



The Bank of East Asia, Limited

(incorporated with limited liability in Hong Kong)

U.S.\$450,000,000

6.125% Subordinated Notes due 2020

Issue Price: 99.040%

The 6.125% Subordinated Notes due 2020 (the “**Notes**”) will be issued in an initial aggregate principal amount of U.S.\$450,000,000 by The Bank of East Asia, Limited (“**BEA**” or the “**Issuer**”). The Notes will bear interest from and including 16 July 2010 at a rate per annum equal to 6.125 per cent. Interest will be payable semi-annually in arrear on 16 January and 16 July of each year commencing on 16 January 2011. See “*Terms and Conditions of the Notes — Interest*”.

Unless previously redeemed or purchased and cancelled as provided in the Terms and Conditions of the Notes (the “**Conditions**”), the Issuer will redeem the Notes at their principal amount on 16 July 2020. See “*Terms and Conditions of the Notes — Redemption and Purchase*”. Subject to satisfaction of certain regulatory approval requirements, all but not some only of the Notes will be redeemable at the option of the Issuer, at a redemption price equal to 100% of their principal amount together with accrued and unpaid interest to the date fixed for redemption, upon the occurrence of certain changes in taxation in Hong Kong requiring the payment of additional amounts as provided in the Conditions. See “*Terms and Conditions of the Notes — Redemption and Purchase*”. In addition, subject to satisfaction of certain regulatory approval requirements, the Notes will be redeemable at the option of the Issuer in whole but not in part, at a redemption price equal to 100% of their principal amount together with accrued and unpaid interest to the date fixed for redemption, upon the occurrence of a Regulatory Redemption Event (as defined in the “*Terms and Conditions of the Notes — Redemption and Purchase*”). See “*Terms and Conditions of the Notes — Redemption and Purchase*”.

The Notes will constitute direct, unconditional and unsecured obligations of the Issuer and will be subordinated in right of payment to the claims of depositors and all other unsubordinated creditors of the Issuer. See “*Terms and Conditions of the Notes — Status*”.

The Notes have been rated “A3” 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.

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 15 for a discussion of certain considerations to be taken into account in connection with an investment in the Notes.

Approval in-principle has been received for the listing of the Notes 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 to the Official List of the SGX-ST is not to be taken as an indication of the merits of the Issuer or the Notes.

The Notes will be represented initially by a global certificate (the “**Global Certificate**”) in registered form, which will be registered in the register of Noteholders in the name of a nominee of, and shall be deposited with a common depository for, Euroclear Bank S.A./N.V. (“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream**”) on or about 16 July 2010 (the “**Closing Date**”). Beneficial interests in the Global Certificate will be shown on, and transfers thereof will be effected only through, the records maintained by Euroclear and Clearstream and their respective account holders. Except in the limited circumstances set out herein, individual certificates for the Notes will not be issued. See “*Summary of Provisions relating to the Notes while in Global Form*”.

Joint Bookrunners and Joint Lead Managers

Citi

J.P. Morgan

Co-Managers

BOC International

Crédit Agricole CIB

HSBC

The Issuer confirms that (i) this Offering Circular contains all information with respect to the Issuer and the Issuer's subsidiaries and affiliates (collectively, the "**Group**") and the Notes which is material in the context of the issue and offering of the Notes; (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 Notes, 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 the Issuer to ascertain such facts and to verify the accuracy of all such information and statements. In addition, the Issuer accepts full responsibility for the accuracy of the information contained in this Offering Circular.

In making an investment decision, you must rely on your own examination of the Issuer and the terms of the offering of the Notes, including the merits and risks involved. By receiving this Offering Circular, you acknowledge that (i) you have not relied on Citigroup Global Markets Limited or J.P. Morgan Securities Ltd. (the "**Joint Lead Managers**", BOCI Asia Limited, Crédit Agricole Corporate and Investment Bank, The Hongkong and Shanghai Banking Corporation Limited (together, the "**Co-Managers**", and together with the Joint Lead Managers, the "**Managers**"), or any person affiliated with the Managers or DB Trustees (Hong Kong) Limited (the "**Trustee**") or any person affiliated with the Trustee in connection with your investigation of the accuracy of any information in this Offering Circular or your investment decision; and (ii) no person has been authorised to give any information or to make any representation concerning the Issuer, the Group or the Notes 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 Issuer or the Managers.

No representation or warranty, express or implied, is made by the Managers or the Trustee or any of the Agents or their respective affiliates or advisors 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 Notes shall, under any circumstances, constitute a representation or create any implication that there has been no change in the affairs of the Issuer 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 Issuer, the Managers, the Trustee, the Agents or any of their respective affiliates or representatives is making any representation to any purchaser of the Notes 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. You should be aware that you may be required to bear the financial risks of an investment in the Notes for an indefinite period. You should consult with your own advisers as to the legal, tax, business, financial and related aspects of a purchase of the Notes.

This Offering Circular does not constitute an offer to sell, or an invitation by or on behalf of the Issuer, the Managers, the Trustee or any of their respective affiliates or representatives to purchase any of the Notes, 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, Singapore and Japan, 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.

The Notes 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 Notes are being offered and sold only outside the United States in accordance with Regulation S.

Each purchaser of Notes must comply with all applicable laws and regulations in force in each jurisdiction in which it purchases, offers or sells such Notes 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 Notes 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 Issuer nor the Managers shall have any responsibility therefor.

In connection with this issue, J.P. Morgan Securities Ltd. (or any person acting on its behalf) may over-allot or effect transactions with a view to supporting the market price of the notes at a level higher than that which might otherwise prevail. However, there is no assurance that J.P. Morgan Securities Ltd. (or any person acting on its behalf) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the Closing Date and 60 days after the date of the allotment of the Notes. Any stabilisation action or over-allotment must be conducted by J.P. Morgan Securities Ltd. (or person(s) acting on its behalf) in accordance with all applicable laws and rules.

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 “**US 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 “**EUR**”, “**euro**” and “**€**” are to the lawful currency of the member states of the European Union that adopt or have adopted the single currency in accordance with the Treaty establishing the European Community as amended by the Treaty of the European Union; all references to “**S\$**” are to the lawful currency of Singapore; all references to “**Renminbi**” and “**RMB**” 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 “**GBP**” and “**£**” 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 and “**HKMA**” is to Hong Kong Monetary Authority.

For convenience only, all Hong Kong dollar amounts in this Offering Circular have been translated into US 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 US 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.

This Offering Circular contains forward-looking statements regarding the intent, belief or current expectations of the Issuer 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”, “risk”, “seek”, “should”, “target” and similar expressions are used in relation to the Issuer 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 Issuer 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 Issuer’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 Issuer*”, 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 31 December 2009, BEA’s consolidated assets, advances to customers and customer deposits were HK\$434,082 million (U.S.\$55,652 million), HK\$247,654 million (U.S.\$31,751 million) and HK\$342,528 million (U.S.\$43,914 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, and (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.

The shares of BEA have been listed on the HKSE since the 1930s. As at 30 April 2010, the authorised share capital of BEA was 4,000 million ordinary shares of HK\$2.50 each and 500,000 substitute preference shares of U.S.\$1,000 each, of which approximately 2,031.2 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 April 2010, BEA’s market capitalisation was approximately HK\$57,178.51 million (U.S.\$7,330.58 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 April 2010, the Group offered a broad range of banking and related financial services in Hong Kong through a network of 88 branches, seven major subsidiaries and 52 wealth management centres called “SupremeGold Centres”.

In order to access the mainland China market and overseas Chinese markets, BEA expanded its operations to mainland China, Taiwan, Macau, the United States, the United Kingdom, the British Virgin Islands and South East Asia. As at 30 April 2010, BEA’s global operations (excluding Hong Kong) totalled 46 branches, 59 sub-branches, three representative offices, and several affiliates and joint ventures.

In 2007, BEA’s wholly-owned subsidiary, The Bank of East Asia (China) Limited (“**BEA (China)**”) was licensed and approved to conduct Renminbi business with local residents in mainland China. As at 30 April 2010, BEA (China) operated 20 branches and 56 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 operates two representative offices. For a discussion of the products and services provided by BEA (China), see “*Business of the Issuer — 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 and three sub-branches in Macau.

As at 31 December 2007, 2008 and 2009, approximately 24.9%, 29.8% and 31.3%, respectively, of the assets of the Group were accounted for in mainland China, Taiwan and Macau. For the years ended 31 December 2007, 2008 and 2009, approximately 23.7%, 18,550%⁽¹⁾ and 45.7%, 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 2007, 2008 and 2009, the Group’s capital adequacy ratio was approximately 12.6%, 13.8% and 13.3%⁽²⁾, respectively, compared with the statutory minimum requirement of 8.0%, and its loan to deposit ratio was approximately 73.6%, 69.9% and 71.7%, respectively. For the years ended 31 December 2007, 2008 and 2009, BEA’s average liquidity ratio was approximately 43.5%, 38.4% and 43.3%, 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 2007, 2008 and 2009, customer deposits accounted for approximately 81.4%, 88.1% and 91.6%, respectively, of borrowed funds. The remainder of the Group’s funding requirements as at 31 December 2007, 2008 and 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 year ended 31 December 2009, the Group’s profit after taxation was HK\$2,638 million (U.S.\$ 338 million), an increase of approximately 2,445.1% from the year ended 31 December 2008. The turnaround in operations and financial performance was the result of gradually improving conditions in the financial markets and global economy, as well as the absence of further substantial write-downs recorded by the Issuer. 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. The Group’s profits in 2008 were severely affected by 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 conducted in Hong Kong.

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.
- (2) Taking into account the issuance of 167.1 million new shares at a price of HK\$30.60 per share in January 2010, the pro forma capital adequacy ratio would be 15.1%.

For the year ended 31 December 2009, the Group achieved a return on average assets of approximately 0.6% and a return on average equity of approximately 7.7%, as compared with approximately 0.01% and 0.12%, respectively, for the year ended 31 December 2008 and approximately 1.2% and 14.6%, respectively, for the year ended 31 December 2007.

STRATEGY

BEA's core objectives are to strengthen its position as the largest independent local 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. 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; and
- Focus on enhancing operational efficiency.

THE OFFERING

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

| | |
|----------------------------|---|
| The Issuer | The Bank of East Asia, Limited, a company incorporated with limited liability in Hong Kong. |
| The Notes | U.S.\$450,000,000 6.125% Subordinated Notes due 2020. |
| Issue Price | 99.040 per cent. |
| Issue Date | 16 July 2010 |
| Interest | The Notes will bear interest at a rate of 6.125% per annum, payable semi-annually in arrear on 16 January and 16 July (subject to adjustment) of each year, commencing on 16 January 2011. |
| Final Redemption | Unless previously redeemed or purchased and cancelled, the Notes will mature and become payable at their principal amount on 16 July 2020. |
| Use of Proceeds | The net proceeds from the sale of the Notes will be used for the purpose of refinancing the Issuer’s existing debt obligations under its outstanding U.S.\$550,000,000 5.625 per cent. Subordinated Notes due 2015 and/or for the general working capital requirements of the Group. See “Use of Proceeds” for further details. |
| Status | The Notes constitute direct, unconditional, unsecured and subordinated obligations of the Issuer, ranking <i>pari passu</i> without any preference among themselves. |

The claims of the holders of the Notes will, in the event of the Winding-Up (as defined in the Conditions) of the Issuer, be subordinated in right of payment in the manner provided in the Conditions and the Trust Deed to the claims of depositors and all other unsubordinated creditors of the Issuer and will rank, in the event of the Winding-Up of the Issuer, at least *pari passu* in right of payment with all other Subordinated Indebtedness (as defined in the Conditions), present and future, of the Issuer. Claims in respect of the Notes will rank in priority to the rights and claims of holders of subordinated liabilities which by their terms rank or are expressed to rank in right of payment junior to the Notes and all classes of equity securities of the Issuer, including holders of preference shares, if any.

Events of Default

If default is made in the payment of principal or interest due in respect of the Notes or any of them and the default continues for a period of five Business Days in Hong Kong (in the case of principal) or 10 Business Days in Hong Kong (in the case of interest) (each such event, an “**Event of Default**”) then the Trustee at its discretion may, subject as provided in the Conditions, in order to enforce payment, without further notice, institute Winding-Up Proceedings (as defined in the Conditions) in Hong Kong against the Issuer, but may take no further action in respect of such default (but without prejudice to the provision below).

If an order is made or an effective resolution is passed for the Winding-Up of the Issuer in Hong Kong (except for the purposes of a reconstruction, amalgamation or reorganisation the terms of which have previously been approved by an Extraordinary Resolution (as defined in the Conditions) of Noteholders) (such event also, an “**Event of Default**”), then the Trustee, at its discretion may, subject as provided below, give written notice to the Issuer that the Notes are, and they shall forthwith thereupon become, immediately due and repayable at their principal amount together with accrued interest without further action or formality.

Enforcement.

The Trustee may, subject as provided below, at its discretion and without further notice, institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer under the Notes or the Trust Deed (other than any obligation for the payment of any principal or interest in respect of the Notes), provided that the Issuer shall not as a consequence of such proceedings be obliged to pay any sum or sums representing or measured by reference to principal or interest in respect of the Notes sooner than the same would otherwise have been payable by it.

The Trustee shall not be bound to take action upon any Event of Default or as referred to in the preceding paragraph or any other action under the Trust Deed unless (i) it shall have been so requested in writing by Noteholders holding at least one-quarter of the principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders and (ii) it shall have been indemnified and/or secured to its satisfaction.

No Noteholder shall be entitled to proceed directly against the Issuer unless the Trustee having become bound so to proceed, fails to do so within a reasonable period and such failure is continuing.

Redemption for Taxation
Reasons

Upon obtaining the approval of the HKMA and satisfying the Trustee immediately before the giving of the notice referred to below that (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction or any change in the official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 9 July 2010, on the occasion of the next payment due in respect of the Notes the Issuer would be required to pay additional amounts as provided or referred to in the provisions of the Notes relating to taxation, and (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it, the Issuer may at its option, having given not less than 30 nor more than 60 days' notice to the Noteholders, redeem all the Notes, but not some only, on the next Interest Payment Date at their principal amount together with interest accrued to but excluding the date of redemption, provided that no such notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer would be required to pay the additional amounts were a payment in respect of the Notes then due. See "*Terms and Conditions of the Notes — Redemption and Purchase — Redemption for Taxation Reasons*".

Redemption upon a Regulatory
Redemption Event

Upon obtaining the approval of the HKMA, the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable) at their principal amount together with interest accrued to but excluding the date fixed for redemption, following the occurrence of a Regulatory Redemption Event.

A "**Regulatory Redemption Event**" occurs if the Notes in whole, and not in part, no longer qualify as term subordinated debt for inclusion in Category II — Supplementary Capital (as defined in the Conditions) of the Issuer as a result of amendments to the relevant provisions of the Banking Ordinance of Hong Kong (Cap. 155 of the Laws of Hong Kong) (the "**Banking Ordinance**") or the statutory guidelines issued by HKMA in relation thereto after the Issue Date (excluding for the avoidance of doubt, non-qualification solely by virtue of the Issuer already having on issue securities with an aggregate principal amount up to or in excess of the limit of Supplementary Capital (as defined in the Conditions) permitted from time to time by the HKMA or solely as a result of any discounting requirements as to the eligibility of the Notes for such inclusion pursuant to the relevant legislation and statutory guidelines in force as at the Issue Date).

Trustee

DB Trustees (Hong Kong) Limited.

Trust Deed

The Notes will be constituted by a Trust Deed to be dated 16 July 2010 between the Issuer and the Trustee.

| | |
|---------------------------------|---|
| Form and Denomination | The Notes are issued in registered form in denominations of U.S.\$100,000 each and integral multiples of U.S.\$1,000 in excess thereof without coupons attached. The Notes will initially be represented by the Global Certificate deposited with a common depositary for, and representing Notes registered in the name of a common nominee of, Euroclear and Clearstream. Beneficial interests in the Global Certificate will be shown on, and transfer thereof will be effected only through, the records maintained by Euroclear and Clearstream. Except in the limited circumstances described in the Global Certificate, owners of interests in Notes represented by the Global Certificate will not be entitled to receive definitive Certificates in respect of their individual holdings of Notes. |
| Payments | All payments of principal, premium (if any) and interest by the Issuer will be made free and clear of, and without withholding or deduction for any taxes or duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of Hong Kong or any political subdivision or taxing authority thereof or therein, unless such withholding or deduction is required by law. In that event, the Issuer will pay such additional amounts as will result in receipt by the holder of a Note of such amount as would have been received by them had no such withholding or deduction been required, subject to certain exceptions (see <i>“Terms and Conditions of the Notes — Taxation — Payment without Withholding or Deduction”</i>). |
| 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 provisions of the Notes and the Trust Deed relating to subordination shall be governed by, and construed in accordance with, Hong Kong law. |
| Listing | Approval in-principle has been received for the listing of the Notes 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. |

SUMMARY FINANCIAL AND OTHER INFORMATION

SUMMARY CONSOLIDATED FINANCIAL AND OTHER INFORMATION RELATING TO THE GROUP

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 2007, 2008 and 2009 set forth below are derived from the Group's audited consolidated financial statements which have been audited by KPMG. The audited consolidated profit and loss accounts of the Group for the years ended 31 December 2007, 2008 and 2009 and the audited consolidated balance sheets of the Group as at 31 December 2007, 2008 and 2009 are included in this Offering Circular. The Group's consolidated financial statements are prepared and presented in accordance with HKFRS.

CONSOLIDATED PROFIT AND LOSS ACCOUNTS

| | <u>2007</u> | <u>2008</u> | <u>2009</u> |
|--|-----------------------|-----------------------|-----------------------|
| | (in HK\$ millions) | (in HK\$ millions) | (in HK\$ millions) |
| Interest income | 18,309 | 17,465 | 12,121 |
| Interest expense | <u>(12,332)</u> | <u>(10,672)</u> | <u>(5,374)</u> |
| Net interest income | <u>5,977</u> | <u>6,793</u> | <u>6,747</u> |
| Fee and commission income | 2,608 | 2,618 | 2,799 |
| Fee and commission expense | (471) | (473) | (537) |
| Net fee and commission | 2,137 | 2,145 | 2,262 |
| Net trading profits/(losses) | 1,417 | (1,292) | 941 |
| Net result from financial instruments designated at fair value through profit or loss | (1,154) | (1,612) | (267) |
| Other operating income | <u>437</u> | <u>423</u> | <u>505</u> |
| Non-interest income/(expense) | <u>2,837</u> | <u>(336)</u> | <u>3,441</u> |
| Operating income | 8,814 | 6,457 | 10,188 |
| Operating expenses | <u>(4,691)</u> | <u>(5,779)</u> | <u>(6,129)</u> |
| Operating profit before impairment losses | <u>4,123</u> | <u>678</u> | <u>4,059</u> |
| Impairment losses on loans and advances | (216) | (558) | (1,105) |
| Impairment losses on held-to-maturity investments | (42) | (44) | (9) |
| Impairment losses on available-for-sale financial assets | (228) | (352) | (14) |
| Impairment losses on associates | (41) | — | — |
| Write back of/(Charge for) impairment losses on bank premises Impairment losses | 132 | 6 | (13) |
| | (395) | (948) | (1,141) |
| Operating profit/(loss) after impairment losses | 3,728 | (270) | 2,918 |
| Net profit/(loss) on sale of held-to-maturity investments | — | 25 | (12) |
| Net profit on sale of available-for-sale financial assets | 667 | 197 | 102 |
| Net profit on disposal of loans and receivables | — | 1 | 2 |
| Net profit/(loss) on sale of subsidiaries/associates | 406 | (8) | — |
| Net profit/(loss) on sale of fixed assets | (1) | 178 | 16 |
| Valuation gains/(losses) on investment properties | 293 | (168) | 206 |
| Share of profits less losses on associates | <u>92</u> | <u>53</u> | <u>264</u> |
| Profit for the year before taxation | <u>5,185</u> | <u>8</u> | <u>3,496</u> |

| | <u>2007</u> | <u>2008</u> | <u>2009</u> |
|------------------------------------|-----------------------|-----------------------|-----------------------|
| | (in HK\$ millions) | (in HK\$ millions) | (in HK\$ millions) |
| Income tax | | | |
| Current tax | | | |
| — Hong Kong | (258) | (64) | (73) |
| — Overseas | (331) | (566) | (454) |
| Deferred tax | (375) | 726 | (331) |
| Profit for the year after taxation | <u>4,221</u> | <u>104</u> | <u>2,638</u> |
| Attributable to: | | | |
| Owners of the parent | 4,144 | 39 | 2,565 |
| Minority interest | 77 | 65 | 73 |
| Profit after taxation | <u>4,221</u> | <u>104</u> | <u>2,638</u> |
| Proposed final dividend per share | <u>HK\$1.18</u> | <u>HK\$0.02</u> | <u>HK\$0.48</u> |
| Per share | | | |
| — Basic earnings | HK\$2.41* | HK\$0.02* | HK\$1.36 |
| — Diluted earnings | HK\$2.39* | HK\$0.02* | HK\$1.36 |
| — Dividends | HK\$1.51* | HK\$0.23* | HK\$0.76 |

