to 5 years	Over 5 years	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Interest rate derivatives .....	11,021,481	11,221,957	4,095,610	26,339,048	2,813,229	15,890,195	1,242,203	19,945,627
Currency derivatives	40,285,437	4,646,255	—	44,931,692	17,689,212	442,264	—	18,131,476
Other derivatives ....	11,137,623	3,277,974	585,048	15,000,645	2,576,242	—	280,800	2,857,042
	<u>62,444,541</u>	<u>19,146,186</u>	<u>4,680,658</u>	<u>86,271,385</u>	<u>23,078,683</u>	<u>16,332,459</u>	<u>1,523,003</u>	<u>40,934,145</u>

(c) Capital Commitments

Capital commitments outstanding at 31st December and not provided for in the accounts were as follows:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Expenditure authorised and contracted for .....	1,880,236	669,184	647,325	656,957
Expenditure authorised but not contracted for .....	<u>131,162</u>	<u>100,777</u>	<u>88,797</u>	<u>97,513</u>
	<u>2,011,398</u>	<u>769,961</u>	<u>736,122</u>	<u>754,470</u>

(d) **Operating Lease Commitments**

At 31st December 2007, the total future minimum lease payments under noncancellable operating leases are payable as follows:

	<b>The Group</b>		<b>The Bank</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
Properties				
Within one year .....	272,332	202,937	119,114	155,647
After one year but within five years .....	618,640	358,357	124,494	269,345
After five years .....	306,538	131,643	1,489	80,277
	<u>1,197,510</u>	<u>692,937</u>	<u>245,097</u>	<u>505,269</u>

	<b>The Group</b>		<b>The Bank</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
Equipment				
Within one year .....	4,426	4,117	1,559	1,593
After one year but within five years .....	9,349	7,765	2,198	2,672
After five years .....	107	—	—	—
	<u>13,882</u>	<u>11,882</u>	<u>3,757</u>	<u>4,265</u>

The Group and the Bank lease certain properties and equipment under operating leases. The leases run for an initial period of one to twenty five years, with an option to renew the lease when all terms are renegotiated. Lease payments are usually adjusted annually to reflect market rentals. None of the leases includes contingent rentals.

### 43. Notes On Consolidated Cash Flow Statement

#### (a) Purchase of Subsidiaries

	2007	2006
	<u>HK\$'000</u>	<u>HK\$'000</u>
Net assets acquired		
Cash and balances with banks and other financial institutions .....	1,943	131,557
Advances and other accounts less provisions .....	4,745	587,204
Fixed assets .....	570	2,373
Deposits and balance of banks .....	—	(778)
Deposits of customers .....	—	(496,161)
Current taxation .....	(134)	(3,970)
Other accounts and provisions .....	(3,494)	(121,716)
Deferred tax liabilities .....	(22)	(54)
Minority interests .....	(3)	(2,561)
	<u>3,605</u>	<u>95,894</u>
Goodwill arising on consolidation .....	36,604	95,251
Intangible assets acquired .....	—	12,986
Total purchase price .....	40,209	204,131
Less: cash and cash equivalents acquired .....	<u>(1,943)</u>	<u>(131,557)</u>
Cash flow on acquisition net of cash acquired .....	<u>38,266</u>	<u>72,574</u>

#### (b) Disposal of Subsidiary

	2007	2006
	<u>HK\$'000</u>	<u>HK\$'000</u>
Cash and balances with banks and other financial institutions .....	15	—
Advances and other accounts less provisions .....	53,132	—
Fixed assets .....	466	—
Taxation .....	(2,771)	—
Other accounts and provisions .....	(1,123)	—
Deferred tax .....	(25)	—
	<u>49,694</u>	—
Add: gain on disposal .....	<u>405,992</u>	—
Cash flow on disposal of subsidiary .....	<u>455,686</u>	—

(c) Cash and Cash Equivalents

(i) Components of cash and cash equivalents in the consolidated cash flow statement

	2007	2006
	HK\$'000	HK\$'000
Cash and balances with banks and other financial institutions (Note 20) .....	14,186,701	8,317,746
Placements with banks and other financial institutions with original maturity within three months .....	87,395,382	63,811,412
Treasury bills with original maturity within three months .....	1,918,705	4,579,791
Certificates of deposit held with original maturity within three months .....	217,542	—
	<u>103,718,330</u>	<u>76,708,949</u>