Note:

(*) denotes that these figures have been adjusted for the bonus issue of shares to BEA's shareholders in April 2009.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| | 2007 | 2008 | 2009 |
|---|-----------------------|-----------------------|-----------------------|
| | (in HK\$ millions) | (in HK\$ millions) | (in HK\$ millions) |
| ASSETS | | | |
| Cash and balances with banks and other financial institutions . . . | 17,853 | 28,105 | 29,712 |
| Placements with banks and other financial institutions | 94,704 | 96,574 | 67,945 |
| Trade bills | 812 | 1,164 | 1,847 |
| Trading assets | 4,847 | 3,437 | 5,722 |
| Financial assets designated at fair value through profit or loss . | 8,658 | 4,130 | 10,392 |
| Advances to customers and other accounts | 231,740 | 243,725 | 261,803 |
| Available-for-sale financial assets | 12,217 | 18,560 | 30,883 |
| Held-to-maturity investments | 10,761 | 5,006 | 7,239 |
| Investments in associates | 2,793 | 2,486 | 2,615 |
| Fixed assets | 6,856 | 9,146 | 11,467 |
| — Investment properties | 1,726 | 1,839 | 2,095 |
| — Other property and equipment | 5,130 | 7,307 | 9,372 |
| Goodwill and intangible assets | 2,668 | 2,734 | 4,135 |
| Deferred tax assets | 70 | 187 | 322 |
| Total Assets | 393,979 | 415,254 | 434,082 |
| EQUITY AND LIABILITIES | | | |
| Deposits and balances of banks and other financial institutions | 39,060 | 27,045 | 11,886 |
| Deposits from customers | 284,186 | 323,802 | 342,528 |
| Trading liabilities | 2,372 | 2,846 | 1,455 |
| Certificates of deposit issued | 12,165 | 5,491 | 2,812 |
| — At fair value through profit or loss | 7,660 | 3,777 | 2,442 |
| — At amortised cost | 4,505 | 1,714 | 370 |
| Current taxation | 229 | 333 | 147 |
| Debt securities issued | — | — | 4,346 |
| Deferred tax liabilities | 872 | 77 | 520 |
| Other accounts and provisions | 10,997 | 12,139 | 18,506 |
| Loan capital | 13,652 | 11,036 | 12,359 |
| — At fair value through profit or loss | 8,983 | 6,395 | 7,712 |
| — At amortised cost | 4,669 | 4,641 | 4,647 |
| Total Liabilities | 363,533 | 382,769 | 394,559 |
| Share capital | 3,936 | 4,183 | 4,623 |
| Reserves | 26,163 | 27,963 | 30,542 |
| Total equity attributable to equity owners of the parent | 30,099 | 32,146 | 35,165 |
| Minority interests | 347 | 339 | 4,358 |
| Total Equity | 30,446 | 32,485 | 39,523 |
| Total Equity and Liabilities | 393,979 | 415,254 | 434,082 |
| OTHER SELECTED FINANCIAL DATA | | | |
| | (%) | (%) | (%) |
| Loan to Deposit Ratio | 73.6 | 69.9 | 71.7 |
| Capital Adequacy Ratio | 12.6 | 13.8 | 13.3 ⁽¹⁾ |
| Average Liquidity Ratio | 43.5 | 38.4 | 43.3 |
| Return on Average Assets | 1.2 | 0.01 | 0.6 |
| Return on Average Shareholders' Funds | 14.6 | 0.1 | 7.7 |

Note

(1) Taking into account the issuance of 167.1 million new shares at a price of HK\$30.60 per share in January 2010, the pro forma capital adequacy ratio would be 15.1%.

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 Notes. The occurrence of one or more events described below could have an adverse effect on BEA's business, financial condition, or results of operations, and could affect its ability to make payments of principal and interest under the Notes. Additional considerations and uncertainties not currently known to BEA, or which BEA currently deems immaterial, may also have an adverse effect on an investment in the Notes.

CONSIDERATIONS RELATING TO BEA

Hong Kong Economy

BEA conducts most of its operations⁽¹⁾ 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 and the results of its 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 continue to affect markets, 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 global 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 reviving their economies. Since the second half of 2009, there has been evidence suggesting that the global economy is recovering, and some of the fiscal measures and other stimulus packages have been scaled back or withdrawn by various countries. However, in early 2010, fear of a sovereign debt crisis which has developed in some European countries including Greece, Spain and Portugal has again caused uncertainty to the global financial markets. The uncertain global economic outlook, together with the withdrawal of the fiscal aid measures put in place by various governments, may have an adverse impact on the Hong Kong economy which may affect 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, 2.5% in 2008 and 8.7% in 2009 (year-on-year), BEA believes that the recovery of, and

Note:

(1) Operations based on size of total assets

the continued growth in, the Hong Kong economy 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 economies of the United States, Europe, the PRC and Hong Kong.

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 which may have significantly greater financial and other resources. In particular, competition in the credit card 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.

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 2009 and 30 April 2010, BEA charged an average of 2.32% (P - 2.93%) and 2.23% (P - 3.02%), 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 14 May 2010, 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 China 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 retail or corporate lending portfolios in mainland China, 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 31 December 2009, total deposits increased from HK\$167,916 million to HK\$345,340 million, and retail deposits grew from HK\$163,738 million to HK\$342,528 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 questioning the liquidity and stability of BEA that BEA believes to be unfounded were disseminated in Hong Kong. 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. In April 2010, a bill seeking to amend the Deposit Protection Scheme Ordinance was gazetted. Among other things, the bill seeks to increase the Deposit Protection Scheme limit from HK\$100,000 to HK\$500,000 which is intended to come into effect upon the expiry of the guarantee at the end of 2010. However, there can be no assurance that the bill will be implemented and that the level of customer deposits of BEA will not be adversely affected by the withdrawal of the guarantee or any other 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. The Bank of East Asia (China) Limited ("**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 these markets. For a discussion of recent or proposed acquisitions and disposals of BEA's businesses, see "*Business of the Issuer — 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 the demand 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 that 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.

Changes in Regulations in the Mainland China Market

The body of law and other regulation which applies to BEA's business in the PRC is extensive, complex and subject to change. The nature and extent of such regulation have been changing over time and this is likely to continue in the future. BEA cannot guarantee that it will be in total compliance at all times with these regulatory requirements. Should BEA fail to meet any regulatory obligations or performance standards, this could result in enforcement action (which may include criminal prosecution) being taken against BEA and/or fines or other sanctions being imposed on BEA. It is also possible that new or stricter standards could be imposed on BEA that will raise BEA's operating costs which may affect BEA's financial performance.

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 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, through BEA (China), been expanding its range of products and services offered in mainland 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 expectation 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 April 2010, BEA's wholly-owned subsidiary, BEA (China), headquartered in Shanghai, operated 20 branches in Shanghai, Beijing, Tianjin, Dalian, Shenyang, Qingdao, Shijiazhuang, Urumqi, Hangzhou, Nanjing, Suzhou, Chengdu, Chongqing, Wuhan, Hefei, Xi'an, Shenzhen, Guangzhou, Zhuhai and Xiamen as well as 56 sub-branches (10 in Shanghai, eight in both Shenzhen and Guangzhou, four in each of Dalian, Xi'an and Xiamen, three in each of Beijing, Chongqing and Zhuhai, two in both Shenyang and Chengdu, one in each of Qingdao, Hangzhou, Foshan, Zhongshan and Huizhou). The three cross-location sub-branches in Foshan, Zhongshan and Huizhou were established under the liberalisation measures of Supplement VI to the CEPA. BEA (China) also operated ten 24-hour self-service banking centres and more than 370 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 two representative offices in Fuzhou and Dongguan. BEA (China) has also obtained preliminary approval to establish four new sub-branches in mainland China. In addition, BEA maintains two branches in Taiwan, which are located in Taipei and Kaohsiung, and one branch and three sub-branches in Macau.

As at 31 December 2007, 2008 and 2009, advances to customers made by BEA's mainland China, Taiwan and Macau branches amounted to HK\$78,566 million, HK\$96,885 million and HK\$101,313 million respectively representing approximately 36.0%, 42.1% and 40.9% 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 and the impact on the changes in regulations governing banking and other businesses). 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 April 2010, BEA's wholly-owned subsidiary, The Bank of East Asia (U.S.A.) N.A. ("BEAUSA") operated 13 branches in the United States. Pursuant to an agreement between BEAUSA and the Office of the Comptroller of the Currency ("OCC"), the primary U.S. federal regulator, BEAUSA adopted a capital programme ("Capital Programme") from 31 December 2008 under which it is required to maintain its regulatory capital at levels higher than those stipulated by published regulations in order to qualify as being "well capitalised". In particular, BEAUSA is required to maintain a minimum capital adequacy ratio ("CAR") of 12.5%. The Capital Programme will remain in place until the OCC is satisfied that BEAUSA's results of operations no longer warrant its capital ratios to remain higher than regulatory levels such that its "well-capitalised" status is preserved. In August 2009, BEA injected U.S.\$ 25 million into BEAUSA for the purposes of maintaining the required CAR and increasing the capital resources of BEAUSA in order to increase its loan portfolio and improve its interest earnings. As at 31 December 2009, the CAR of BEAUSA was 17.2%.

Given the current uncertain market and economic conditions in 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 Programme, 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 BEAUSA has entered into with third parties.

For the year ended 31 December 2009, BEAUSA made provisions of U.S.\$8.0 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

Exposure to the Property Market

BEA has significant direct and indirect exposure to the property market through its portfolio of property-related advances and property used as collateral.

As at 31 December 2007, 2008 and 2009, property related loans amounted to HK\$37,639 million, HK\$43,181 million and HK\$42,754 million which accounted for approximately 47.9%, 44.6% and 42.2%, respectively, of BEA's total outstanding customer advances in mainland China, Taiwan and Macau.

As at 31 December 2007, 2008 and 2009, home mortgage advances (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, which amounted to HK\$37,286 million, HK\$25,615 million, and HK\$26,749 million, respectively, which accounted for approximately 17.1%, 11.1% and 10.8% respectively of the Group's total advances to customers. In particular, advances under GHOS, PSPS and TPS accounted for HK\$1,041 million, HK\$1,318 million and HK\$1,529 million, respectively, or approximately 0.5%, 0.6% and 0.6%, respectively, of the Group's total advances to customers. Advances for property development and investment in Hong Kong amounted to HK\$35,103 million, HK\$36,286 million and HK\$39,177 million, which accounted for approximately 16.1%, 15.8% and 15.8%, respectively, of BEA's total advances to customers.

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 signs of recovery since 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 2007, 2008 and 2009, BEA's net interest income represented approximately 67.8%, 105.2% and 66.2%, 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 2007, 2008 and 2009 were 1.91%, 1.85% and 1.80% 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, or any increase at all, in loan demand. 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, high 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 depends on various quantitative and qualitative factors, including the number of months by which payments have fallen into 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 2007, 2008 and 2009, approximately 91.3%, 85.9% and 83.9% 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 if they do, BEA's liquidity and funding will not be adversely affected by such incidents.

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. In April 2010, a bill seeking to amend the Deposit Protection Scheme Ordinance was gazetted. Among other things, the bill seeks to increase the Deposit Protection Scheme limit from HK\$100,000 to HK\$500,000 which is intended to come into effect upon the expiry of the guarantee at the end of 2010. However, there can be no assurance that the bill will be implemented and that the level of customer deposits, and therefore of BEA's liquidity, will not be adversely affected by the withdrawal of the guarantee or any other changes to the Deposit Protection Scheme.

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, 25% 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 2007, 2008 and 2009, BEA held a substantial part of its spot assets in U.S. dollars amounting to HK\$94,859 million, HK\$83,532 million and HK\$82,024 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 of 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. As at 31 December 2007, 2008 and 2009, at least 70% of the Group's advances were secured by collateral. 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 2009, BEA had a total investment in debt securities of HK\$40,537 million, of which approximately 12% were rated Aaa, 29% were rated between Aa1 to Aa3, 19% were rated between A1 to A3, 5% were rated lower than A3, 25% were rated P-1 and 10% were unrated.

In respect of BEA's exposure to sovereign debt in Europe, as at 30 April 2010, BEA holds government agency bonds guaranteed by the governments of the U.K. and the Netherlands amounting to approximately U.S.\$33 million. Accordingly, BEA does not consider its exposure to European sovereign debt to be significant.

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 2009, 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 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 ("Mini-Bonds"), subscribed or purchased through BEA. As at 30 April 2010, approximately 98.4% of the eligible persons have accepted the offer (see "*Business of the Issuer — Litigation*") and the remaining 1.6% (i.e. 14 Mini-Bonds holders) have rejected the offer. In February 2010, one Mini-Bonds holder who did not accept the offer made 4 claims against BEA in the Small Claims Tribunal of Hong Kong for around HK\$200,000. The relevant proceedings are still ongoing. In addition, BEA has recently reached settlement with one of the 14 Mini-Bonds holders. It is still uncertain at this stage whether the remaining 12 Mini-Bonds holders 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 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. 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 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. In December 2009, the Basel Committee on Banking Supervision issued a consultative document with proposals to reform the capital adequacy standards of the banking sector. There is no certainty as to the final framework for capital and adequacy standards which will be developed and implemented, which may require increased capital requirements and impact existing business models, or the timing of the implementation. If such final recommended measures are adopted by the HKMA, BEA may incur substantial costs in monitoring and complying with the new requirements.

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 Issuer'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. In 2009, there has also been a significant number of confirmed cases of Human Swine Influenza A (H1N1) globally which resulted in 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, 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 Notes 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 NOTES

No limitation on issuing senior or pari passu securities in respect of the Notes

There is no restriction on the amount of securities which the Issuer may issue and which rank senior to, or pari passu with, the Notes. The issue of any such securities may reduce the amount recoverable by the Noteholders in case of a Winding-Up of the Issuer. The Notes are subordinated obligations of the Issuer. Accordingly, in the Winding-Up of the Issuer, there may not be sufficient amount to satisfy the amounts owing to the holders of the Notes.

Subordination of the Notes

BEA's obligations under the Notes will be direct, unconditional and unsecured, and will be subordinated in right of payment to the claims of depositors and all other unsubordinated creditors of the Issuer in the event of a Winding-Up of the Issuer. Although the Notes may pay a higher rate of interest than comparable notes which are unsubordinated, an investor in the Notes may lose all or some of his investment should BEA become insolvent.

Restricted Remedy for Non-Payment

The sole remedy against BEA available to the Trustee to receive any amounts owing in respect of the principal of, or interest on, the Notes will be to institute proceedings for the Winding-Up of BEA and/or prove in such Winding-Up.

Modification, Waivers and Substitution

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.

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 14.

Change of Law

The Conditions, and any non-contractual obligations arising out of or in connection with them, are governed by English law (except for the provisions relating to subordination which are governed by Hong Kong law). No assurance can be given as to the impact of any possible judicial decision or change to English or Hong Kong law or administrative practice after the date of issue of the Notes.

Secondary Market

The Notes may have no established trading market when issued and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a material adverse effect on the market value of Notes.

Credit Ratings

The Notes have been rated A3 by Moody's and BBB+ by S&P. The ratings may not reflect the potential impact of all risks related to the structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. Rating agencies may also revise or replace entirely the methodology applied to derive credit ratings.

USE OF PROCEEDS

The net proceeds of the issue of the Notes will be approximately U.S.\$445,005,000, after deducting the commissions but before expenses incurred in connection with the issue of the Notes. The Issuer intends to use the proceeds from the issue of the notes for the purpose of refinancing its existing debt obligations under its outstanding US\$550,000,000 5.625 per cent. Subordinated Notes due 2015 and/or for its general working capital purposes.

CAPITALISATION AND INDEBTEDNESS

CAPITALISATION AND INDEBTEDNESS OF THE GROUP

As at 31 December 2009, the Issuer had an authorised share capital of HK\$6,500 million consisting of 2,600 million ordinary shares of HK\$2.50 each, and an authorised share capital of U.S.\$500 million consisting of 0.5 million substitute preference shares of U.S.\$1,000 each, each issued and fully paid up share capital of approximately HK\$4,623 million consisting of approximately 1,849 million ordinary shares of HK\$2.50 each.

The following table sets out the Group's consolidated capitalisation and indebtedness as at 31 December 2009 and as adjusted for the issue of the Notes.

| | As at 31 December 2009 | | | |
|--|------------------------|-------------------------|-----------------------|-------------------------|
| | Actual | Actual | As adjusted | As adjusted |
| | HK\$ (in millions) | U.S.\$ (in millions) | HK\$ (in millions) | U.S.\$ (in millions) |
| Short-term borrowings ⁽¹⁾ | | | | |
| Customer deposit accounts | 331,461 | 42,495 | 331,461 | 42,495 |
| Certificates of deposits in issue | 1,414 | 181 | 1,414 | 181 |
| Deposits from banks | 11,833 | 1,517 | 11,833 | 1,517 |
| Loan capital | 4,281 | 549 | 4,281 | 549 |
| Total short-term borrowings | <u>348,989</u> | <u>44,742</u> | <u>348,989</u> | <u>44,742</u> |
| Medium-term borrowings ⁽²⁾ | | | | |
| Customer deposit accounts | 11,067 | 1,419 | 11,067 | 1,419 |
| Certificates of deposits in issue | 1,094 | 140 | 1,094 | 140 |
| Debt securities issue | 4,346 | 557 | 4,346 | 557 |
| Deposits from banks | 20 | 3 | 20 | 3 |
| Loan capital | 8,078 | 1,036 | 8,078 | 1,036 |
| Total medium-term borrowings | <u>24,605</u> | <u>3,154</u> | <u>24,605</u> | <u>3,154</u> |
| Long-term borrowings ⁽³⁾ | | | | |
| Certificates of deposits in issue | 304 | 39 | 304 | 39 |
| Total Notes to be issued | — | — | 3,510 | 450 |
| Total long-term borrowings | <u>304</u> | <u>39</u> | <u>3,814</u> | <u>489</u> |
| Capital resources ⁽⁴⁾ | | | | |
| Share capital | 4,623 | 593 | 4,623 | 593 |
| Reserves | 30,542 | 3,916 | 30,542 | 3,916 |
| Shareholders' funds | 35,165 | 4,508 | 35,165 | 4,508 |
| Minority interests | 4,358 | 559 | 4,358 | 559 |
| Total minority interests | 4,358 | 559 | 4,358 | 559 |
| Total capital resources | <u>39,523</u> | <u>5,067</u> | <u>39,523</u> | <u>5,067</u> |
| Total capitalisation ⁽⁵⁾ | <u>64,432</u> | <u>8,261</u> | <u>67,942</u> | <u>8,711</u> |
| Short-term borrowings and total capitalisation | <u>413,421</u> | <u>53,003</u> | <u>416,931</u> | <u>53,453</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) In January 2010, the Issuer issued 167.1 million new shares at a price of HK\$30.60 per share.
- (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 31 December 2009.

BUSINESS OF THE ISSUER

INTRODUCTION

Overview

Incorporated in 1918, BEA is the largest independent local bank in Hong Kong in terms of assets. As at 31 December 2009, BEA's consolidated assets, advances to customers and customer deposits were HK\$434,082 million (U.S.\$55,652 million), HK\$247,654 million (U.S.\$31,751 million) and HK\$342,528 million (U.S.\$43,914 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, and 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.

The shares of BEA have been listed on the HKSE since the 1930s. As at 30 April 2010, the authorised share capital of BEA was 4,000 million ordinary shares of HK\$2.50 each and 500,000 substitute preference shares of U.S.\$1,000 each, of which approximately 2,031.2 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 April 2010, BEA's market capitalisation was approximately HK\$57,178.51 million (U.S.\$7,330.58 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. BEA Life and Blue Cross 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 April 2010, the Group offered a broad range of banking and related financial services in Hong Kong through a network of 88 branches, seven major subsidiaries and 52 wealth management centres called "SupremeGold Centres".

As at 30 April 2010, BEA's overseas operations had in total 45 branches, 59 sub-branches and three representative offices as well as several affiliates and joint ventures in mainland China, Taiwan, Macau, the United States, the United Kingdom, the British Virgin Islands and South East Asia.

BEA is one of the first foreign banks to have received approval to establish a locally-incorporated bank in mainland China. The locally-incorporated bank and BEA's wholly-owned subsidiary, 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, loans, deposits, trade finance, guarantees, remittance, Renminbi forward, SupremeGold accounts, Renminbi debit and credit cards, private banking, Cyberbanking, Qualified Domestic Institutional Investors ("QDII") services, derivative and investment products, agency services for general and life insurance products, and cross-border Renminbi trade settlement services.

As at 30 April 2010, BEA (China), with its headquarters in Shanghai, operated 20 branches and 56 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 two representative offices.

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

As at 31 December 2007, 2008 and 2009, approximately 24.9%, 29.8% and 31.3%, respectively, of the assets of the Group were accounted for in mainland China, Taiwan and Macau. The corresponding figures for Hong Kong as at 31 December 2007, 2008 and 2009 were 64.1%, 60.3% and 57.8%. For the years ended 31 December 2007, 2008 and 2009, approximately 23.7%, 18,550%⁽¹⁾ and 45.7%, respectively, of BEA's consolidated profit before taxation were accounted for in mainland China, Taiwan and Macau. The corresponding figures for Hong Kong as at 31 December 2007, 2008 and 2009 were 68.8%, -23,450% and 55.2%.

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 2007, 2008 and 2009, the Group's capital adequacy ratio was approximately 12.6%, 13.8% and 13.3%⁽²⁾, respectively, compared with the statutory minimum requirement of 8.0%, and its loan to deposit ratio was approximately 73.6%, 69.9% and 71.7%, respectively. For the years ended 31 December 2007, 2008 and 2009, BEA's average liquidity ratio was approximately 43.5%, 38.4% and 43.3%, 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 2007, 2008 and 2009, customer deposits accounted for approximately 81.4%, 88.1% and 91.6%, respectively, of borrowed funds. The remainder of the Group's funding requirements as at 31 December 2007, 2008 and 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 year ended 31 December 2009, the Group's profit after taxation was HK\$2,638 million (U.S.\$ 338 million), an increase of approximately 2,445.1% from the year ended 31 December 2008. The turnaround in operations and financial performance was the result of gradually improving conditions in the financial markets and global economy, as well as the absence of further substantial write-downs recorded by the Issuer. For the year ended 31 December 2008, the Group's profit after taxation was

Notes:

- (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.
- (2) Taking into account the issuance of 167.1 million new shares at a price of HK\$30.60 per share in January 2010, the pro forma capital adequacy ratio would be 15.1%.

HK\$104 million (U.S.\$13 million), a decrease of approximately 97.5% from the year ended 31 December 2007 (HK\$4,221 million (U.S.\$541 million)). The Group's profits in 2008 were severely affected by 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 conducted in Hong Kong.

For the year ended 31 December 2009, the Group achieved a return on average assets of approximately 0.6% and a return on average equity of approximately 7.7%, as compared with approximately 0.01% and 0.12%, respectively, for the year ended 31 December 2008 and approximately 1.2% and 14.6%, respectively, for the year ended 31 December 2007.

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 the deterioration in the global economy. A severe decrease in 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.

History

Incorporated in 1918, BEA is 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 of the restrictions on Hong Kong banks in 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 Renminbi-denominated bonds in an aggregate principal amount of RMB 4 billion 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. BEA (China) will continue to offer Renminbi trade settlement services in the pilot cities including Shanghai, Guangzhou, Shenzhen and Zhuhai.

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.

Over the years, BEA has continuously expanded its network in mainland China and has a total of 80 outlets in mainland China, including the headquarters of BEA (China), 20 branches, 56 sub-branches, two representative offices and one booking branch as at 30 April 2010. 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. 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.

BEA (China)’s achievements were further recognised through a number of awards received in 2009, including the “Best Development Team for Information Technology”, the “Best Information Technology Strategy Award” and the “Best Technical Strategy Award” in 2008 from the National Information Evaluation Centre, the “Best Financial Services in 2008” at the Golden-Shell Award of Finance hosted by the 21st Century Business Herald, the “30 Years of Reform and Opening-up - Leadership Award for Best Industry Contribution” from China Internet Week, the “2009 Best Foreign Bank Website” from Hexun.com, the “2009 Best SME Services in Asia” in the 4th Asian Banks Competitive Rankings held during the 21st Century Annual Finance Summit of Asia, the “2009 Best Localised Foreign Bank” and the “2009 Best Secured Credit Card” from Moneyweek, and the “2009 Best Wealth Management Bank” in the 2009 Bank Rating hosted by money.sohu.com.

STRATEGY

BEA’s core objectives are to strengthen its position as the largest independent local 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. The key components of BEA’s strategy are set out below.

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 through capitalising on opportunities arising from the full liberalisation of the banking sector and the 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 its network of ATMs and 24-hour self service centres. Such automated systems will provide accessibility and 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 and intends to strengthen its treasury operations across its network of branches in mainland China.

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 April 2010, BEA operated 52 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 “*Business of the Issuer — 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 further enhance efficiency and market competitiveness. 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 2007, 2008 and 2009, approximately 17.1%, 11.1% and 10.8%, 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 16.1%, 15.8% and 15.8%, respectively, comprised advances for property development and property investment. As at 30 April 2010, BEA had over 1.4 million retail customers in Hong Kong, which include 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 April 2010, BEA had 88 branches and 52 SupremeGold Centres in Hong Kong. BEA is a founding member of JETCO, which currently provides over 2,410 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 acceptance locations in Hong Kong, Macau and Shenzhen.

As at 30 April 2010, BEA had in total 46 branches, 59 sub-branches and three representative offices, as well as several affiliates and joint ventures outside of Hong Kong. In mainland China, Taiwan and Macau, BEA has 24 branches (including the BEA booking branch), 59 sub-branches and two representative offices. Headquartered in Shanghai, BEA (China) operates 20 branches and 56 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 but are not limited to loans, deposits, trade finance, guarantees, remittance, Renminbi forward, SupremeGold accounts, Renminbi debit and credit cards, private banking, Cyberbanking, QDII services, derivative and investment products, agency services for general and life insurance products, and cross-border Renminbi trade settlement services. As at 31 December 2007, 2008 and 2009, approximately 24.9%, 29.8% and 31.3%, respectively, of the Group's assets and approximately 23.7%, 18,550%⁽¹⁾ and 45.7%, respectively, of BEA's consolidated profit before taxation for the years ended 31 December 2007, 2008 and 2009 were accounted for in mainland China, Taiwan and Macau.

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.

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. On 1 January 2010, the Consultant was renamed Senior Advisor.

On 1 April 2010, an additional General Manager was appointed to oversee the business of Blue Cross, BEA Life, Bank of East Asia (Trustees) Limited, Insurance Services Department of BEA, and Blue Care Medical Centre under the newly established Insurance and Retirement Benefits Division.

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

| | <u>Operating income</u> | <u>Profit before taxation</u> |
|--|------------------------------------|------------------------------------|
| | <u>Year ended 31 December 2007</u> | <u>Year ended 31 December 2007</u> |
| | (in HK\$ millions) | (in HK\$ millions) |
| Personal Financial Services ⁽¹⁾ | 3,052 | 988 |
| Corporate Banking ⁽²⁾ | 3,416 | 1,934 |
| Investment Banking ⁽³⁾ | 1,288 | 1,525 |
| Corporate Services ⁽⁴⁾ | 760 | 314 |
| Others ⁽⁵⁾ | 270 | 346 |
| Unallocated ⁽⁶⁾ | 186 | 78 |
| Inter-segment elimination | <u>(158)</u> | <u>—</u> |
| Total | <u>8,814</u> | <u>5,185</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.

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 accounts has accordingly been 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 years ended 31 December 2008 and 2009, the Group's operating income and profit before taxation by business segment were as follows:

| | Operating income/(loss) | | | Profit/(loss) before taxation | | |
|--|--|--------------|-------------------------|--|----------|-------------------------|
| | Year ended 31 December | | | Year ended 31 December | | |
| | 2009 | 2008 | Increase/ (decrease) | 2009 | 2008 | Increase/ (decrease) |
| | (in HK\$ millions, except percentages) | | | (in HK\$ millions, except percentages) | | |
| Hong Kong Region | | | | | | |
| Personal Banking ⁽¹⁾ | 2,435 | 1,943 | 25.3% | 1,021 | 563 | 81.3% |
| Corporate Banking ⁽²⁾ | 1,410 | 84 | 1,578.6% | 1,250 | (140) | 992.9% |
| Treasury Markets ⁽³⁾ | 130 | (1,006) | 112.9% | 5 | (1,138) | 100.4% |
| Wealth Management ⁽⁴⁾ | 342 | 252 | 35.7% | 223 | 112 | 99.1% |
| Others | | | | | | |
| China Operations ⁽⁵⁾ | 3,472 | 3,377 | 2.8% | 1,525 | 1,453 | 5.0% |
| Overseas Operations ⁽⁶⁾ | 1,077 | 673 | 60.0% | (416) | 95 | (537.9)% |
| Corporate Services ⁽⁷⁾ | 817 | 816 | 0.1% | 299 | 301 | (0.7)% |
| Others ⁽⁸⁾ | 1,236 | 977 | 26.5% | (108) | (1,042) | 89.6% |
| Inter-segment elimination . . | (731) | (659) | 10.9% | (303) | (196) | (54.6)% |
| Total | 10,188 | 6,457 | 57.8% | 3,496 | 8 | 43,600% |

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 and related assets in Hong Kong.
- (5) China operations include all branches and subsidiaries in China, except those subsidiaries carrying out corporate services and associates operating in China.
- (6) Overseas operations include overseas branches and subsidiaries, except those subsidiaries carrying out corporate services and associates operating in overseas.
- (7) Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.
- (8) Other businesses include insurance business, property-related business, supporting units of Hong Kong operations, investment properties, bank premises, the net results of associates and other subsidiaries in Hong Kong.

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 as compared with the year ended 31 December 2007. For the Treasury Markets 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. Comparisons of financial performance for the years ended 31 December 2007 and 2008 are made using the previous method of presenting segment information prior to 1 January 2009 when BEA adopted the revised HKFRS 8, where all segments were presented on a Group basis and included all overseas operations.

The results for the year ended 31 December 2009 have improved significantly compared with the year ended 31 December 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 with the year ended 31 December 2008, it did not record any substantial write-down or impairment on its portfolio. Similarly, the 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 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 2007, 2008 and 2009, 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 | | |
| | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 |
| | (in HK\$ millions) | | | (in HK\$ millions) | | |
| Hong Kong | 5,938 | 2,962 | 6,461 | 3,568 | (1,876) | 1,931 |
| People's Republic of China ⁽¹⁾ . . | 2,391 | 3,447 | 3,527 | 1,227 | 1,484 | 1,598 |
| Other Asian Countries | 446 | 525 | 585 | 229 | 381 | 163 |
| Others | 578 | 492 | 883 | 161 | 19 | (196) |
| Inter-Segment Elimination | <u>(539)</u> | <u>(969)</u> | <u>(1,268)</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| Total | <u>8,814</u> | <u>6,457</u> | <u>10,188</u> | <u>5,185</u> | <u>8</u> | <u>3,496</u> |

Note:

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

HONG KONG

Home Mortgages

As at 31 December 2007, 2008 and 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\$37,286 million, HK\$25,615 million and HK\$26,749 million, respectively, or approximately 17.1%, 11.1% and 10.8%, respectively, of the Group's total advances to customers. As at 31 December 2007, 2008 and 2009, advances under GHOS, PSPS and TPS accounted for HK\$1,041 million, HK\$1,318 million and HK\$1,529 million, respectively, or approximately 0.5%, 0.6% and 0.6%, 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.

BEA intends to increase its market share in the mortgage business in 2010 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. BEA provides various different mortgage plans, including fixed Prime-based rate and floating HIBOR-based rate mortgage plans which are repayable by instalments. As at 31 March 2010, 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, which 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, issuance of 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 on either 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 31 December 2009, trade finance and commercial mortgages amounted to HK\$17,011 million, representing a decline of approximately 4% as compared with the corresponding period ended 31 December 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 with the corresponding period ended 31 December 2007, and accounted for approximately 7.1% of the Group's total advances to customers.

Consumer Finance

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.

BEA runs an annual tax loan promotion campaign, the "Tax Loan Programme", during the tax season in Hong Kong. As with previous years, the Tax Loan Programme was offered to customers in 2009 with a loan book of HK\$1,474 million and recorded a growth of 596% in programme drawdowns as compared with 2008.

In April 2010, BEA launched the new "Instalment Loan Programme", which offers tiered pricing based on a drawdown amount with a 12-month annualised percentage rate ranging from 3.5% to 7.85%. To further enhance BEA's services to its customers, a 30-minute express approval process was introduced to auto-payroll customers while a streamlined loan drawdown procedure was put in place for all BEA customers. Attractive product terms such as a repayment holiday were provided to suit customers' financial needs.

As at 31 December 2009, total outstanding consumer advances amounted to HK\$1,920 million, representing a significant increase of 90.1% as compared with 31 December 2008, which accounted for approximately 0.8% of the Group's total advances to customers as at 31 December 2009. The increase is mainly attributed to the increases in advances under the Tax Loan Programme for the relevant period.

As at 31 December 2008, the corresponding figure was HK\$1,010 million, representing a decline of approximately 5.0% as compared with 31 December 2007, which accounted for approximately 0.4% of the Group's total advances to customers as at 31 December 2008.

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 April 2010, CGFC operated through 14 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 31 December 2009 was HK\$144 million and HK\$208 million, respectively, which represented 0.06% and 0.08%, respectively, of the total advances to customers of the Group.

Credit Cards

As at 31 December 2009, credit card advances amounted to HK\$2,675 million, which accounted for approximately 1.1% of the Group's total advances to customers and represented a decline of 10.7% as compared with 31 December 2008. BEA believes that the decline was due mainly to the increased acceptance of the personal tax loans offered by BEA to its credit card customers which resulted in fewer customers making tax payments by credit cards for the relevant period.

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 with the corresponding period in 2007. The growth in credit card advances was attributable to various dining and entertainment offers and attractive spending rewards introduced in the latter part of 2008 which stimulated credit card usage.

In January 2010, BEA launched the “BEA CUP Dual Currency PLATINUM” Credit Card (the “**Dual Currency Platinum Card**”), which facilitates dual-currency settlement in both HKD and RMB. Transactions carried out in the mainland are settled in RMB while those carried out in Hong Kong and overseas are settled in HKD. Holders of the Dual Currency Platinum Card can therefore dispense with the need to incur currency conversion charges and handling fees when transacting in different countries.

BEA launched various promotional activities throughout 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. Priority bookings in respect of a series of concerts proved to be very popular with our customers.

BEA has also been focusing on building up a younger client base, in particular the university student sector, as it believes that customers in this sector have the potential to become lifelong high-value customers of the Issuer. 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 increase their spending using 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 it has received major awards such as “Capital Weekly PRO Choice Award — Medical & General Insurance”, “Quality Life Award — Quality Insurance Service Award”, “The Best Editor's Pick 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”, 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 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”, “Cancer Care Series — Premier Choice (for Telemarketing)” 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 repeat purchases.

The total premium income of the insurance business for the year ended 31 December 2009 was HK\$1,697 million, which increased by 5% as compared with the year ended 31 December 2008. The non-life insurance premium income for the year ended 31 December 2009 was HK\$689 million, a 3% increase as compared with the year ended 31 December 2008.

The life insurance premium income for the year ended 31 December 2009 was HK\$1,008 million, a 7% increase as compared with the year ended 31 December 2008. The corresponding figure as calculated by the 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\$335 million, a 10% increase as compared with the year ended 31 December 2008. These positive results recorded by BEA Life are attributable to the aforementioned new insurance plans, which were well received by customers.

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 Mandatory Provident Fund (“**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 12 constituent funds for investment including 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) Global Equity Fund, BEA (MPF) European Equity Fund, BEA (MPF) Long Term Guaranteed Fund and BEA (MPF) Conservative Fund. BEA (MPF) Industry Scheme consists of six constituent funds including BEA (Industry Scheme) Growth Fund, BEA (Industry Scheme) Balanced Fund, BEA (Industry Scheme) Stable Fund, BEA (Industry Scheme) Greater China Growth Fund, BEA (Industry Scheme) Hong Kong Growth Fund and BEA (Industry Scheme) MPF Conservative Fund. All constituent funds (except BEA (MPF) Long Term Guaranteed Fund, BEA (MPF) Conservative Fund and BEA (Industry Scheme) 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 strongest 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. Moreover, BEA Union Investment Management Limited, investment manager of the BEA MPF schemes, 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.

According to the latest Mercer MPF Index, BEA was ranked as the top MPF service provider for the year ending 31 December 2009. In addition, BEA won Asia Asset Management magazine's "Best MPF Trustee in Hong Kong" Award as part of its "Best of the Best Awards 2009". BEA received these industry awards in recognition of the performance of its MPF services.

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, as the administrator of estates, as attorney administrator for overseas estates having assets in Hong Kong and as escrow agent for commercial transactions. BEAT also acts as trustee for family or other trusts and settlement, investment funds, unit trusts, charities, public funds and capital market issues. BEAT recorded growth in revenue of approximately 20% for the year ended 31 December 2009 (HK\$3.71 million), as compared with the revenue levels for the year ended 31 December 2008 (HK\$3.10 million), from its private trust business.

Internet Banking Services

Internet banking services provided by BEA include its Cyberbanking and Cybertrading services.

Cyberbanking

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, over fixed-line telephones, 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 transactions and redemption of bonus points for gifts, an 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 deposit. 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, deposit and withdrawal history and current investments and obtain fund information.

As at 30 April 2010, the number of registered Cyberbanking users and Corporate Cyberbanking users were up 9% and 7%, respectively, as compared with the respective number of users as at 30 April 2009.

Cybertrading

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. In June 2009, East Asia Securities launched a new promotional campaign for its securities trading services, intended to gain new securities clients and increase its volume of transactions in anticipation of a potential recovery of the financial markets in 2009 and 2010. East Asia Securities saw the number of Cybertrading accounts rise by 4% during 2009 and, as at 31 December 2009, more than 60% of East Asia Securities clients had subscribed to Cybertrading. With a view to further enhancing the Cybertrading service, an e-Statement Service was launched in January 2010. With the implementation of the eStatement service, Cybertrading clients can view their daily

consolidated statements and monthly account statements over the internet up to the last 90 days and 12 months respectively.

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.

East Asia Futures recorded a 4.3% increase in net fees and commission income for the year ended 31 December 2009 as compared with the year ended 31 December 2008. As at 31 December 2009, approximately 74% of East Asia Futures' clients had subscribed to the Futures Cybertrading Services, and for the year ended 31 December 2009, 79% of East Asia Futures' total number of transactions were traded via the Cybertrading platform; whereas for East Asia Securities, the volume of transactions executed via the Cybertrading platform, expressed as a percentage of total turnover, reached 62% of the number of trades and 46% of the gross transaction value for the year ended 31 December 2009. BEA believes that the high volume of online trading recorded by East Asia Securities and East Asia Futures suggests that online trading is becoming increasingly popular with retail investors.

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 private or state-owned enterprises in mainland China.

The Hong Kong corporate loan market exhibited weakness in 2008 and in the first quarter of 2009, as the impact of the financial crisis was felt throughout the Hong Kong economy. Loan demand was mainly driven by refinancing needs. The weak first quarter of 2009 was followed by a rebound from the second quarter of 2009. Corporate and individual investors took advantage of the improving local credit environment from the second quarter to pursue investment opportunities, leading to a gradual revival in corporate lending business for the year ended 31 December 2009.

In light of the tenuous nature of the global economic recovery, BEA is taking a proactive approach to expanding its client base by focussing on high quality local and mainland China enterprises. With its strong Mainland network, BEA is particularly well positioned to serve local and mainland Chinese customers, and meet both their onshore and offshore financing needs.

The majority of the project financing in which BEA participates is extended on a recourse basis and is secured by the underlying project. Typically, the average maturity of BEA's corporate advances is 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 on advances to these borrowers are generally more attractive than margins on unsecured syndicated advances to large property developers.

As at 31 December 2009, bilateral advances and syndicated advances outstanding totalled HK\$43,178 million, representing a growth of approximately 15.3% from 31 December 2008, and accounted for approximately 17.4% of the Group's total advances to customers as at 31 December 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.