(ii) Reconciliation with the consolidated balance sheet

	2007	2006
	HK\$'000	HK\$'000
Cash and balances with banks and other financial institutions (Note 20) .....	14,186,701	8,317,746
Placements with banks and other financial institutions (Note 21) .....	94,703,893	66,864,045
Treasury bills and certificates of deposit held		
- trading assets (Note 23) .....	1,194,530	497,915
- designated at fair value through profit or loss (Note 24) .....	49,600	95,685
- advances and other accounts (Note 25) .....	39,003	38,890
- available-for-sale (Note 26) .....	3,675,687	5,164,722
- held-to-maturity (Note 27) .....	1,691,858	1,698,072
	<u>6,650,678</u>	<u>7,495,284</u>
Amounts shown in the consolidated balance sheet .....	<u>115,541,272</u>	<u>82,677,075</u>
Less: amounts with an original maturity of beyond three months .....	<u>(11,822,942)</u>	<u>(5,968,126)</u>
Cash and cash equivalents in the consolidated cash flow statement .....	<u>103,718,330</u>	<u>76,708,949</u>

**44. Assets Pledged as Security**

The following balances with banks have been pledged as collateral for securities borrowings and margin deposits of derivatives.

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cash collateral for borrowed securities .....	—	142,041	—	142,041
Collateral deposit for derivatives dealing .....	54,605	43,995	54,605	43,995
	<u>54,605</u>	<u>186,036</u>	<u>54,605</u>	<u>186,036</u>

These transactions are conducted under terms that are usual and customary to standard lending and securities borrowing and lending activities.

#### 45. Loans to Officers

The aggregate of loans to officers of the Bank disclosed pursuant to Section 161B(4B) and (4C) of the Hong Kong Companies Ordinance is as follows:

	2007	2006
	HK\$'000	HK\$'000
Aggregate amount of relevant loans outstanding at 31st December		
By the Bank .....	1,432,258	1,336,206
By subsidiaries .....	624,679	—
	<u>2,056,937</u>	<u>1,336,206</u>
The maximum aggregate amount of relevant loans outstanding during the year		
By the Bank .....	1,864,271	1,738,078
By subsidiaries .....	624,886	—
	<u>2,489,157</u>	<u>1,738,078</u>

There was no interest due but unpaid nor any impairment allowance made against these loans at 31st December 2007 and 31st December 2006.

#### 46. Material Related Party Transactions

The Group maintains certain retirement benefit schemes for its staff as per Note 2(q)(iii). In the year 2007, the total amount of contributions the Group made to the schemes was HK\$93,180,000 (2006: HK\$78,663,000).

The Group enters into a number of transactions with the Group's related parties, including its associates, and key management personnel and their close family members and companies controlled or significantly influenced by them. The transactions include accepting deposits from and extending credit facilities to them. Except that there is interest free shareholder's advance extended to one (2006: one) associate amounting to HK\$6,500,000 at 31st December 2007 (2006: HK\$6,500,000), all interest rates in connection with the deposits taken and credit facilities extended are under terms and conditions normally applicable to customers of comparable standing.

The interest received from and interest paid to the Group's related parties for the year, outstanding balances of amounts due from and due to at the year end, and maximum outstanding balance of amounts due from and due to them during the year are aggregated as follows:

	Key management personnel		Subsidiaries		Associates	
	2007	2006	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Interest income .....	154,727	166,850	833,288	33,679	9,450	11,097
Interest expense .....	134,130	109,314	203,740	200,133	106	39
Amounts due from .....	10,447,760	4,270,266	17,864,170	1,834,495	213,247	225,482
Amounts due to .....	3,960,622	3,052,075	1,645,297	1,701,643	10,336	9,434
Maximum amounts due from .....	11,361,040	6,769,561	23,699,257	3,012,575	422,367	463,356
Maximum amounts due to .....	8,592,507	7,780,820	1,894,320	9,848,368	61,708	33,304

#### 47. Equity Compensation Plans

The Bank has adopted Staff Share Option Schemes whereby the Board of the Bank may at its discretion grant to any employees, including Executive Directors and Chief Executive, of the Group options to subscribe for shares of the Bank. The options may be exercised during the period beginning on the first anniversary of the Date of Grant and ending on the fifth anniversary of the Date of Grant. All options were granted for nil consideration.

##### (a) Particulars of Share Options

Date of Grant	Vesting Period	Exercise Period	Exercise Price Per Share HK\$
18/4/2002 .....	18/4/2002 — 17/4/2003	18/4/2003 — 18/4/2007	15.80
02/5/2003 .....	02/5/2003 — 01/5/2004	02/5/2004 — 02/5/2008	14.90
22/4/2004 .....	22/4/2004 — 21/4/2005	22/4/2005 — 22/4/2009	23.23
03/5/2005 .....	03/5/2005 — 02/5/2006	03/5/2006 — 03/5/2010	22.95
03/5/2006 .....	03/5/2006 — 02/5/2007	03/5/2007 — 03/5/2011	33.05
10/5/2007 .....	10/5/2007 — 09/5/2008	10/5/2008 — 10/5/2012	47.13

##### (b) Movement of Share Options

###### 2007

Date of Grant	Number of Share Options				Outstanding at 31/12/2007
	Outstanding at 1/1/2007	Granted	Exercised	Lapsed	
18/4/2002 .....	1,855,000	—	1,855,000	—	Nil
02/5/2003 .....	2,895,000	—	690,000	—	2,205,000
22/4/2004 .....	5,750,000	—	1,835,000	—	3,915,000
03/5/2005 .....	10,310,000	—	3,080,000	—	7,230,000
03/5/2006 .....	3,250,000	—	50,000	—	3,200,000
10/5/2007 .....	—	2,750,000	—	—	2,750,000
Total .....	<u>24,060,000</u>	<u>2,750,000</u>	<u>7,510,000</u>	<u>—</u>	<u>19,300,000</u>

###### 2006

Date of Grant	Number of Share Options				Outstanding at 31/12/2006
	Outstanding at 1/1/2006	Granted	Exercised	Lapsed	
19/4/2001 .....	2,015,000	—	2,015,000	—	NIL
18/4/2002 .....	2,285,000	—	430,000	—	1,855,000
02/5/2003 .....	6,270,000	—	3,375,000	—	2,895,000
22/4/2004 .....	14,350,000	—	8,550,000	50,000	5,750,000
03/5/2005 .....	15,990,000	—	5,475,000	205,000	10,310,000
03/5/2006 .....	—	3,250,000	—	—	3,250,000
Total .....	<u>40,910,000</u>	<u>3,250,000</u>	<u>19,845,000</u>	<u>255,000</u>	<u>24,060,000</u>

(c) No share options were cancelled during the years ended 31st December 2007 and 2006.

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(d) Details of Share Options Exercised

Exercise Period	Date of Grant	Number of Share Options	
		2007	2006
January .....	19/4/2001	—	25,000
	18/4/2002	20,000	—
	02/5/2003	55,000	250,000
	22/4/2004	390,000	30,000
	03/5/2005	420,000	—
February .....	19/4/2001	—	165,000
	18/4/2002	55,000	55,000
	02/5/2003	55,000	800,000
	22/4/2004	155,000	1,020,000
	03/5/2005	320,000	—
March .....	19/4/2001	—	940,000
	18/4/2002	930,000	110,000
	02/5/2003	125,000	1,065,000
	22/4/2004	180,000	2,820,000
	03/5/2005	180,000	—
April .....	19/4/2001	—	885,000
	18/4/2002	850,000	25,000
	02/5/2003	10,000	265,000
	22/4/2004	75,000	1,370,000
	03/5/2005	290,000	—
May .....	18/4/2002	—	95,000
	02/5/2003	210,000	240,000
	22/4/2004	155,000	985,000
	03/5/2005	390,000	2,285,000
June .....	02/5/2003	150,000	25,000
	22/4/2004	65,000	65,000
	03/5/2005	655,000	205,000
July .....	02/5/2003	—	35,000
	22/4/2004	75,000	145,000
	03/5/2005	145,000	280,000
August .....	02/5/2003	30,000	145,000
	22/4/2004	120,000	280,000
	03/5/2005	105,000	850,000
September .....	02/5/2003	—	235,000
	22/4/2004	30,000	250,000
	03/5/2005	115,000	280,000
October .....	02/5/2003	—	55,000
	22/4/2004	180,000	610,000
	03/5/2005	100,000	490,000
November .....	18/4/2002	—	120,000
	02/5/2003	15,000	200,000
	22/4/2004	310,000	520,000
	03/5/2005	160,000	545,000
	03/5/2006	50,000	—
December .....	18/4/2002	—	25,000
	02/5/2003	40,000	60,000
	22/4/2004	100,000	455,000
	03/5/2005	200,000	540,000
		<u>7,510,000</u>	<u>19,845,000</u>

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#### **48. Non-Adjusting Post Balance Sheet Events**

After the balance sheet date the directors proposed a final dividend. Further details are disclosed in Note 15 (a).

On 27th December 2007, the Bank entered into a subscription agreement in relation to the subscription as principal of 78,700,000 ordinary shares of the Bank at HK\$50.24 per new share with *Negocio de Finanzas e Inversiones I, SLU* which is a wholly owned subsidiary of *Criteria CaixaCorp, S.A.* (“Criteria”). Criteria is a listed Spanish holding company controlled by “la Caixa”, a leading Spanish financial institution focused in retail banking. These 78,700,000 shares represent approximately 5.0% of the entire issued share capital of the Bank prior to the subscription and approximately 4.76% of the entire issued share capital of the Bank as enlarged by the subscription. The subscription price represents a discount of approximately 2.45% to the closing price of HK\$51.50 per share quoted on the Stock Exchange on 27th December 2007.