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 to clients who are searching for asset protection, 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 services, structured and treasury products, mutual funds, insurance and premium financing, succession and estate planning services, services relating to the Capital Investment Entrance Scheme, asset custodian services, trusts, discretionary asset management services and certain banking services such as time deposits and loans. The division provides private banking services to the very high net worth segment, and is also responsible for providing investment products support to general banking customers. As from 1 April 2010, the division is also responsible for the Issuer's private trust business.

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 four years and has achieved a critical mass in terms of clients and business acquisition. The number of clients in BEA Private Banking increased by over 15% in 2009 from 2008, a year which was greatly affected by the global financial crisis. BEA continues to look for growth in its private banking business with particular emphasis on mainland China, Hong Kong, Taiwan and Macau.

BEA Private Banking has clients from many different countries and its clientele from mainland China is growing significantly. In mid 2009, BEA acquired the AIG Group's Taiwan wealth management business, which was renamed BEA Wealth Management Services (Taiwan) Limited. BEA expects that there will be enhanced opportunities to promote wealth management services in Taiwan across the Group and between the two countries.

As at 31 December 2009, the assets under management of BEA Private Banking increased by 25% from the corresponding period in the previous year. The net profit of the department increased substantially from HK\$43 million in 2008 to HK\$175 million in 2009.

BEA continues to stress the importance of diversification of investments. Prior to the financial crisis, customers had a tendency towards highly leveraged investment in stocks for a quick return. This proved to be risky and BEA has since placed a strong emphasis on educating customers the need for diversification to weather market downturns. This has proven to be successful as many customers were able to recuperate their losses whilst maintaining a healthy portfolio of investments. Customers' interest in investment products has also shifted increasingly towards more transparent and simpler products such as vanilla bonds and simple structured products rather than complicated structures incorporating various derivatives. After the outbreak of the global financial crisis which resulted from the collapse of Lehman Brothers, in 2008, the investment climate in Hong Kong started to recuperate in the second quarter of 2009. Structured investment business volume in 2009 achieved 78% of the 2007 levels in Hong Kong, and in China, 6.7 times its lower-based figure in 2007. Since the beginning of 2010, the structured products and mutual funds business has also improved; first quarter profits were approximately 65% up from the corresponding period in 2008.

Regulatory changes as a result of the collapse of Lehman Brothers which were introduced in early 2009 meant that businesses involving equity-linked products and various other structured products in the market were suspended for a few months. In June 2009, BEA was the first bank in Hong Kong to obtain re-authorisation to offer equity-linked deposits followed by other structured products.

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.

The last 12 months also saw the Issuer's increased capability to provide a wider range of information to clients on their fund investments and returns through an upgrade of the Issuer's financial planning system.

For the year ended 31 December 2009, the Wealth Management Division's profit before taxation was HK\$223 million, a 99% increase from the previous year.

Since the financial crisis and in response to the increase in claims against the banking sector for the mis-selling of financial products in 2008 and 2009, the regulatory authorities in Hong Kong have, for the protection of customers, introduced new guidelines and rules to ensure proper selling. BEA has since reviewed its internal procedures and controls on risk exposures, and implemented new measures governing the sale process of financial products. These measures include, for example, strict guidelines on the categorisation of financial products based on objective criteria and standards, and the matching of customers' risk profiles and their product suitability, which might include the customers' previous investment experience, their liquidity situation and technical knowledge about a particular investment product. Considerable resources were also deployed by BEA Private Banking to improve systems and controls to ensure adherence to regulations and protection to customers, leading to an increase in the cost of compliance as a result.

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, 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 2007, 2008 and 2009, fees and commission income attributable to Tricor was approximately 28.9%, 31.2% and 28.8%, 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 Services (Malaysia) Sdn. Bhd. acquired a majority interest in Roots Consulting Sdn. Bhd., which provides training and consulting services in the field of corporate governance, performance management and risk management for companies. Tricor currently employs approximately 1,400 professional and support staff and provides services in 21 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 a 75% interest in ICEA Finance Holdings Limited (“**ICEA Finance**”) from ICBC. The transaction completed on 28 January 2010 and ICEA Finance became a wholly-owned subsidiary of BEA, which has reinforced the Issuer's position in the securities broking business in Hong Kong.

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 of 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 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 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 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 2009, including the “Best Development Team for Information Technology”, the “Best Information Technology Strategy Award” and the “Best Technical Strategy Award” in 2008 from the National Information Evaluation Centre, the “Best Financial Services in 2008” at the Golden-Shell Award of Finance hosted by the 21st Century Business Herald, the “30 Years of Reform and Opening-up — Leadership Award for Best Industry Contribution” from China Internet Week, the “2009 Best Foreign Bank Website” from Hexun.com, the “2009 Best SME Services in Asia” in the 4th Asian Banks Competitive Rankings held during the 21st Century Annual Finance Summit of Asia, the “2009 Best Localised Foreign Bank” and the “2009 Best Secured Credit Card” from Moneyweek, and the “2009 Best Wealth Management Bank” in the 2009 Bank Rating hosted by money.sohu.com.

In July 2009, BEA (China) issued Renminbi-denominated bonds in an aggregate principal amount of RMB 4 billion 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 April 2010, BEA's wholly-owned subsidiary, BEA (China), operated 20 branches in Shanghai, Beijing, Tianjin, Dalian, Shenyang, Qingdao, Shijiazhuang, Urumqi, Hangzhou, Nanjing, Suzhou, Chengdu, Chongqing, Wuhan, Hefei, Xi'an, Shenzhen, Guangzhou, Zhuhai and Xiamen, as well as 56 sub-branches (10 in Shanghai, eight in both Shenzhen and Guangzhou, four in each of Dalian, Xi'an

and Xiamen, three in each of Beijing, Chongqing and Zhuhai, two in both Shenyang and Chengdu, one in each of Qingdao, Hangzhou, Foshan, Zhongshan and Huizhou). The three cross-location sub-branches in Foshan, Zhongshan and Huizhou were established under the liberalisation measures of Supplement VI to the CEPA. To take advantage of these new measures, BEA will continue to submit applications for the establishment of sub-branches in Guangdong. BEA (China) also operates ten 24-hour self-service banking centres and more than 370 automatic teller machines in major urban areas nationwide. In addition to the BEA (China) network, BEA also operates a branch in Shanghai which provides foreign exchange wholesale services to corporate customers and has two representative offices in Fuzhou and Dongguan. BEA has also obtained preliminary approval to establish four new sub-branches in mainland China.

BEA provides a full range of Renminbi and foreign currency banking services in mainland China, including but not limited to loans, deposits, trade finance, guarantees, remittance, Renminbi forward, SupremeGold accounts, Renminbi debit and credit cards, private banking, Cyberbanking, QDII services, derivative and investment products, agency services for general and life insurance products, 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 liberalisation of the banking sector and from the CEPA between Hong Kong and mainland China.

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

BEA maintains two branches in Taiwan, which are located in Taipei and Kaohsiung. The acquisition of BEAWMS was completed in June 2009. BEAWMS provides a wide range of wealth management services, including securities brokerage, wealth management, insurance brokerage, and securities investment consultancy services for high net worth clients. Such acquisition complements BEA's existing commercial banking business and marks BEA's first step in wealth management in Taiwan.

BEA commenced its property-related lending business in Taiwan in 2009 and is planning to launch its trust business in 2010, including trust of real estate accounts for its property-related loan business and custodian services for wealth management accounts of BEAWMS.

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 distributed insurance products in Macau in the third quarter of 2009. In light of Macau's recovering economy since the second half of 2009, BEA in Macau will continue to extend credit facilities to both quality corporate and retail customers, and focus on personal banking business by expanding its sub-branch network prudently and launching a wider range of retail products and services in the market.

For the years ended 31 December 2007, 2008 and 2009, BEA's operations in mainland China, Taiwan and Macau accounted for approximately 23.7%, 18,550%⁽¹⁾ and 45.7% respectively of the Group's total profit before taxation and approximately 24.9%, 29.8%, 31.3% respectively of the Group's total assets as at 31 December 2007, 2008 and 2009.

The main source of income for BEA's operations in mainland China, Taiwan and Macau is interest income on loans and the performance in this business area is largely driven by market conditions. As part of BEA's expansion plan, BEA aims to diversify into other business areas (including trade finance, personal banking, wealth management and treasury businesses) to increase its fee income.

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

| | As at 31 December | | |
|--------------------------------------|--------------------|---------------|----------------|
| | 2007 | 2008 | 2009 |
| | (in HK\$ millions) | | |
| Trade Finance | 150 | 105 | 146 |
| Property Related Loans | 37,639 | 43,181 | 42,754 |
| Non-Property Related Loans | 40,420 | 53,144 | 58,018 |
| Others | 357 | 456 | 396 |
| Total | <u>78,566</u> | <u>96,886</u> | <u>101,314</u> |

The primary strategic focus of BEA (China) is currently Renminbi-denominated lending, which as at 31 December 2007, 2008 and 2009 amounted to HK\$57,058 million, HK\$70,337 million and HK\$74,733 million respectively or approximately 76%, 77% and 78% respectively of the total customer advances of BEA (China). Borrowers comprise 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 in the mainland China banking market because of its long history, sound track record, good relationships with regulators and local enterprises, extensive local knowledge and experienced local talent.

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.

INTERNATIONAL

BEA's international operations were commenced to meet the requirements of its core customers as their interests expanded 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 April 2010.

| 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 |

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**”). Currently BEAUSA operates a total of 13 branches in the United States (10 branches in California and three branches in New York). In 2009, BEAUSA undertook measures to control its operating expenses and improve its net interest margin, principally through lowering its cost of funds by reducing its reliance on high-priced time deposits. Despite incurring a net loss for the full year ended 31 December 2009, as a result of such measures BEAUSA recorded a net profit (for reporting purposes in the United States) in the third and fourth quarters of 2009. BEAUSA also recorded a net profit in the first quarter of 2010 (for reporting purposes in the United States).

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*”.

The Singapore branch of BEA was relocated to its new building at 60 Robinson Road in October 2009. The Branch serves as the Bank's hub for the Group's activities in 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 was holding a 21.725% interest as at 30 April 2010.

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. 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. As a result of these transactions, ICEA Finance became a wholly-owned subsidiary of BEA, and BEA (Canada) ceased to be a subsidiary of BEA and is held as to 30% by BEA and 70% by ICBC. BEA and ICBC have continued to cooperate in the operations

and management of BEA (Canada). BEA believes that the transactions have further strengthened the Group's overall financial services capability and in particular the securities broking business in Hong Kong. At the same time, BEA also aims to leverage on the global strength of ICBC to reinforce the development of BEA (Canada).

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 year ended and as at 31 December 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 31 December 2009, the Group's principal subsidiaries were as follows:

| Name of subsidiary of the Issuer | Place of incorporation and operation the Group | Issued and paid-up capital | % held by | | Nature of business |
|---|--|----------------------------|------------|-----------|---------------------------------------|
| | | | The Issuer | The Group | |
| Ample Delight Limited | Hong Kong | HK\$450,000,000 | | 100% | Investment holding |
| 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 | U.S.\$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\$374,580,000 | 51% | | Asset management |
| BEA Wealth Management Services (Taiwan) Limited | Taiwan, Republic of China | NTD218,000,000 | | 100% | Wealth management services |
| CCSL St. Lucia Limited | St. Lucia | U.S.\$1,200 | | 60.49% | Holding company |
| Central Town Limited | Hong Kong | HK\$2 | 100% | | Property investment |
| Century Able Limited | Hong Kong | HK\$866,951,045 | | 100% | Investment holding |
| Corona Light Limited | BVI | HK\$866,951,045 | | 100% | Investment holding |
| Credit Gain Finance Company Limited . . | Hong Kong | HK\$1 | 100% | | Money lenders |
| Crystal Gleaming Limited | BVI | HK\$866,951,045 | 100% | | Investment holding |
| East Asia Corporate Services (BVI) Limited | BVI | U.S.\$250,000 | | 75.61% | Registered agent and trustee services |

| Name of subsidiary of the Issuer | Place of incorporation and operation the Group | Issued and paid-up capital | % held by | | Nature of business |
|--|--|----------------------------|------------|-----------|---|
| | | | The Issuer | The Group | |
| East Asia Facility Management Limited . | Hong Kong | HK\$10,000 | | 100% | Facility management |
| East Asia Financial Services (BVI) Ltd. . | BVI | U.S.\$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. | U.S.\$5 | 100% | | Bank holding company |
| East Asia Indonesian Holdings Limited . | Seychelles | U.S.\$100,000 | | 100% | Investment holding |
| East Asia Investment Holdings Limited. . | Hong Kong | HK\$100,000,000 | 100% | | Investment holding |
| East Asia Investments Holdings (BVI) Ltd. | BVI | HK\$186,038,725 | 100% | | Investment holding |
| East Asia Marketing Limited | BVI | U.S.\$1 | | 75.61% | Marketing services to related companies |
| East Asia Property Agency Company Limited | Hong Kong | HK\$1,000,000 | 100% | | Property agency |
| East Asia Properties Holding Company Limited | Hong Kong | HK\$10,000 | 100% | | Investment holding |
| East Asia Properties (US), Inc.* | U.S.A. | U.S.\$5 | | 100% | Property holding |
| 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 | U.S.\$50,000,000 | 100% | | Investment holding |
| Flowery World Corporation | BVI | U.S.\$1 | | 75.61% | Holding company |
| Innovate Holdings Limited | BVI | U.S.\$1 | 100% | | Special purpose vehicle 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 | 30% | | Banking services |
| The Bank of East Asia (China) Limited ¹ | PRC | RMB8,000,000,000 | 100% | | Banking and related financial services |
| The Bank of East Asia (U.S.A.) N.A.* . | U.S.A. | U.S.\$4,500 | | 100% | Banking |
| Tricor Consultancy (Beijing) Limited ¹ . | PRC | U.S.\$1,850,000 | | 75.61% | Business consultancy in China |
| Tricor Holdings Limited | BVI | U.S.\$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 |

| Name of subsidiary of the Issuer | Place of incorporation and operation the Group | Issued and paid-up capital | % held by | | Nature of business |
|--|--|----------------------------|------------|-----------|---|
| | | | The Issuer | The Group | |
| Tricor Services Limited | Hong Kong | HK\$2 | | 75.61% | Business, corporate and investor services |
| Tricor Services (BVI) Limited | BVI | U.S.\$250,000 | | 75.61% | Registered agent and trustee services |
| Tricor Services (Malaysia) Sdn. Bhd. | Malaysia | RM5,672,484 | | 60.49% | Investment holding |
| Vitaway (Mauritius) Limited | Mauritius | U.S.\$1 | | 75.61% | Regional treasurer |

Notes

1. Represents a wholly foreign-owned enterprise.
2. BVI denotes the British Virgin Islands.

* *Companies not audited by KPMG. The accounts of the subsidiaries not audited by KPMG reflect total net assets and total income constituting approximately 6.3% and 2.1% 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, adequacy of resources, qualifications and experience of the accounting and financial reporting function, 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 the Chief Executive, Senior Management 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, Senior Management and Division Heads of BEA, and for the review of management succession plans for Executive Directors, Senior Management 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; the 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 in respect of fixed income, equity and equity related investments for BEA, East Asia Investment Holdings Limited, The Bank of East Asia, Limited Employees Provident Funds and The Bank of East Asia, Limited Employees Provident Fund (UCB); 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 12 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 Insurance & Retirement Benefits 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, the Risk Management Division and the 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 55,587 square feet, 133,815 square feet and 63,418 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 31 December 2009, the net book value for BEA's investment properties and bank premises amounted to HK\$2,095 million and HK\$8,572 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 cover 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 acts; 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 cover. BEA also requires borrowers to obtain appropriate insurance cover 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 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 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.

Claims by private banking clients

In two connected court proceedings initiated in September 2009 in the High Court of Hong Kong, two private banking clients claimed 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 clients' 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. These proceedings are in the preliminary stages and no provisions have been made by BEA as at 31 December 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 the 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 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 accounts for the expected cost in respect of the repurchase of the aforementioned structured investment products.

As at 30 April 2010, approximately 98.4% of the eligible persons have accepted the offer and the remaining 1.6% (i.e. 14 Mini-Bonds holders) have rejected the offer. In February 2010, one Mini-Bonds holder who did not accept the offer made four claims against BEA in the Small Claims Tribunal of Hong Kong for around HK\$200,000. The relevant proceedings are still ongoing. In addition, BEA has recently reached settlement with one of the 14 Mini-Bonds holders. It is still uncertain at this stage whether the remaining 12 Mini-Bonds holders will make monetary or compensatory claims against BEA.

EMPLOYEES

As at 30 April 2010, the Group had a total of 10,720 employees as set forth in the following table:

| | <u>No. of employees</u> |
|---|-----------------------------|
| Commercial and retail banking | 2,170 |
| Head office and operational support | 2,062 |
| Overseas (mainland China only) | 4,202 |
| (excluding mainland China) | 1,193 |
| Subsidiaries | <u>1,093</u> |
| Total | <u><u>10,720</u></u> |

As at 30 April 2010, approximately 25% 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 ordinary shares in BEA have been granted to eligible employees and executive director(s). As at 30 April 2010, approximately 17,384,500 shares, representing approximately 0.85% 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, 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. In April 2010, a bill seeking to amend the Deposit Protection Scheme Ordinance was gazetted. Among other things, the bill seeks to increase the Deposit Protection Scheme limit from HK\$100,000 to HK\$500,000 which is intended to come into effect upon the expiry of the guarantee at the end of 2010. However, there can be no assurance that the bill will be implemented and that the level of customer deposits of BEA will not be adversely affected by the withdrawal of the guarantee or any other changes to the Deposit Protection Scheme.

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 2007, 2008 and 2009, and should be read in conjunction with the information contained elsewhere in this Offering Circular, including “*Business of the Issuer*”.

ADVANCE PORTFOLIO

Overview

As at 31 December 2007, 2008 and 2009, the Group’s total outstanding advances to customers were HK\$218,184 million, HK\$230,339 million and HK\$247,654 million, respectively, which represented approximately 55.4%, 55.5% and 57.1%, 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 2007, 2008 and 2009, represented approximately 32.7%, 26.3% and 26.0%, 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 | | | | | |
|---|-------------------|------------------------|----------------|------------------------|----------------|------------------------|
| | 2007 | Percentage of total | 2008 | Percentage of total | 2009 | Percentage of total |
| (in HK\$ millions, except percentages) | | | | | | |
| Loans for use in Hong Kong | | | | | | |
| Industrial, commercial and financial | | | | | | |
| - Property development | 9,080 | 4.2% | 8,855 | 3.9% | 9,411 | 3.8% |
| - Property investment | 26,023 | 11.9% | 27,431 | 11.9% | 29,766 | 12.0% |
| - Financial concerns | 1,932 | 0.9% | 2,542 | 1.1% | 2,699 | 1.1% |
| - Stockbrokers | 659 | 0.3% | 550 | 0.2% | 1,190 | 0.5% |
| - Wholesale and retail trade | 1,469 | 0.7% | 2,405 | 1.0% | 3,265 | 1.3% |
| - Manufacturing | 1,934 | 0.9% | 2,055 | 0.9% | 2,177 | 0.9% |
| - Transport and transport equipment | 4,345 | 2.0% | 3,642 | 1.6% | 3,794 | 1.5% |
| - Recreational activities | 285 | 0.1% | 285 | 0.1% | 45 | — |
| - Information technology | 5 | — | 4 | — | 8 | — |
| - Others ⁽¹⁾ | 9,673 | 4.4% | 9,954 | 4.3% | 13,006 | 5.3% |
| - Sub-total | <u>55,405</u> | <u>25.4%</u> | <u>57,723</u> | <u>25.0%</u> | <u>65,361</u> | <u>26.4%</u> |
| Individuals | | | | | | |
| - Loans for the purchase of flats in the GHOS, PSPS and TPS | 1,041 | 0.5% | 1,318 | 0.6% | 1,529 | 0.6% |
| - Loans for the purchase of other residential properties | 36,245 | 16.6% | 24,297 | 10.5% | 25,220 | 10.2% |
| - Credit card advances | 2,619 | 1.2% | 2,997 | 1.4% | 2,675 | 1.1% |
| - Others ⁽²⁾ | 5,450 | 2.5% | 6,553 | 2.8% | 8,839 | 3.5% |
| - Sub-total | <u>45,355</u> | <u>20.8%</u> | <u>35,165</u> | <u>15.3%</u> | <u>38,263</u> | <u>15.4%</u> |
| Total loans for use in Hong Kong | 100,760 | 46.2% | 92,888 | 40.3% | 103,624 | 41.8% |
| Trade finance | 3,714 | 1.7% | 2,905 | 1.3% | 2,652 | 1.1% |
| Loans for use outside Hong Kong ⁽³⁾ | 113,710 | 52.1% | 134,546 | 58.4% | 141,378 | 57.1% |
| Total advances to customers | <u>218,184</u> | <u>100.0%</u> | <u>230,339</u> | <u>100.0%</u> | <u>247,654</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.