#### **49. Comparative Figures**

The comparative figures of segment reporting have been restated to conform with current year’s presentation due to reclassification of interest income and interest expense from trading financial assets and liabilities and financial instruments designated at fair value. Further details of these changes are disclosed in Note 19.

As a result of adopting HKFRS 7, *Financial instruments: Disclosures*, the amendments to HKAS 1, *Presentation of financial statements: Capital disclosures*, and complying with the *Banking (Disclosure) Rules*, certain comparative figures have been adjusted to conform with changes in disclosures in the current year and to show separately comparative amounts in respect of items disclosed for the first time 2007. Further details of these developments are disclosed in Note 3.

#### **50. Accounting Estimates And Judgements**

The preparation of accounts requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of these accounts and the reported amounts of revenues and expenses for the years presented. Changes in assumptions may have a significant impact on the accounts in the periods where the assumptions are changed. The application of assumptions and estimates means that any selection of different assumptions would cause the Group’s reporting to differ. The Group believes that the assumptions that have been made are appropriate and that the accounts therefore present the financial position and results fairly, in all material respects.

Management discussed with the Audit Committee the development, selection and disclosure of the Group’s significant accounting policies and estimates and the application of these policies and estimates.

##### **(a) Key Sources of Estimation Uncertainty**

Notes 30, 36 and 41 contain information about the assumptions and their risk factors relating to goodwill impairment, fair value of share options granted and fair values of financial instruments. Other key sources of estimation uncertainty are as follows:

##### *(i) Impairment losses*

###### *Loans and advances*

Loan portfolios are reviewed periodically to assess whether impairment losses exist. The Group makes judgement as to whether there is any objective evidence that a loan portfolio is impaired, i.e. whether there is a decrease in estimated future cash flows. Objective evidence for impairment includes observable data that the payment status of borrowers in a group has adversely changed. It may also include observable data that correlate with defaults on the assets in the Group. If management has determined, based on their judgement, that objective evidence for impairment exists, expected future cash flows are estimated based on historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of the current observable data. Management reviews the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

###### *Available-for-sale financial assets and held-to-maturity investments*

The Group determines that available-for-sale financial assets and held-to-maturity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. The determination of when a decline in fair value below its cost is not recoverable within a reasonable time period is judgmental by nature, so profit and loss could be affected by differences in this judgement.

(ii) *Valuation of financial instruments*

The Group's accounting policy for valuation of financial instruments is included in Note 2. The fair value of the financial instruments is mainly based on the quoted market price on a recognised stock exchange or a price quoted from a broker/dealer for non-exchanged traded financial instruments. The fair value of collateralised debt obligations is based on bid prices quoted by reputable brokers and has been carefully assessed for reasonableness by management. The fair value of special investment vehicles ("SIV") is based on their net asset values as provided by the SIV's managers.

(b) **Critical Accounting Judgements in Applying The Group's Accounting Policies**

Certain critical accounting judgements in applying the Group's accounting policies are described below:

(i) *Held-to-maturity investments*

The Group classifies non-derivative financial assets with fixed or determinable payments and fixed maturity and where the Group has a positive intention and ability to hold to maturity as held-to-maturity investments. In making this judgement, the Group evaluates its intention and ability to hold such investments till maturity.

If the Group fails to hold these investments to maturity other than for certain specific circumstances, the Group will have to reclassify the entire portfolio of held-to-maturity investments as available-for-sale, as such class is deemed to have been tainted.

This would result in held-to-maturity investments being measured at fair value instead of at amortised cost.

**51. Proposed Impacts Of Amendments, New Standards And Interpretations Issued But Not Yet Effective For the Year ended 31st December, 2007**

Up to the date of issue of these accounts, the HKICPA has issued a number of amendments, new standard and interpretations which are not yet effective for the accounting year ended 31st December 2007 and which have not been adopted in these accounts.

The Group is in the process of making an assessment of what the impact of these amendments, new standards, new interpretations and additional disclosures is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Bank's results of operations and financial position.

In addition, the following developments may result in new or amended disclosures in the accounts:

	<b>Effective for accounting periods beginning on or after</b>
HK(IFRIC) 13 — Customer loyalty programmes .....	1st July 2008
HKFRS 8 — Operating segments .....	1st January 2009
HKAS (Revised) Borrowing Costs .....	1st January 2009
Amendment to HKAS 1, Presentation of financial statements: capital disclosures.....	1st January 2009

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