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.⁽¹⁾

| | As at 31 December | | | | | |
|---|-------------------|------------------------|----------------|------------------------|----------------|------------------------|
| | 2007 | Percentage of total | 2008 | Percentage of total | 2009 | Percentage of total |
| (in HK\$ millions, except percentages) | | | | | | |
| Hong Kong | 123,539 | 56.6% | 112,038 | 48.7% | 121,538 | 49.1% |
| People's Republic of China ⁽²⁾ | 62,518 | 28.7% | 85,741 | 37.2% | 93,084 | 37.6% |
| Other Asian Countries ⁽³⁾ | 10,340 | 4.7% | 10,798 | 4.7% | 10,103 | 4.1% |
| Others ⁽⁴⁾ | 21,787 | 10.0% | 21,762 | 9.4% | 22,929 | 9.2% |
| Total | <u>218,184</u> | <u>100.0%</u> | <u>230,339</u> | <u>100.0%</u> | <u>247,654</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 Concentration

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 31 December 2009, the Group's exposure to its 20 largest borrowers (including groups of individuals and companies) amounted to approximately HK\$32,796 million, or approximately 13.2% of the Group's gross advances, with the largest accounting for HK\$4,152 million, or approximately 1.7% 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.

Advance Analysis

As a significant proportion of the Group's gross advances are made for the purchase of residential property, as at 31 December 2007, 2008 and 2009, approximately 28.4%, 24.1% and 24.8% of advances had a remaining maturity of more than five years, respectively.

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 | | | | | | |
|--|----------------|------------------------|----------------|------------------------|----------------|------------------------|
| | 2007 | Percentage of total | 2008 | Percentage of total | 2009 | Percentage of total |
| (in HK\$ millions, except percentages) | | | | | | |
| Repayable on demand ⁽¹⁾ | 4,200 | 1.9% | 4,437 | 1.9% | 4,354 | 1.8% |
| 3 months or less | 35,394 | 16.2% | 42,013 | 18.2% | 35,254 | 14.2% |
| 1 year or less but over 3 months | 33,382 | 15.3% | 40,712 | 17.7% | 45,088 | 18.2% |
| 5 years or less but over 1 year | 82,678 | 37.9% | 85,835 | 37.3% | 100,683 | 40.7% |
| After 5 years | 61,831 | 28.4% | 55,411 | 24.1% | 61,516 | 24.8% |
| Undated | 699 | 0.3% | 1,931 | 0.8% | 759 | 0.3% |
| Gross advances to customers | <u>218,184</u> | <u>100.0%</u> | <u>230,339</u> | <u>100.0%</u> | <u>247,654</u> | <u>100.0%</u> |

Note:

(1) Includes overdrafts.

As at 31 December 2007, 2008 and 2009, approximately 87.2%, 93.4% and 86.6% 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 3% below the prime rate (which is currently 5.25%). The interest rate for Hong Kong dollar consumer finance advances is typically calculated on the initial principal amounts of such advances and typically ranges from 0.2% to 1.2% per month flat for fixed rate products and from 3.5% (P-1.75%) to 7.25% (P+2%) per annum for prime based products. 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 2007, 2008 and 2009, approximately 50.5%, 44.8% and 46.9%, respectively, of advances made by the Group were denominated in Hong Kong dollars, approximately 15.2%, 17.6% and 15.6%, respectively, were denominated in U.S. dollars and approximately 26.2%, 30.5% and 30.2%, 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 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 |
| (in HK\$ millions, except percentages) | | | | | | |
| 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 |
| (in HK\$ millions, except percentages) | | | | | | |
| 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 31 December 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 31 December 2009 | | | | | | |
|---|--------------------|---------------------|---------------------------|---------------------|----------------|---------------------|
| | HK dollar advances | | Foreign currency advances | | Total | |
| | Amount | Percentage of total | Amount | Percentage of total | Amount | Percentage of total |
| (in HK\$ millions, except percentages) | | | | | | |
| Fixed rate | 21,054 | 18.4% | 12,153 | 9.1% | 33,207 | 13.4% |
| Floating rate | 93,498 | 81.6% | 120,949 | 90.9% | 214,447 | 86.6% |
| Total | <u>114,552</u> | <u>100.0%</u> | <u>133,102</u> | <u>100.0%</u> | <u>247,654</u> | <u>100.0%</u> |

As at 31 December 2007, 2008 and 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 Issuer'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 43.5%, 38.4% and 43.3% for the years ended 31 December 2007, 2008 and 2009, respectively, which is above the statutory minimum ratio of 25%.

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 |
| (in HK\$ millions) | | | |
| Credit Committee | Any amount | Any amount | Any amount |
| Division Head | 80 (20) ⁽¹⁾ | 80 | 20 |
| Department Head | 30 (5) ⁽¹⁾ | 30 | 2 |
| Manager (Levels M4 to SM2) | 1.5 (0.5) to 7.5 (3.5) ⁽¹⁾ | 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 in Hong Kong (excluding advances under GHOS, PSPS and TPS) are limited to 60% (for property value at or above HK\$20 million) and 70% (for property value below HK\$20 million, and maximum loan amount being capped at HK\$12 million). 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 2007, 2008 and 2009, property lending (excluding advances under GHOS, PSTS and TPS) accounted for approximately 32.7%, 26.3% and 26.0%, 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 2007, 2008 and 2009, home mortgage advances (including advances under GHOS, PSPS and TPS) in Hong Kong amounted to HK\$37,286 million, HK\$25,615 million and HK\$26,749 million, respectively, or approximately 17.1%, 11.1% and 10.8%, 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 2007, 2008 and 2009, BEA's PRC exposure is approximately 36.0%, 42.1% and 40.9%, respectively, of the Group's total advances and its PRC classified advances account for approximately 0.3%, 0.3% and 0.2%, 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 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.

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.

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

| | Years ended 31 December | | |
|--|-------------------------|--------------|--------------|
| | 2007 | 2008 | 2009 |
| (in HK\$ millions, except percentages) | | | |
| Provisions for impairment allowance: | | | |
| Beginning balance | 732 | 728 | 1,076 |
| Provision during the period/year | 414 | 779 | 1,246 |
| Bad debts charges recovered | (198) | (221) | (141) |
| Loans written-off | (341) | (351) | (885) |
| Other movements | 121 | 141 | 89 |
| Closing balance | <u>728</u> | <u>1,076</u> | <u>1,385</u> |
| Provisions for impairment allowance as a percentage of: | | | |
| Total loans at period/year end | 0.3% | 0.5% | 0.6% |
| Total impaired loans at period/year end | 58.6% | 67.8% | 56.6% |
| Write-offs as a percentage of: | | | |
| Average total loans during the period/year | 0.2% | 0.2% | 0.4% |
| Total loans at period/year end | 0.2% | 0.2% | 0.4% |
| Total impaired loans at period/year end | 27.5% | 22.1% | 36.2% |

As at 31 December 2009, the provision for impairment allowance was HK\$1,385 million which had increased by HK\$309 million as compared with the provision as at 31 December 2008 (HK\$1,076 million). A larger provision was recorded as at 31 December 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 year ended 31 December 2009, HK\$141 million of bad debts had been recovered, which represents a decrease of HK\$80 million as compared against the bad debts recovered for the year ended 31 December 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 2007, 2008 and 2009, the Group's ten largest impaired loans accounted for approximately 0.3%, 0.3% and 0.4%, respectively, of its total advances and approximately 52.7%, 43.4% and 41.9%, 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 71.1%, 45.8% and 66.0% of the aggregate exposure relating to such ten largest impaired loans as at 31 December 2007, 2008 and 2009, respectively. As at 31 December 2009, the Group's exposure under its ten largest impaired loans ranged from HK\$59 million to HK\$225

million per impaired loan, and amounted to approximately HK\$1,026 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.

As at 31 December 2007, 2008 and 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 | | |
|--|--|--------------|--------------|
| | 2007 | 2008 | 2009 |
| | (in HK\$ millions, except percentages) | | |
| Gross impaired loans | 1,242 | 1,586 | 2,448 |
| Aggregate individual impairment loss allowance | <u>264</u> | <u>523</u> | <u>534</u> |
| Net impaired loans | <u>978</u> | <u>1,063</u> | <u>1,914</u> |
| Gross impaired loans as a percentage of total loan portfolio | 0.6% | 0.7% | 1.0% |
| Net impaired loans as a percentage of total loan portfolio | 0.4% | 0.5% | 0.8% |

Held-to-maturity Debt Securities

The Group's held-to-maturity debt securities included listed and unlisted debt securities. As at 31 December 2007, 2008 and 2009, the book value of these securities were HK\$10,761 million, HK\$5,006 million and HK\$7,239 million, respectively, which represented approximately 30.5%, 16.9% and 13.6% 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 Issuer (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 30 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 the 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 31 December 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 31 December 2009, amounted to HK\$429,000 (U.S.\$55,000).

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.

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 | | | | | |
|--|-------------------|---------------|--------------|---------------|--------------|---------------|
| | 2007 | | 2008 | | 2009 | |
| | Amount | Percentage | Amount | Percentage | Amount | Percentage |
| (in HK\$ millions, except percentages) | | | | | | |
| Held-to-maturity securities issued by: | | | | | | |
| Central governments and central banks | 5,411 | 50.3% | 243 | 4.8% | 1,510 | 20.9% |
| Public sector entities | 664 | 6.2% | 318 | 6.4% | 621 | 8.6% |
| Banks and other financial institutions | 3,507 | 32.6% | 3,344 | 66.8% | 4,328 | 59.8% |
| Corporate entities | <u>1,179</u> | <u>10.9%</u> | <u>1,101</u> | <u>22.0%</u> | <u>780</u> | <u>10.7%</u> |
| Total | <u>10,761</u> | <u>100.0%</u> | <u>5,006</u> | <u>100.0%</u> | <u>7,239</u> | <u>100.0%</u> |

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 three Senior Advisors; four Deputy Chief Executives; Head of Risk Management Division; Head of Strategic Planning & Control Division and 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.

As at 31 December 2008, the combined currency asset-liability gap position for BEA's local Hong Kong banking operations were as follows:

| | <u>Total</u> | <u>Up to 1 month</u> | <u>1 month to 3 months</u> | <u>3 months to 6 months</u> | <u>6 months to 12 months</u> | <u>Greater than 1 year</u> |
|---|----------------|--------------------------|--------------------------------|---------------------------------|----------------------------------|--------------------------------|
| (in HK\$ millions) | | | | | | |
| ASSETS | | | | | | |
| 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 | <u>17,246</u> | <u>7,202</u> | <u>4,993</u> | <u>4,791</u> | <u>253</u> | <u>7</u> |
| 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> |
| LIABILITIES | | | | | | |
| 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 | <u>968</u> | <u>738</u> | <u>30</u> | <u>100</u> | <u>100</u> | <u>—</u> |
| 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 | <u>—</u> | <u>32</u> | <u>(4,823)</u> | <u>(3,651)</u> | <u>(206)</u> | <u>8,648</u> |
| 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 31 December 2009, the combined currency asset-liability gap position for BEA's local Hong Kong banking operations were as follows:

| | <u>Total</u> | <u>Up to 1 month</u> | <u>1 month to 3 months</u> | <u>3 months to 6 months</u> | <u>6 months to 12 months</u> | <u>Greater than 1 year</u> |
|---|----------------|--------------------------|--------------------------------|---------------------------------|----------------------------------|--------------------------------|
| (in HK\$ millions) | | | | | | |
| ASSETS | | | | | | |
| Total loans | 113,053 | 97,978 | 9,493 | 2,268 | 2,138 | 1,176 |
| Total investments | 28,860 | 3,246 | 9,378 | 1,144 | 770 | 14,322 |
| Placements | 78,378 | 42,449 | 18,674 | 10,716 | 6,134 | 405 |
| Others | <u>15,248</u> | <u>11,973</u> | <u>1,838</u> | <u>448</u> | <u>934</u> | <u>55</u> |
| Total assets | <u>235,539</u> | <u>155,646</u> | <u>39,383</u> | <u>14,576</u> | <u>9,976</u> | <u>15,958</u> |
| LIABILITIES | | | | | | |
| Total deposits | 209,868 | 161,078 | 34,361 | 12,084 | 2,322 | 23 |
| Acceptances | 3,407 | 1,489 | 1,383 | 487 | 48 | 0 |
| Certificates of deposit and Subordinated notes | 19,576 | 305 | 5,144 | 994 | 4,265 | 8,868 |
| Others | <u>1,093</u> | <u>1,093</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> |
| Total liabilities | <u>233,944</u> | <u>163,965</u> | <u>40,888</u> | <u>13,565</u> | <u>6,635</u> | <u>8,891</u> |
| Off-balance-sheet items | <u>(615)</u> | <u>839</u> | <u>(4,299)</u> | <u>(3,309)</u> | <u>4,246</u> | <u>1,908</u> |
| Asset-Liability Gap | <u>980</u> | <u>(7,480)</u> | <u>(5,804)</u> | <u>(2,298)</u> | <u>7,587</u> | <u>8,975</u> |

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

| | As at 31 December 2009 | | | As at 31 December 2008 | | |
|---|------------------------|------------------|------------------|------------------------|------------------|------------------|
| | HK\$ | U.S.\$ | RMB | HK\$ | U.S.\$ | RMB |
| | HK\$ millions | HK\$ millions | HK\$ millions | HK\$ millions | HK\$ millions | HK\$ millions |
| Impact on earnings over the next 12 months if interest rates rise by 200 basis points | (112) | (72) | (25) | 64 | (26) | 185 |
| Impact on economic value if interest rates rise by 200 basis points | (231) | (312) | (152) | (98) | (203) | 113 |

Given the re-pricing position of the assets and liabilities for BEA as at 31 December 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 to decrease by HK\$112 million, HK\$72 million and HK\$25 million, respectively, and the economic value for BEA to decrease by HK\$231 million, HK\$312 million and HK\$152 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 43.5%, 38.4% and 43.3% for the years ended 31 December 2007, 2008 and 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 Issuer 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 "*— Asset Quality — Held-to-maturity Debt Securities*".

As at 31 December 2007, 2008 and 2009, approximately 87.2%, 93.4% and 86.6%, 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.

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 2007, 2008 and 2009. Average balances of interest-earning assets and interest-bearing liabilities for the years ended 31 December 2007, 2008 and 2009 are based on the arithmetic mean of the respective balances at the beginning and the end of such period.

| | Years ended 31 December | | | | | | | | |
|---|-------------------------|---------------|------------------------|--------------------|---------------|------------------------|--------------------|---------------|------------------------|
| | 2007 | | | 2008 | | | 2009 | | |
| | Average balance | Interest | Average rate (%) | Average balance | Interest | Average rate (%) | Average balance | Interest | Average rate (%) |
| (in HK\$ millions, except percentages) | | | | | | | | | |
| ASSETS | | | | | | | | | |
| Interest-earning assets | | | | | | | | | |
| Customer loans and credit advances to customers . . . | 198,373 | | | 237,112 | | | 231,914 | | |
| Trade bills less provision . . . | 703 | | | 1,121 | | | 1,156 | | |
| Total | 199,076 | 11,960 | 6.0% | 238,233 | 12,099 | 5.1% | 233,070 | 8,781 | 3.8% |
| Interbank placements and loans | | | | | | | | | |
| Cash and balances with banks | 8,397 | | | 20,451 | | | 20,915 | | |
| Money at call and short notice | 55,299 | | | 45,309 | | | 38,707 | | |
| Placements | 21,627 | | | 33,174 | | | 44,785 | | |
| Advances to banks | 2,852 | | | 1,071 | | | 1,351 | | |
| Total | 88,175 | 4,167 | 4.7% | 100,005 | 3,033 | 3.0% | 105,758 | 1,417 | 1.3% |
| Securities | | | | | | | | | |
| Treasury bills | 5,206 | | | 4,781 | | | 11,597 | | |
| Certificates of deposit | 2,692 | | | 2,347 | | | 3,109 | | |
| Debt securities | 22,825 | | | 22,514 | | | 23,263 | | |
| Total | 30,723 | 1,375 | 4.5% | 29,642 | 1,242 | 4.2% | 37,969 | 1,015 | 2.7% |
| Total interest-earning assets . | 317,974 | 17,502 | 5.5% | 367,880 | 16,374 | 4.5% | 376,797 | 11,213 | 3.0% |
| Allowance for possible loan losses | (740) | | | (735) | | | (1,247) | | |
| Non-interest earning assets . . | 25,710 | | | 29,755 | | | 34,474 | | |
| Total assets | 342,944 | | | 396,900 | | | 410,024 | | |

Years ended 31 December

| | 2007 | | | 2008 | | | 2009 | | |
|---|-----------------------|---------------------|------------------------|-----------------------|---------------------|------------------------|-----------------------|---------------------|------------------------|
| | Average balance | Interest | Average rate (%) | Average balance | Interest | Average rate (%) | Average balance | Interest | Average rate (%) |
| (in HK\$ millions, except percentages) | | | | | | | | | |
| LIABILITIES | | | | | | | | | |
| Interest-bearing liabilities | | | | | | | | | |
| Deposits | | | | | | | | | |
| Deposits from customers | 239,206 | 9,128 | 3.8% | 291,922 | 7,678 | 2.6% | 319,289 | 3,395 | 1.1% |
| Deposits and balances of banks | <u>39,656</u> | <u>1,144</u> | 2.9% | <u>34,346</u> | <u>901</u> | 2.6% | <u>19,959</u> | <u>247</u> | 1.2% |
| Total deposits | <u>278,862</u> | <u>10,272</u> | 3.7% | <u>326,268</u> | <u>8,579</u> | 2.6% | <u>339,248</u> | <u>3,642</u> | 1.1% |
| Other liabilities | | | | | | | | | |
| Certificates of deposits | 9,002 | | | 9,138 | | | 3,313 | | |
| Debt securities issued | — | | | — | | | 4,323 | | |
| Loan capital | <u>12,201</u> | | | <u>12,932</u> | | | <u>11,825</u> | | |
| Total | <u>21,203</u> | <u>425</u> | 2.0% | <u>22,070</u> | <u>301</u> | 1.4% | <u>19,461</u> | <u>137</u> | 0.7% |
| Total interest-bearing liabilities | 300,065 | 10,697 | 3.6% | 348,338 | 8,880 | 2.5% | 358,709 | 3,779 | 1.1% |
| Non interest-bearing liabilities | <u>14,391</u> | | | <u>15,272</u> | | | <u>19,222</u> | | 0.7% |
| Total liabilities | <u>314,456</u> | | | <u>363,610</u> | | | <u>377,931</u> | | 1.1% |
| NET INTEREST INCOME | | <u>6,805</u> | | | <u>7,494</u> | | | <u>7,434</u> | |
| NET INTEREST SPREAD | | | 1.9% | | | 2.0% | | | 1.9% |

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 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 regulatory changes relevant to the operations of the Group.

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 April 2010, the Board of Directors of BEA comprised the following individuals:

| Name | Age | Title | Address |
|---------------------------------------|-----|--|---|
| Dr. The Hon. Sir David Li Kwok-po . | 71 | 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 | 59 | 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 | 81 | Independent Non-executive Director | 76th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong |
| Mr. Aubrey Li Kwok-sing | 60 | Non-executive Director | 19th Floor, St. George's Building, 2 Ice House Street, Central, Hong Kong |
| Dr. William Mong Man-wai | 82 | 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 | 71 | Non-executive Director | 5th Floor, Menara PMI, No. 2 Jalan Changkat Ceylon, 50200 Kuala Lumpur, Malaysia |
| Mr. Thomas Kwok Ping-kwong | 58 | Independent Non-executive Director | 46/F., Sun Hung Kai Centre, 30 Harbour Road, Hong Kong |
| Mr. Richard Li Tzar-kai | 43 | Non-executive Director | 42/F., PCCW Tower, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong |
| Mr. Kenneth Lo Chin-ming | 68 | 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 |

| <u>Name</u> | <u>Age</u> | <u>Title</u> | <u>Address</u> |
|---------------------------------------|------------|--|--|
| Mr. Stephen Charles Li Kwok-sze . . . | 50 | Non-executive Director | Unit 26-F, Star Crest — 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 | 64 | 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 |

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 71, joined the Issuer in 1969. He was appointed 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 members of the Group, and he is also the chairman or a member of various committees appointed by the Board.

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 S.H. Ho College of the Chinese University of Hong Kong.

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 and Chairman of the Saint Joseph's College Foundation Limited. He is also an Emeritus Trustee of the Cambridge Foundation, a Trustee of the Cambridge Overseas Trust and a Trustee Emeritus of the Institute for Advanced Study in Princeton. 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 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 AFFIN Holdings Berhad (listed in Malaysia), Criteria CaixaCorp, S.A. (listed in Spain), China Overseas Land & Investment Limited, COSCO Pacific Limited, Guangdong Investment Limited, The Hong Kong and China Gas Company Limited, The Hongkong and Shanghai Hotels, Limited, PCCW Limited, San Miguel Brewery Hong Kong Limited, SCMP Group Limited and

Vitasoy International Holdings Limited. He is also a director of Hong Kong Interbank Clearing Limited, The Hong Kong Mortgage Corporation Limited and IMG Worldwide Holdings, Inc. He was a director of China Merchants China Direct Investments Limited and Dow Jones & Company, Inc (listed in the United States).

Sir David is a member of the Board of Trustees of the Asia Society International Council and Asia Business Council, a member of the Crédit Agricole S.A. International Advisory Board, a member of the Deutsche Bank Asia Pacific Advisory Board, a member of the Munich Re Greater China Advisory Board, and Chairman of the Asian Youth Orchestra Board. He serves on the advisory boards of Carlos P. Romulo Foundation for Peace and Development, Federal Reserve Bank of New York's International Advisory Committee, Hospital for Special Surgery and Scripps International Network. 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, Non-executive Director

Professor Li, aged 64, was a Director of the Issuer (1995-2002) and was re-appointed a Director in January 2008. He is a director of AFFIN Holdings Berhad (listed in Malaysia). 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 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 59, was appointed 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 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 81, was appointed 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 60, was appointed 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, Kunlun Energy Company Limited, Kowloon Development Co. Ltd, Pokfulam Development Company Limited and AFFIN Bank Berhad. He was the chairman of Atlantis Asian Recovery Fund plc (listed in the Republic of Ireland), and 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 82, was appointed 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.

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 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 71, was appointed 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 (both listed in Malaysia). Dr. Khoo is also the Chairman of Laura Ashley Holdings plc (listed in London) and Corus Hotels Limited the United Kingdom, Pan Malaysian Industries Berhad (listed in Malaysia) and Morning Star Resources Limited. He is also a director of SCMP Group Limited.

Dr. Khoo is a trustee of Regent University, Virginia, USA, 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, Member of the Remuneration Committee

Mr. Kwok, aged 58, was appointed 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 serves on the Commission on Strategic Development, is a non-official member of the Provisional Minimum Wage Commission, and until 30 April 2010, he served as a government appointed Member of the Exchange Fund Advisory Committee. 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, the Business Facilitation Advisory Committee, the Council for Sustainable Development and the Construction Industry Council. 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 43, was appointed a Director in 2001. Mr. Li is an executive director and the Chairman of PCCW Limited, one of Asia's leading companies in Information and Communications Technologies. He is also the Chairman and Chief Executive of the Pacific Century Group, an executive director and the Chairman of Pacific Century Premium Developments Limited and Singapore-based

Pacific Century Regional Developments Limited (listed in Singapore). 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 68, was appointed a Director in 2005. Mr. Lo is the Chairman and Chief Executive Officer of the Industrial Bank of Taiwan, the Chairman of EverTrust Bank (USA) 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 been 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 Chairman of IBT Venture Co., 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 recognised professional accomplishments, Mr. Lo is also active in public service. He is the Vice Chairman of the Chinese National Association of Industry and Commerce, a 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 a Director in 2006. Mr. Li is a non-executive director of BEA Life and Blue Cross. 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, U.S.A., 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 50, was appointed 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 hedge funds in the United Kingdom and the United States. 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.

Mr. William DOO Wai-hoi, *BSc, MSc, G.G., Chevalier de la Légion d'Honneur, JP*
Independent Non-executive Director and Member of the Audit Committee

Mr. Doo, aged 65, was appointed a Director in 2008. He is currently the vice-chairman of New World China Land Limited and the deputy chairman of NWS Holdings 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 a deputy chairman of Taifook Securities Group Limited.

Mr. Doo is Member of 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 54, was appointed a Director in 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 of which are listed in Thailand.

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

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

Independent Non-executive Director and Member of the Audit Committee

Mr. Cheung, aged 64, was appointed a Director in 2008. He was a partner at KPMG, a leading international accounting firm in Hong Kong, until his retirement in 2001. He has extensive experience in assurance and corporate finance work, particularly in trading and manufacturing corporations in Hong Kong and the PRC. Mr. Cheung 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 Winteam Pharmaceutical Group Limited (formerly known as Wing Shan International Limited).

Mr. Cheung is currently an independent non-executive director, the chairman of the audit committee and the connected transactions control committee of BEA(China).

Dr. Isidro FAINÉ CASAS

Non-executive Director and Member of the Nomination Committee

Dr. Fainé, aged 67, was appointed a Director in June 2009. Dr. Fainé is the Chairman of the following companies: (i) Criteria CaixaCorp, S.A., the holding company of the largest industrial and financial investment group in Spain (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 controlling shareholder of Criteria CaixaCorp, S.A. and (iii) "la Caixa" Foundation.

Dr. Fainé currently holds chairmanships and directorships in other listed companies as follows: (i) First Deputy Chairman of Abertis Infraestructuras, S.A. (infrastructure manager, listed in Spain), (ii) Deputy Chairman of Telefónica, S.A. (integrated operator in the telecommunication sector, listed in Spain), (iii) Second Deputy Chairman of Repsol YPF, S.A. (oil company, listed in Spain), (iv) Director of Banco BPI, S.A. (financial and multi-specialist group focusing on the banking business, listed in Portugal) and (v) Director of Grupo Financiero Inbursa, S.A.B. de C.V. (financial and banking group, listed in Mexico).

Dr. Fainé was 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, Chairman of the Association of Spanish Savings Banks and Chairman of the Association of Catalan Savings Banks. He is also Chairman of the Spanish Confederation of Directors and Executives and the Spanish Chapter of the Club of Rome. He has been a member of the Executive Committee of the Deposit Guarantee Fund for Savings Bank since 2007.

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 “la Caixa” and was appointed Deputy Executive General Manager in 1982. He was appointed General Manager in 1999 and was further appointed Chairman of “la Caixa” in 2007.

Among other academic and professional qualifications, Dr. Fainé holds a PhD in Economic and Business Sciences, an International Senior Managers Program 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. Li, aged 36, joined the Issuer 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. Li is primarily responsible for the overall management and control of the Issuer’s business in Hong Kong, including corporate banking, personal banking, wealth management, insurance and retirement benefits. He is also a director of various members of the Group and a member of various committees appointed by the Board.

Mr. 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. Li is a member of the Ninth and Tenth Guangdong Provincial Committees of the Chinese People’s Political Consultative Conference (“CPPCC”) and was formerly a member of the Ninth and Tenth Guangzhou Committees of the CPPCC. He is also a member of the Ninth and Tenth Committees of the All-China Youth Federation, the Deputy Chairman of the Ninth Committee of the Beijing Youth Federation and a Counsellor of the Hong Kong United Youth Association. 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 the 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. Li holds a Master Degree in Management from Kellogg Graduate School of Management, Northwestern University, Evanston, Illinois, United States, and a Bachelor of Arts Degree and a Master of Arts Degree in Law from the University of Cambridge, United Kingdom. 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. Li, aged 35, 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 Issuer'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.

Mr. Li is currently an Independent Non-executive Director of Towngas China Company Limited, an Independent Director of Goldwind Science & Technology Company Limited and an Alternate Director of AFFIN Bank Berhad.

Mr. 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 the Hong Kong-Taiwan Business Cooperation Committee, 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. Li is a Member of the Hong Kong Institute of Certified Public Accountants and a Member of Treasury Markets Association. Mr. Li is an Associate of The Institute of Chartered Accountants in England and Wales and holds an MBA from Stanford University as well as an MA and a 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 Issuer 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 Issuer from 1997 to March 2009. He was promoted to Deputy Chief Executive & Chief Investment Officer in April 2009. Mr. Li is primarily responsible for the Issuer's investment activities and treasury & broking operations including treasury markets, as well as the management of East Asia Securities and East Asia Futures. He is also a director of various members of the Group and a member of various committees appointed by the Board.

Mr. Li is currently an Independent Non-executive Director and the Chairman of Audit Committee of China Merchants China Direct Investments Limited.

Mr. 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 51, joined the Issuer in 1975. He was promoted to Assistant General Manager in 1995 and 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 Issuer. He is also a director of various members of the 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. 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 2007, 2008 and 2009, the outstanding balances of amounts due from and due to them as at 31 December 2007, 2008 and 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 | | |
| | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 |
| | (in HK\$ millions) | | | (in HK\$ millions) | | | (in HK\$ millions) | | |
| Interest income | 155 | 264 | 125 | 833 | 1,079 | 588 | 9 | 8 | 3 |
| Interest expense | 134 | 88 | 25 | 204 | 148 | 560 | — | — | — |
| Amounts due from . . . | 10,448 | 8,209 | 6,971 | 17,964 | 16,398 | 12,719 | 213 | 124 | 626 |
| Amounts due to | 3,961 | 3,696 | 5,147 | 1,634 | 1,994 | 1,642 | 10 | 7 | 4 |
| Maximum amounts due from | 11,361 | 12,429 | 10,443 | 23,699 | 22,072 | 15,953 | 422 | 446 | 924 |
| Maximum amounts due to | 8,593 | 8,527 | 9,826 | 1,894 | 2,850 | 2,295 | 62 | 34 | 14 |

PRINCIPAL SHAREHOLDERS' AND DIRECTORS' INTERESTS

REGISTERED SHAREHOLDERS

As at 30 April 2010, the following corporations were holding 5% or more of the issued ordinary shares of BEA according to its Register of Members:

| Name of Shareholder | Number of shares held | Percentage of shares |
|--|-----------------------|----------------------|
| HKSCC Nominees Limited | 1,545,595,099 | 76.09 |
| The Bank of East Asia (Nominees) Limited | 170,791,164 | 8.41 |

INTERESTS OF SUBSTANTIAL SHAREHOLDERS AND OTHER PERSONS

As at 30 April 2010, 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 ordinary shares of the Issuer:

| 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 | 302,258,869 ¹ | 14.99 | 14.1.2010 |
| Criteria CaixaCorp, S.A. | Interest of corporation | 302,258,869 ¹ | 14.99 | 14.1.2010 |
| Caja de Ahorros y Pensiones de Barcelona . | Interest of corporation | 302,258,869 ¹ | 14.99 | 14.1.2010 |
| Guoco Management Company Limited | Beneficial owner | 162,003,726 ^{2,3} | 8.03 ⁴ | — |
| Guoco Group Limited | Interest of corporation | 162,003,726 ² | 8.03 | 9.2.2010 |
| GuoLine Overseas Limited. | Interest of corporation | 162,003,726 ^{2,3} | 8.03 ⁴ | — |
| GuoLine Capital Assets Limited. | Interest of corporation | 162,003,726 ² | 8.03 ⁴ | — |
| Hong Leong Company (Malaysia) Berhad . . | Interest of corporation | 162,003,726 ^{2,3} | 8.03 | 9.2.2010 |
| HL Holdings Sdn Bhd | Interest of corporation | 162,003,726 ² | 8.03 | 9.2.2010 |
| Quek Leng Chan | Interest of corporation | 162,003,726 ² | 8.03 | 9.2.2010 |
| Hong Leong Investment Holdings Pte. Ltd. . | Interest of corporation | 162,003,726 ³ | 8.03 | 9.2.2010 |
| Davos Investment Holdings Private Limited | Interest of corporation | 162,003,726 ³ | 8.03 | 9.2.2010 |
| Kwek Leng Kee | Interest of corporation | 162,003,726 ³ | 8.03 | 9.2.2010 |

Notes:

- 1 As at 31 December 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 302,258,869 shares held by Negocio de Finanzas e Inversiones I, S.L.U. These 302,258,869 shares represented approximately 14.88% of the issued share capital of the Issuer as at 30 April 2010.

- 2 The references to 162,003,726 shares of the Issuer in Notes 2 and 3 relate to the same block of shares. Guoco Management Company Limited was the beneficial owner of 162,003,726 shares (equivalent to approximately 7.98% of the issued share capital of the Issuer as at 30 April 2010). Hong Leong Company (Malaysia) Berhad was deemed to be interested in the 162,003,726 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 owned a 100% interest in Guoco Management Company Limited. GuoLine Capital Assets Limited, GuoLine Overseas Limited and Guoco Group Limited were all deemed to be interested in the 162,003,726 shares held by Guoco Management Company Limited.

Quek Leng Chan was deemed to be interested in the 162,003,726 shares held by Guoco Management Company Limited by virtue of his 100% interest in HL Holdings Sdn Bhd (“**HLH**”). Hong Leong Company (Malaysia) Berhad was held as to 46.68% and 2.43% by HLH and Quek Leng Chan respectively.

- 3 The references to 162,003,726 shares of the Issuer 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 in turn 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 162,003,726 shares (equivalent to approximately 7.98% of the issued share capital of the Issuer as at 30 April 2010) held by Guoco Management Company Limited by virtue of their interests in Hong Leong Company (Malaysia) Berhad.

Kwek Leng Kee was deemed to be interested in the 162,003,726 shares held by Guoco Management Company Limited by virtue of his 41.92% interest in Davos Investment Holdings Private Limited.

- 4 GuoLine Overseas Limited and GuoLine Capital Assets Limited are wholly-owned subsidiaries of Hong Leong Company (Malaysia) Berhad and Guoco Management Company Limited is a wholly-owned subsidiary of Guoco Group Limited. With the filing of the substantial shareholder notices by Hong Leong Company (Malaysia) Berhad and Guoco Group Limited, GuoLine Overseas Limited, GuoLine Capital Assets Limited and Guoco Management Company Limited 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 or underlying shares of BEA were recorded in the Register.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS

As at 30 April 2010, the interests and short positions of the Directors and Chief Executive of the Issuer in the shares, underlying shares and debentures of the Issuer 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 ordinary shares of the Issuer:

| Name | Capacity and nature | No. of shares | Total | % of issued share capital |
|----------------------------------|------------------------------------|---------------|-------------------------|---------------------------|
| David LI Kwok-po | Beneficial owner | 46,492,863 | | |
| | Interest of spouse | 1,514,314 | 48,007,177 ¹ | 2.36 |
| Arthur LI Kwok-cheung | Beneficial owner | 9,613,420 | | |
| | Founder of discretionary trust | 13,345,556 | 22,958,976 ² | 1.13 |
| Allan WONG Chi-yun | Beneficial owner | 339,217 | | |
| | Interest of spouse | 136 | | |
| | Founder of discretionary trust | 12,720,718 | 13,060,071 ³ | 0.64 |
| WONG Chung-hin | Beneficial owner | 51,491 | | |
| | Interest of spouse | 378,544 | 430,035 ⁴ | 0.02 |
| LEE Shau-kee | Beneficial owner | 2,092,183 | | |
| | Interest of corporation | 1,100,000 | 3,192,183 ⁵ | 0.16 |
| Aubrey LI Kwok-sing | Beneficial owner | 25,730 | | |
| | Interest of spouse | 18,626 | | |
| | Beneficiary of discretionary trust | 33,976,516 | 34,020,872 ⁶ | 1.68 |
| William MONG Man-wai | Beneficial owner | 2,042,950 | | |
| | Interest of spouse | 33,000 | | |
| | Interest of corporation | 6,041,926 | 8,117,876 ⁷ | 0.40 |
| Winston LO Yau-lai | — | — | Nil | Nil |
| KHOO Kay-peng | Interest of corporation | 5,287,213 | 5,287,213 ⁸ | 0.26 |
| Thomas KWOK Ping-kwong | — | — | Nil | Nil |
| Richard LI Tzar-kai | Interest of corporation | 5,568,860 | 5,568,860 ⁹ | 0.27 |
| Kenneth LO Chin-ming | — | — | Nil | Nil |

| <u>Name</u> | <u>Capacity and nature</u> | <u>No. of shares</u> | <u>Total</u> | <u>% of issued share capital</u> |
|------------------------------------|--|----------------------|--------------------------|----------------------------------|
| Eric LI Fook-chuen | Beneficial owner | 4,291,634 | | |
| | Founder and beneficiary of discretionary trust | 21,451,555 | | |
| | Interest of corporation | 8,819,799 | 34,562,988 ¹⁰ | 1.70 |
| Stephen Charles LI Kwok-size . . . | Beneficial owner | 11,602,560 | | |
| | Interest of children | 530,724 | | |
| | Beneficiary of discretionary trusts | 2,218,368 | 14,351,652 ¹¹ | 0.71 |
| William DOO Wai-hoi | — | — | Nil | Nil |
| KUOK Khoon-ean | — | — | Nil | Nil |
| Valiant CHEUNG Kin-piu | — | — | Nil | Nil |
| Isidro FAINÉ CASAS | — | — | Nil | Nil |

Notes:

- 1 David LI Kwok-po was the beneficial owner of 46,492,863 shares and he was deemed to be interested in 1,514,314 shares through the interests of his spouse, Penny POON Kam-chui.
- 2 Arthur LI Kwok-cheung was the beneficial owner of 9,613,420 shares. Arthur LI Kwok-cheung made a voluntary disclosure of 13,345,556 shares held by a discretionary trust of which he is the founder but has no influence on how the trustee exercises his discretion.
- 3 Allan WONG Chi-yun was the beneficial owner of 339,217 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 12,720,718 shares held by a discretionary trust, The Wong Chung Man 1984 Trust, of which Allan WONG Chi-yun was a founder.
- 4 WONG Chung-hin 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.
- 5 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 39.88% 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.
- 6 Aubrey LI Kwok-sing was the beneficial owner of 25,730 shares and he was deemed to be interested in 18,626 shares through the interests of his spouse, Elizabeth WOO. The remaining 33,976,516 shares were held by The Fook Wo Trust, a discretionary trust in which Aubrey LI Kwok-sing was one of the discretionary beneficiaries.

- 7 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.
- 8 KHOO Kay-peng was deemed to be interested in 5,287,213 shares out of which (i) 1,178,916 shares were held through Bonham Industries Limited, a company in which he held 99.9% of the issued capital, and (ii) 4,108,297 shares were held through the Malayan United Industries Berhad Group of which he is the Chairman and Chief Executive and a deemed substantial shareholder.
- 9 Richard LI Tzar-kai was deemed to be interested in 5,568,860 shares held by certain corporations in their capacity as investment managers, out of which (i) 5,390,120 shares were held by PineBridge Investments Asia Limited (“PBI A”), and (ii) 178,740 shares were held by PineBridge Investments LLC (“PBI LLC”). PBI A and PBI LLC were indirect wholly-owned subsidiaries of Chitonlink Limited which was 100% owned by Richard LI Tzar-kai.
- 10 Eric LI Fook-chuen was the beneficial owner of 4,291,634 shares, and 21,451,555 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 8,819,799 shares held by The Kowloon Dairy Limited of which he is the Chairman and Chief Executive Officer.
- 11 Stephen Charles LI Kwok-sze was the beneficial owner of 11,602,560 shares, and he was deemed to be interested in 530,724 shares through the interests of his children under the age of 18. Of the remaining 2,218,368 shares, (i) 2,034,600 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) 183,768 shares were held by a discretionary trust, Longevity Trust, of which his children under the age of 18 were beneficiaries.

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

Shares options, being unlisted physically settled equity derivatives, to subscribe for the ordinary shares of the Issuer were granted to David LI Kwok-po pursuant to the approved Staff Share Option Schemes. As at 30 April 2010, the outstanding share options were as follows:

| Name | Date of Grant | Exercise Period | Exercise | Number of shares in the options |
|----------------------------|---------------|----------------------------|---------------------------|---------------------------------|
| | | | Price per share (in HK\$) | |
| David LI Kwok-po | 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 Issuer:

| Name | Capacity and nature | Amount of debentures |
|--------------------------------|--------------------------------------|----------------------|
| David LI Kwok-po | Beneficial owner ¹ | GBP1,000,000 |
| William MONG Man-wai | Interest of corporation ² | U.S.\$2,000,000 |

Notes:

- 1 David LI Kwok-po was the beneficial owner of the above interests in the 6.125% step-up perpetual subordinated notes issued by the Bank. The perpetual subordinated notes, with a face value of GBP300 million, were issued by the Bank in 2007 and are listed on Singapore Exchange Securities Trading Limited.
- 2 The above interests in the 5.625% subordinated notes of the Issuer 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. The subordinated notes, with a principal amount of U.S.\$550,000,000 were issued by the Issuer in 2005 and are listed on The Stock Exchange of Hong Kong Limited.

IV. Interests in debentures of associated corporation of the Issuer:

| Name | Capacity and nature | Amount of debentures |
|------------------------------|---------------------------------|----------------------|
| Allan WONG Chi-yun | Interest of spouse ¹ | RMB20,000,000 |
| Eric LI Fook-chuen | Beneficial owner ² | RMB10,000,000 |

Notes:

- 1 Allan WONG Chi-yun was deemed to be interested in the Renminbi bonds issued by BEA(China), through the interests of his spouse, Margaret Kwok Chi-wai. The bonds, with an aggregate principal amount of RMB4 billion, were issued in 2009 at an annual interest rate of 2.8%.
- 2 Eric LI Fook-chuen was the beneficial owner of the above interests in the Renminbi bonds issued by The BEA (China), a wholly-owned subsidiary of the Issuer. The bonds, with an aggregate principal amount of RMB4 billion, were issued in 2009 at an annual interest rate of 2.8%.

V. Interests in Hybrid Tier I Capital Instruments:

Allan WONG Chi-yun was the beneficial owner of the following capital instruments (*Note*):

| Issuer | Type/Class of securities | Amount of debentures | No. of shares |
|--|---|----------------------|---------------|
| The Bank of East Asia, Limited | Subordinated Notes | U.S.\$4,500,000 | — |
| Innovate Holdings Limited | Preference Shares | — | 4,500 |
| The Bank of East Asia, Limited | Substitute Preference Shares (unissued) | — | 4,500 |

Note: In November 2009, the Issuer issued capital instruments qualifying as hybrid tier 1 capital with a face value of U.S.\$500 million. The capital instruments comprise 8.5% step-up subordinated notes due 2059 issued by the Issuer (the “Innovate Notes”) stapled with perpetual non-cumulative step-up preference shares issued by Innovate Holdings Limited, a wholly-owned subsidiary of the Issuer (the “Innovate Preference Shares”). The Innovate Notes and the Innovate Preference Shares are listed on the SGX-ST. The substitute preference shares (being perpetual non-cumulative step-up preference shares having a par value of U.S.\$1,000 each) are to be created, and issued upon the occurrence of a Substitution Event (as defined in the circular to shareholders of the Issuer dated 11 November 2009) by the Issuer as a term of the issue of the Innovate Notes and the Innovate Preference Shares.

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.

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 July 2010 and the HKMA Annual Report 2009, 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 14 May 2010 comprised 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 14 May 2010, there were 146 licensed banks, 24 restricted licence banks and 27 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 70 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 31 December 2009 the Group's capital adequacy ratio was approximately 13.3%⁽¹⁾. 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 decreased approximately 0.86% from HK\$10,754 billion as at 31 December 2008 to HK\$10,661 billion as at 31 December 2009.

Note

- (1) Taking into account the issuance of 167.1 million new shares at a price of HK\$ 30.60 per share in January 2010, the pro forma capital adequacy ratio would be 15.1%.

Loans and Advances

As at 31 December 2009, loans and advances to customers represented approximately 30.9% 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 0.09% from HK\$3,286 billion as at 31 December 2008 to HK\$3,289 billion as at 31 December 2009. Approximately 73.0% of loans and advances to customers extended by all authorised institutions in Hong Kong were denominated in Hong Kong dollars as at 31 December 2009, with the rest in foreign currencies. As at that date, of the total loans and advances to customers of HK\$3,289 billion extended by all authorised institutions, approximately 81.3% was classified as “Loans and Advances for use in Hong Kong plus trade finance” and approximately 18.7% 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 2009.

| Sector | Percentage of Total |
|--|------------------------|
| Building, Construction, Property Development and Investment | 26 |
| Financial Concerns (other than authorised institution) | 7 |
| Hong Kong’s visible trade | 7 |
| Manufacturing | 5 |
| Wholesale and Retail Trade | 6 |
| Transport and Transport Equipment | 6 |
| Individuals: | |
| - to purchase flats in GHOS, PSPS and TPS | 2 |
| - to purchase other residential properties | 24 |
| - other purposes | 8 |
| Others | <u>10</u> |
| Total | <u>100</u> |

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 2009, interbank lending represented approximately 35.2% of the total assets of all authorised institutions in Hong Kong, with approximately 85.5% of such lending being to banks outside Hong Kong.

FUNDING

Deposits from Customers

As at 31 December 2009, deposits from customers represented approximately 59.9% of the total liabilities of all authorised institutions in Hong Kong. Total deposits from customers of all authorised institutions increased approximately 5.3% from HK\$6,060 billion as at 31 December 2008 to HK\$6,381 billion as at 31 December 2009, of which approximately 53.0% of total customer deposits with authorised institutions were denominated in Hong Kong dollars. Hong Kong dollar deposits increased approximately 11.2% while deposits denominated in foreign currencies decreased approximately 0.6%, in each case from 31 December 2008 to 31 December 2009. As at 31 December 2009, deposits from customers with licensed banks represented approximately 99.6% of deposits from customers with all authorised institutions in Hong Kong. As at 31 December 2009, time deposit accounts, demand accounts and savings accounts accounted for approximately 46.6%, 11.1%, and 42.3%, respectively, of total deposits by customers with all authorised institutions in Hong Kong.

Interbank Funds

Interbank transactions are significant in funding the Hong Kong banking system. As at 31 December 2009, interbank liabilities represented approximately 27.0% 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 2009, approximately 81.0% 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 March 2010, the total outstanding value of negotiable certificates of deposit issued by authorised institutions in Hong Kong amounted to HK\$108,902 million, of which approximately 73.0% 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. In April 2010, a bill seeking to amend the Deposit Protection Ordinance was gazetted. Among other things, the bill seeks to increase the Deposit Protection Scheme limit from HK\$100,000 to HK\$500,000 which is intended to come into effect upon the expiry of the guarantee at the end of 2010.

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 has undergone 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 |
|---|--------------------------------|----------|----------|----------|----------|---|
| | 2004 | 2005 | 2006 | 2007 | 2008 | Annual Growth Rate (2004-2008) |
| | (in RMB, except percentages) | | | | | |
| GDP per capita | 12,336.0 | 14,053.0 | 16,165.0 | 19,524.0 | 22,698.0 | 21.08% |
| Annual disposable income of urban households per capita | 9,421.6 | 10,493.0 | 11,760.0 | 13,786.0 | 15,781.0 | 13.76% |
| Annual net income of rural households per capita | 2,936.4 | 3,254.9 | 3,587.0 | 4,140.4 | 4,760.6 | 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 Chinese citizens within the territory of the mainland China with a local currency business licence, while previously, Renminbi business could only be provided to foreign individuals, foreign-invested enterprises and local enterprises 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 April 2010, BEA (China) has 20 branches and 56 sub-branches in mainland China.

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 certain 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 alternative standardised 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 accepted 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 or incur any other liability 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 or of another company of which it is a subsidiary.

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;
- (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.

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:

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

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

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%.

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the Conditions of the Notes which (subject to modification and except for the paragraphs in italics) will be endorsed on the Certificates issued in respect of the Notes:

The U.S.\$450,000,000 6.125 per cent. Subordinated Notes due 2020 (the “**Notes**”, which expression shall in these Conditions, unless the context otherwise requires, include any further Notes issued pursuant to Condition 16) of The Bank of East Asia, Limited (the “**Issuer**”) are constituted by a trust deed (the “**Trust Deed**”) dated 16 July 2010 (the “**Issue Date**”) made between the Issuer and DB Trustees (Hong Kong) Limited (the “**Trustee**”, which expression shall include its successors(s)) as trustee for the holders (as defined below) of the Notes. The issue of the Notes was authorised by resolutions of the Committee of the Board of Directors of the Issuer on 23 June 2010. These terms and conditions (the “**Conditions**”) include summaries of, and are subject to, the detailed provisions of and definitions in the Trust Deed. Copies of the Trust Deed and the agency agreement dated 16 July 2010 (the “**Agency Agreement**”) made between the Issuer, Deutsche Bank AG, Hong Kong Branch as initial principal paying agent (the “**Principal Paying Agent**”), the other paying agents named therein (together with the Principal Paying Agent, the “**Paying Agents**”, which expression includes any successor or additional paying agents appointed from time to time in connection with the Notes), Deutsche Bank AG, Hong Kong Branch as registrar (the **Registrar**), Deutsche Bank AG, Hong Kong Branch as transfer agent (the “**Transfer Agent**”) and the Trustee are available for inspection during normal business hours by the Noteholders at the principal office for the time being of the Trustee, being at the date of issue of the Notes at 48th Floor, Cheung Kong Center, 2 Queen’s Road Central, Hong Kong, and at the specified office of each of the Agents. The Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and are deemed to have notice of those provisions of the Agency Agreement applicable to them. The Paying Agents, Registrar and Transfer Agent are together referred to as the “**Agents**” and each as “**Agent**”. References in these Conditions to an Agent shall include any successor appointed under the Agency Agreement.

1 FORM, DENOMINATION AND TITLE

1.1 Form and Denomination

The Notes are issued in registered form in denominations of U.S.\$100,000 and integral multiples of U.S.\$1,000 in excess thereof without coupons attached. A note certificate (each a “**Certificate**”) will be issued to each Noteholder in respect of its registered holding of Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the Register (as defined in Condition 2) which the Issuer will procure to be kept by the Registrar.

*Upon issue, the Notes will be represented by a Global Certificate deposited with a common depository for, and representing Notes registered in the name of a common nominee of, Euroclear Bank S.A./N.V. (“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream**”). The Conditions are modified by certain provisions contained in the Global Certificate. Except in the limited circumstances described in the Global Certificate, owners of interests in Notes represented by the Global Certificate will not be entitled to receive definitive Certificates in respect of their individual holdings of Notes. The Notes are not issuable in bearer form.*

1.2 Title

Title to the Notes passes only by transfer and registration in the Register as described in Condition 2. 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 or any writing on (other than a duly completed and signed form of transfer), 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 Conditions “**Noteholder**” and (in relation to a Note) “**holder**” means the person in whose name a Note is registered in the Register.

2 TRANSFERS OF NOTES AND ISSUE OF CERTIFICATES

2.1 Register

The Issuer will cause to be kept at the specified office of the Registrar and in accordance with the terms of the Agency Agreement a register 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 (the “**Register**”).

Each Noteholder shall be entitled to receive only one Certificate in respect of its entire holding.

2.2 Transfers

Subject to Conditions 2.5 and 2.6, a Note may be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer on the back duly completed and signed by the holder or his attorney duly authorised in writing, at the specified office of the Registrar or any of the Agents. No transfer of title to a Note will be valid unless and until entered on the Register.

Transfers of interests in the Notes evidenced by the Global Certificate will be effected in accordance with the rules of the relevant clearing systems.

2.3 Delivery of new Certificates

Each new Certificate to be issued upon transfer or exchange of Notes will, within five business days of receipt by the Registrar or the relevant Agent of the original Certificate and the duly completed and signed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address specified in the form of transfer. For the purposes of this Condition, “**business day**” shall mean a day on which banks are open for business in the city in which the specified office of the Agent with whom a Certificate is deposited in connection with a transfer or exchange is located.

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 some but not all of the Notes in respect of which a Certificate is issued are to be transferred, exchanged or redeemed, a new Certificate in respect of the Notes not so transferred exchanged or redeemed will, within five business days of receipt by the Registrar or the relevant Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred, exchanged or redeemed to the address of such holder appearing on the register of Noteholders or as specified in the form of transfer.

2.4 Formalities free of charge

Registration of transfer of Notes and issuances of new Certificates will be effected without charge by or on behalf of the Issuer or any Agent but upon (i) payment (or the giving of such indemnity as the Issuer or any Agent may reasonably require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer and (ii) the Issuer or the relevant Agent being satisfied that the regulations concerning transfer of Notes have been complied with.

2.5 Closed periods

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal, premium (if any) or interest on that Note.

2.6 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 Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Registrar and the Trustee. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3 STATUS

3.1 Subordination

- (a) The Notes constitute direct, unconditional, unsecured and, in accordance with sub-paragraph (b) below, subordinated obligations of the Issuer, ranking *pari passu* without any preference among themselves.
- (b) The claims of the holders of the Notes will, in the event of the Winding-Up (as defined in Condition 9) of the Issuer, be subordinated in right of payment in the manner provided in this Condition 3.1 and the Trust Deed (to the claims of depositors and all other unsubordinated creditors of the Issuer) and will rank, in the event of the Winding-Up of the Issuer, at least *pari passu* in right of payment with all other Subordinated Indebtedness (as defined in Condition 3.4), present and future, of the Issuer. Claims in respect of the Notes will rank in priority to the rights and claims of holders of subordinated liabilities which by their terms rank or are expressed to rank in right of payment junior to the Notes and of all classes of equity securities of the Issuer, including holders of preference shares, if any.

3.2 Waiver of Set-Off

Claims in respect of any Notes may not be set-off, or be the subject of a counterclaim, by the holder against or in respect of any obligations of the holder to the Issuer or to any other persons and the holder of any Note shall, by virtue of being the holder of any Note, be deemed to have waived all such rights of set-off and counterclaim to the fullest extent permitted by applicable law.

3.3 Noteholders to Account

In the event that any Noteholder nevertheless receives (whether by set-off or otherwise) directly in a Winding-Up Proceeding (as defined in Condition 9) in respect of the Issuer any payment by, or distribution of assets of, the Issuer of any kind or character, whether in cash, property or securities, in respect of any amount owing to it by the Issuer arising under or in connection with the Notes, other than in accordance with this Condition 3 and Clause 5 of the Trust Deed, such Noteholder shall, subject to applicable law, immediately pay an amount equal to the amount of such payment or discharge to the liquidator for the time being in the Winding-Up of the Issuer for distribution in accordance with Clause 5 of the Trust Deed and each Noteholder, by virtue of becoming a Noteholder, shall be deemed to have so agreed and undertaken with and to the Issuer and all depositors and other unsubordinated creditors of the Issuer for good consideration.

3.4 Definition

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

4 INTEREST

The Notes bear interest from and including 16 July 2010 at the rate of 6.125 per cent. per annum, payable semi-annually in arrear in equal instalments of U.S.\$30.625 per Calculation Amount (as defined below) on 16 January and 16 July in each year (each an “**Interest Payment Date**”). Each Note will cease to bear interest from the due date for redemption unless, upon due presentation, payment of principal is improperly withheld or refused. In such event it shall continue to bear interest at such rate (both before and after judgment) until whichever is the earlier of (a) 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 holder, and (b) the day seven days after the Trustee or the Principal Paying Agent has notified Noteholders of receipt of all sums due in respect of all the Notes up to that seventh day (except to the extent that there is failure in the subsequent payment to the relevant holders under these Conditions). If interest is required to be calculated for a period of less than a complete Interest Period (as defined below), the relevant day-count fraction will be determined on the basis of a 360-day year consisting of 12 months of 30 days each.

In these Conditions, the period beginning on and including 16 July 2010 and ending on but excluding the first Interest Payment Date and each successive period beginning on and including an Interest Payment Date and ending on but excluding the next succeeding Interest Payment Date is called an “**Interest Period**”.

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 period shall, save as provided above in relation to equal instalments, be equal to the product of 6.125 per cent., the Calculation Amount and the day-count fraction for the relevant period, rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

5 PAYMENTS

5.1 Payments in respect of Notes

Payments of principal and interest will be made by transfer to the registered account of the Noteholder or by U.S. dollar cheque drawn on a bank that processes payments in U.S. dollars mailed to the registered address of the Noteholder if it does not have a registered account. Payments of principal and payments of interest due otherwise than on an Interest Payment Date will only be made against surrender of the relevant Certificate at the specified office of any of the Agents. Interest on Notes due on an Interest Payment Date will be paid to the holder shown on the Register at the close of business on the date (the “**record date**”) being the fifteenth day before the relevant Interest Payment Date.

For the purposes of this Condition, a Noteholder’s “**registered account**” means the U.S. dollar account maintained by or on behalf of it with a bank that processes payments in U.S. dollars, details of which appear on the Register at the close of business, in the case of principal and interest due otherwise than on an Interest Payment Date, on the second Business Day (as defined below) before the due date for payment and, in the case of interest due on an Interest Payment Date, on the relevant record date, and a Noteholder’s “**registered address**” means its address appearing on the Register at that time.

5.2 Payments subject to Applicable Laws

Payments in respect of principal and interest on Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 7.

5.3 No commissions

No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition.

5.4 Payment on Business Days

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day (as defined below), for value 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, on the Business Day preceding the due date for payment or, in the case of a payment of principal or a payment of interest due otherwise than on an Interest Payment Date, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of an Agent.

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 or is lost in the mail.

In this Condition “**Business Day**” means a day (other than a Saturday or Sunday) on which commercial banks are open for business in Hong Kong, New York City and, in the case of presentation of a Certificate, in the place in which the Certificate is presented.

5.5 Partial Payments

If the amount of principal or interest which is due on the Notes is not paid in full, the Registrar will annotate the Register with a record of the amount of principal or interest in fact paid.

5.6 Agents

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents provided that it will at all times maintain:

- (a) a Principal Paying Agent;
- (b) a Registrar in Hong Kong;
- (c) a Paying Agent having a specified office in Singapore where the Notes may be presented or surrendered for payment or redemption, so long as the Notes are listed on the Singapore Exchange Securities Trading Limited (the “**SGX-ST**”) and the rules of that exchange so require; and
- (d) a Paying Agent with 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 termination or appointment and of any changes in specified offices will be given to the Noteholders promptly by the Issuer in accordance with Condition 12.

So long as the Notes are listed on the SGX-ST and the rules of that exchange so require, in the event that the Global Certificate is exchanged for definitive Certificates, the Issuer 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 Certificate is exchanged for definitive Certificates, announcement of such exchange shall be made 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.

6 REDEMPTION AND PURCHASE

6.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled, the Issuer will redeem the Notes at their principal amount on 16 July 2020 (the “**Maturity Date**”).

6.2 Redemption for Taxation Reasons

Subject to Condition 6.7, if the Issuer satisfies the Trustee immediately before the giving of the notice referred to below that (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction (as defined in Condition 7.2(b) below) or any change in the official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 9 July 2010, on the occasion of the next payment due in respect of the Notes the Issuer would be required to pay additional amounts as provided or referred to in Condition 7, and (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it, the Issuer may at its option, having given not less than 30 nor more than 60 days’ notice to the Noteholders in accordance with Condition 12 (which notice shall be irrevocable and shall specify the date fixed for redemption), redeem all the Notes, but not some only, at their principal amount together with interest accrued to but excluding the date of redemption, provided that no such notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer would be required to pay the additional amounts were a payment in respect of the Notes then due. Prior to the publication of any notice of redemption pursuant to this Condition 6.2, the Issuer shall deliver to the Trustee a certificate signed by two Authorised Signatories (as defined in the Trust Deed) of the Issuer stating that the requirement referred to in (a) above will apply on the occasion of the next payment due in respect of the Notes and cannot be avoided by the Issuer taking reasonable measures available to it and the Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders.

6.3 Redemption upon a Regulatory Redemption Event

Subject to Condition 6.7, the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days’ notice to the Noteholders (which notice shall be irrevocable) at their principal amount together with interest accrued to but excluding the date fixed for redemption, following the occurrence of a Regulatory Redemption Event.

A “**Regulatory Redemption Event**” occurs if the Notes in whole, and not in part, no longer qualify as term subordinated debt for inclusion in Category II - Supplementary Capital of the Issuer as a result of amendments to the relevant provisions of the Banking Ordinance or the statutory guidelines issued by the Hong Kong Monetary Authority (or any successor thereto) (the “**HKMA**”) in relation thereto after the Issue Date (excluding for the avoidance of doubt, non-qualification solely by virtue of the Issuer already having outstanding securities with an aggregate principal amount up to or in excess of the limit of Supplementary Capital permitted from time to time by the HKMA or solely as a result of any discounting requirements as to the eligibility of the Notes for such inclusion pursuant to the relevant legislation and statutory guidelines in force as at 16 July 2010).

“**Category II - Supplementary Capital**” has the meaning given to it from time to time in the HKMA Supervisory Policy Manual CA-S-7, as amended, supplemented or replaced from time to time.

“**Supplementary Capital**” has the meaning given to it from time to time in the Part 3 of the Banking (Capital) Rules (Cap. 155L) of Hong Kong, as amended, supplemented or replaced from time to time.

6.4 Purchases

Subject to Condition 6.7 below, the Issuer or any of its Subsidiaries (may at any time purchase Notes in any manner and at any price.

In these Conditions, “**Subsidiary**” means each subsidiary as defined in section 2 of the Companies Ordinance for the time being of the Issuer.

6.5 Cancellations

All Notes which are (a) redeemed or (b) purchased by or on behalf of the Issuer or any of its Subsidiaries will forthwith be cancelled and accordingly may not be held, reissued or resold. For the avoidance of doubt, this provision shall not apply to the Issuer or any of its Subsidiaries holding the Notes in a purely nominee capacity.

6.6 Notices Final

Upon the expiry of any notice as is referred to in Condition 6.2 or Condition 6.3 above, the Issuer shall be bound to redeem the Notes to which the notice refers in accordance with the terms of such Condition.

6.7 Conditions for Redemption and Purchase

Notwithstanding any other provision in these Conditions, the Notes (other than pursuant to Condition 6.1 or 9 and subject as provided below) may not be redeemed or purchased and cancelled without the prior consent of the HKMA. Accordingly (i) the Issuer shall not redeem any of the Notes (other than pursuant to Condition 6.1 or 9) and (ii) neither the Issuer nor its Subsidiaries shall purchase the Notes (as principal not as agent) unless the prior written consent of the HKMA thereto shall have been obtained provided, however, that if from time to time the consent of the HKMA is not a requirement of any such Notes to constitute Category II - Supplementary Capital (or equivalent) of the Issuer for the purposes of, and as defined in, the Banking Ordinance (Cap. 155) of Hong Kong, or any successor legislation, then the condition to the redemption or purchase and cancellation of the relevant Notes set out in this Condition 6.7 shall not apply. For the avoidance of doubt, this provision shall not apply to the Issuer or any of its Subsidiaries holding the Notes in a purely nominee capacity.

Noteholders should note that it is intended that the Notes should constitute Category II Supplementary Capital of the Issuer and, accordingly, under statutory requirements prevailing at the date hereof relating to Category II Supplementary Capital, and by virtue of the above provisions, any redemption of the Notes, other than at maturity or following an event of default, and any purchase of the Notes by the Issuer or any of its Subsidiaries, is subject to the prior written consent of the HKMA at the relevant time.

7 TAXATION

7.1 Payment without Withholding or Deduction

All payments of principal, premium (if any) and interest by or on behalf of the Issuer in respect of the Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or within the Relevant Jurisdiction, unless such withholding or deduction is required by

law. In that event the Issuer shall pay such additional amounts as will result in receipt by the Noteholders of such amounts as would have been received by them had no such withholding or deduction been required, except that no such additional amounts shall be payable in respect of any Note:

- (a) to a holder (or to a third party on behalf of a holder) who is subject to such taxes, duties, assessments or governmental charges in respect of such Note by reason of his having some connection with the Relevant Jurisdiction otherwise than merely by holding the Note or by the receipt of amounts in respect of the Note; or
- (b) (in the case of a payment of principal or premium) if the Certificate in respect of such Note is surrendered more than 30 days after the Relevant Date except to the extent that the holder would have been entitled to such additional amount on surrendering the relevant Certificate for payment on the last day of such period of 30 days; or
- (c) 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
- (d) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a Member State of the European Union.

7.2 Interpretation

In these Conditions:

- (a) “**Relevant Date**” means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received in New York City by the Principal Paying 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 shall have been given to the Noteholders; and
- (b) “**Relevant Jurisdiction**” means the Hong Kong Special Administrative Region of the People’s Republic of China (“**Hong Kong**”) or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal or interest on the Notes.

7.3 Additional Amounts

Any reference in these Conditions to principal, premium (if any) and/or interest in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable under this Condition or under any undertaking given in addition to or substitution for it under the Trust Deed.

8 PRESCRIPTION

Claims in respect of principal and interest will become prescribed unless made within 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date.

9 EVENTS OF DEFAULT

- 9.1** If default is made in the payment of principal or interest due in respect of the Notes or any of them and the default continues for a period of five Business Days in Hong Kong (in the case of principal) or 10 Business Days in Hong Kong (in the case of interest) (each such event, an “**Event of Default**”), then the Trustee at its discretion may, subject as provided in Condition 10.2, in order to enforce payment, without further notice, institute Winding-Up Proceedings in Hong Kong against the Issuer, but may take no further action in respect of such default (but without prejudice to Condition 9.2 below).
- 9.2** If an order is made or an effective resolution is passed for the Winding-Up of the Issuer in Hong Kong (except for the purposes of a reconstruction, amalgamation or reorganisation the terms of which have previously been approved by an Extraordinary Resolution of the Noteholders) (such event also, an “**Event of Default**”), then the Trustee at its discretion may, subject as provided in Condition 10.2, give written notice to the Issuer that the Notes are, and they shall forthwith thereupon become, immediately due and repayable at their principal amount together with accrued interest without further action or formality.

In these Conditions:

“**Winding-Up**” shall mean, with respect to the Issuer, a final and effective order or resolution for the bankruptcy, winding-up, liquidation, administrative receivership or similar proceeding in respect of the Issuer (as applicable); and

“**Winding-Up Proceeding**” shall mean, with respect to the Issuer, proceedings in Hong Kong for the bankruptcy, liquidation, winding-up, administrative receivership, or other similar proceeding of the Issuer (as applicable).

10 ENFORCEMENT

- 10.1** Without prejudice to Condition 9, the Trustee may, subject as provided below, at its discretion and without further notice, institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer under the Notes or the Trust Deed (other than any obligation for the payment of any principal or interest in respect of the Notes), provided that the Issuer shall not as a consequence of such proceedings be obliged to pay any sum or sums representing or measured by reference to principal or interest in respect of the Notes sooner than the same would otherwise have been payable by it.
- 10.2** The Trustee shall not be bound to take action as referred to in Condition 9 or Condition 10.1 above or any other action under the Trust Deed unless (i) it shall have been so requested in writing by Noteholders holding at least one-quarter of the principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders and (ii) it shall have been indemnified and/or secured to its satisfaction.
- 10.3** No Noteholder shall be entitled to proceed directly against the Issuer unless the Trustee having become bound so to proceed, fails to do so within a reasonable period and such failure is continuing. Subject to applicable laws, no remedy (including the exercise of any right of set-off or analogous event) other than those provided for in Condition 9 and Conditions 10.1 and 10.2 or submitting a claim in the Winding-Up of the Issuer will be available to the Trustee or the Noteholders. No Noteholder shall be entitled to institute Winding-Up Proceedings in Hong Kong (or elsewhere) against the Issuer or to submit a claim in such Winding-Up except that, if the Trustee, having become bound to institute such proceedings as aforesaid, fails to do so, or, being able and bound to submit a claim in such Winding-Up, fails to do so, in each case within a reasonable period and such failure is continuing, then any such holder may, himself institute Winding-Up Proceedings against the Issuer in Hong Kong (but not elsewhere) and/or submit a claim in such Winding-Up to the same extent (but not further or otherwise) that the Trustee would have been entitled to do.

11 REPLACEMENT OF CERTIFICATES

Should any Certificate be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

12 NOTICES

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the Register maintained by the Registrar. The Issuer shall also ensure that notices are duly given in a manner which complies with the rules and regulations of any stock exchange on which the Notes are for the time being listed. Any such notice will be deemed to have been given on the second day after being so mailed. If notification as provided above is not practicable, notice shall be given in such other manner, and shall be deemed to have been given on such date, as the Trustee may approve.

So long as the Notes are represented by a Global Certificate 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 the entitled accountholders in substitution for notification, as required by these Conditions.

13 MEETING OF NOTEHOLDERS, MODIFICATION ETC.

13.1 Provisions for Meetings

The Trust Deed contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification by Extraordinary Resolution of any of these Conditions or any of the provisions of the Trust Deed. Such a meeting may be convened by the Issuer or by the Trustee and shall be convened by the Trustee upon the request in writing of Noteholders holding not less than one-tenth of the aggregate principal amount of the outstanding Notes. The quorum at any meeting for passing an Extraordinary Resolution will be two or more persons present holding or representing more than 50 per cent. in principal amount of the Notes for the time being outstanding, or at any adjourned meeting two or more persons present whatever the principal amount of the Notes held or represented by him or them, except that at any meeting the business of which includes the modification of certain of the provisions of these Conditions and certain of the provisions of the Trust Deed (including any proposal to change the maturity of the Notes, 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 12 shall not be a reserved matter)) the necessary quorum for passing an Extraordinary Resolution will be two or more persons present holding or representing not less than two-thirds, or at any adjourned meeting not less than one-third, of the principal amount of the Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders will be binding on all Noteholders, whether or not they are present at the meeting.

In addition, a resolution in writing signed by or on behalf of Noteholders of at least 90 per cent. in aggregate principal amount of Notes for the time being outstanding who for the time being are entitled to receive notice of a meeting of Noteholders will take effect as if 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.

13.2 Modification and Waiver

The Trustee may, without the consent of the Noteholders agree 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 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. No modification to these Conditions or any other provisions of the Trust Deed shall become effective unless the Issuer shall have received prior written approval 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 as soon as practicable thereafter in accordance with Condition 12.

13.3 Exercise of Powers by Trustee

In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution), the Trustee shall have regard to the general interests of the Noteholders as a class but 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 any such exercise for individual Noteholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub division thereof and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer 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 7 and/or any undertaking given in addition to, or in substitution for, Condition 7 pursuant to the Trust Deed.

14 SUBSTITUTION

The Trustee may, without the consent of the Noteholders, agree with the Issuer to the substitution in place of the Issuer (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 3) of a Subsidiary of the Issuer, or a holding company of the Issuer or any other subsidiary of any such holding company (in each case, the “**Substitute Issuer**”), subject to (a) the prior written approval of the HKMA (if and to the extent then required), (b) the Trustee being satisfied that the interests of the Noteholders will not be materially prejudiced by the substitution, (c) (unless the Issuer’s successor in business is the Substituted Issuer) the obligations of the Substitute Issuer in these Conditions shall be guaranteed by the Issuer on equivalent terms to Condition 3 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 Agency Agreement provided that such change would not in the opinion of the Trustee be materially prejudicial to the interests of the Noteholders.

15 INDEMNIFICATION OF THE TRUSTEE

The Trust Deed contains provisions for the indemnification of, and/or the provision of security for, the Trustee and for its relief from responsibility. The Trustee is entitled to enter into business transactions with the Issuer and any entity related to the Issuer without accounting for any profit.

The Trustee may rely without liability to Noteholders on a report, confirmation or certificate or any advice of any accountants, financial advisers, financial institution or any other expert, whether or not addressed to it and whether their liability in relation thereto is limited (by its terms or by any engagement letter relating thereto entered into by the Trustee or in any other manner) by reference to a monetary cap, methodology or otherwise. The Trustee may accept and shall be entitled to rely on any such report, confirmation or certificate or advice and such report, confirmation or certificate or advice shall be binding on the Issuer, the Trustee and the Noteholders.

16 FURTHER ISSUES

The Issuer is at liberty from time to time, without the consent of the Noteholders, to create and issue further notes or bonds (whether in bearer or registered form) either (a) ranking *pari passu* in all respects (or in all respects save for the first payment of interest thereon) and so that the same shall be consolidated and form a single series with the outstanding notes or bonds of any series (including the Notes) or (b) upon such terms as to ranking, interest, conversion, redemption and otherwise as the Issuer may determine at the time of the issue. Any further notes or bonds forming a single series with the outstanding notes or bonds of any series (including the Notes) constituted by the Trust Deed or any supplemental deed shall, and any other further notes or bonds may (with the consent of the Trustee), be constituted by a deed supplemental to the Trust Deed. The Trust Deed contains provisions for convening a single meeting of the Noteholders and the holders of notes or bonds of other series in certain circumstances where the Trustee so decides.

17 CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

18 GOVERNING LAW AND SUBMISSION TO JURISDICTION

18.1 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 Clause 5 of the Trust Deed and Condition 3 shall be governed by, and construed in accordance with, Hong Kong law.

18.2 Jurisdiction of English Courts

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 and accordingly any suit, action or proceedings arising out of or in connection therewith (together referred to as “**Proceedings**”) may be brought in the courts of England. Pursuant to the Trust Deed, the Issuer has irrevocably and unconditionally submitted to the jurisdiction of such courts.

18.3 Appointment of Process Agent

Pursuant to the Trust Deed, the Issuer has irrevocably and unconditionally appointed its London branch at its registered office for the time being (now at 75 Shaftesbury Avenue, London W1D 5BB, United Kingdom (Attention: General Manager)) as its agent for service of process in England in respect of any Proceedings.

SUMMARY OF PROVISIONS RELATING TO THE NOTES WHILE IN GLOBAL FORM

The Global Certificate contains provisions, which apply to the Notes in respect of which the Global 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 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 Certificate is issued. The Trustee may allow a person with an interest in Notes in respect of which the Global 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 Certificate and in the Register of Noteholders.

TRUSTEE'S POWERS

In considering the interests of Noteholders while the Global 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 their Notes and (b) consider such interests on the basis that such accountholders were the holders of the Notes in respect of which the Global Certificate is issued.

PAYMENT

Payments of principal and interest in respect of Notes represented by the Global 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 Certificate to or to the order of the Principal Paying Agent or such other Agent as shall have been notified to the Noteholders for such purpose. Each payment will be made to, or to the order of, the person whose name is entered on the Register at the close of business on the Clearing System Business Day immediately prior to the date for payment, where Clearing System Business Day means Monday to Friday inclusive except 25 December and 1 January.

NOTICES

So long as Notes are represented by the Global Certificate and such Global Certificate is held on behalf of Euroclear or Clearstream or any alternative clearing system on behalf of which the Notes evidenced by the Global 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 Notes 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 in exchange for interests in Notes in respect of which the Global 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

Transfers of interests in the Notes 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 principal amount of Notes in respect of which the Global Certificate is issued (in which regard any certificate or other document issued by Euroclear or Clearstream (or any Alternative Clearing System) as to the principal amount of Notes represented by such Global 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.

TAXATION

The statements herein regarding taxation are based on the laws and practice in force as at the date of this Offering Circular and are subject to any changes in law or practice 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 Notes.

HONG KONG

Withholding Tax

No withholding tax is payable in Hong Kong in respect of payments of principal or interest on the Notes or in respect of any capital gains arising from the sale of the Notes.

Profits Tax

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 company, 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 person, other than a company, carrying on a trade, profession or business in Hong Kong and is in respect of the funds of that trade, profession or business and such interest is of a Hong Kong source; or
- (iii) 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, notwithstanding that the moneys in respect of which the interest is received or accrues are made available outside Hong Kong.

Pursuant to the Exemption from Profits Tax (Interest Income) Order, interest income 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*, a financial 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 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 has a Hong Kong source. However, where the sum is considered to be a capital gain in the hands of the investor who is not a financial institution, such capital gain will not be subject to Hong Kong profits tax.

Stamp Duty

No Hong Kong stamp duty is payable on the issue of a note not in bearer form. If the transfer of a non-bearer note is required to be registered in Hong Kong, stamp duty will be payable unless:

- (i) the note is denominated in a currency other than the currency of Hong Kong and is not repayable in any circumstance in the currency of Hong Kong; or
- (ii) the note constitutes loan capital (as defined in the Stamp Duty Ordinance (Cap. 117) of Hong Kong).

No Hong Kong stamp duty will be chargeable upon the issue or subsequent transfer of the Notes.

Estate Duty

No estate duty will be payable in respect of the Notes.

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 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.

SUBSCRIPTION AND SALE

SUBSCRIPTION AGREEMENT

The Issuer has entered into a subscription agreement with Citigroup Global Markets Limited, J.P. Morgan Securities Ltd. (together, the “Joint Lead Managers”), BOCI Asia Limited, Crédit Agricole Corporate and Investment Bank, The Hongkong and Shanghai Banking Corporation Limited (together, the “Co-Managers”, and together with the Joint Lead Managers, the “Managers”), dated 9 July 2010 (the “Subscription Agreement”), pursuant to which and subject to certain conditions contained therein, the Issuer agreed to sell to the Managers, and the Managers agreed to severally but not jointly subscribe and pay for the aggregate principal amount of the Notes indicated opposite its name in the following table. In addition, the Issuer has agreed to reimburse the Managers for certain of its expenses in connection with the issue of the Notes.

| | <u>Aggregate principal amount of Notes</u> |
|---|--|
| Citigroup Global Markets Limited | U.S.\$217,500,000 |
| J.P. Morgan Securities Ltd. | U.S.\$217,500,000 |
| BOCI Asia Limited | U.S.\$ 5,000,000 |
| Crédit Agricole Corporate and Investment Bank | U.S.\$ 5,000,000 |
| The Hongkong and Shanghai Banking Corporation Limited | U.S.\$ 5,000,000 |
| Total | <u>U.S.\$450,000,000</u> |

The Subscription Agreement provides that the Issuer will indemnify the Managers against certain liabilities in connection with the offer and sale of the Notes. The Subscription Agreement provides that the obligations of the Managers are subject to certain conditions precedent, and entitles the Joint Lead Managers (on behalf of the Managers) to terminate it in certain circumstances prior to payment being made to the Issuer.

The Managers and certain of their affiliates may have performed certain investment banking and advisory services for the Issuer and/or its affiliates from time to time for which they have received customary fees and expenses and may, from time to time, engage in transactions with and perform services for the Issuer and/or its affiliates in the ordinary course of their business. The Managers or certain of their affiliates may purchase the Notes and be allocated the Notes for asset management and/or proprietary purposes but not with a view to distribution.

The Managers or their respective affiliates may purchase the Notes for its or their own account and enter into transactions, including credit derivatives, such as asset swaps, repackaging and credit default swaps relating to the Notes and/or other securities of the Issuer or its subsidiaries or associates at the same time as the offer and sale of the Notes or in secondary market transactions. Such transactions would be carried out as bilateral trades with selected counterparties and separately from any existing sale or resale of the Notes to which this Offering Circular relates (notwithstanding that such selected counterparties may also be purchasers of the Notes).

SELLING RESTRICTIONS

General

The distribution of this Offering Circular or any offering material and the offering, sale or delivery of the Notes is restricted by law in certain jurisdictions. Therefore, persons who may come into possession of this Offering Circular or any offering material are advised to consult with their own legal advisers as to what restrictions may be applicable to them and to observe such restrictions. This Offering Circular may not be used for the purpose of an offer or invitation in any circumstances in which such offer or invitation is not authorised.

United States

The Notes have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in accordance with Regulation S or pursuant to any other exemption from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.

The Managers have agreed that it will offer, and sell the Notes (i) as part of their distribution at any time and (ii) otherwise until 40 days after the later of the commencement of the offering and the Closing Date, only in accordance with Rule 903 of Regulation S under the Securities Act, and it will have sent to each dealer to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S.

The Notes are being offered and sold outside of the United States to non-U.S. persons in reliance on Regulation S. In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”), each of the Managers has represented 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 Notes which are the subject of the offering contemplated by this Offering Circular as completed by the final terms in relation thereto to the public in that Relevant Member State except that it may, with effect from and including the Relevant Implementation Date, make an offer of such Notes to the public in that Relevant Member State:

- (i) if the final terms in relation to the Notes specify that an offer of those Notes may be made other than pursuant to Article 3(2) of the Prospectus Directive in that Relevant Member State (a “**Non-exempt Offer**”), following the date of publication of a prospectus in relation to such Notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, provided that any such prospectus has subsequently been completed by the final terms contemplating such Non-exempt Offer, in accordance with the Prospectus Directive, in the period beginning and ending on the dates specified in such prospectus or final terms, as applicable;
- (ii) at any time 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;
- (iii) at any time to any legal entity which has two or more of (a) an average of at least 250 employees during the last financial year; (b) a total balance sheet of more than €43,000,000 and (c) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts;
- (iv) at any time 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 nominated by the Issuer for any such offer; or

- (v) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive, provided that no such offer of Notes referred to in (ii) to (v) above shall require the Issuer or any Manager to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of Notes to the public” in relation to any Notes 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 Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, 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 in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; 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 Notes in, from or otherwise involving the United Kingdom.

Hong Kong

Each of the Managers has represented 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 Notes other than (a) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance; 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 or which do not constitute an offer to the public within the meaning of that Ordinance; and
- (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, in each case whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Notes, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance.

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 Notes or caused such Notes to be made the subject of an invitation for subscription or purchase and will not offer or sell such Notes or cause such Notes 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 such Notes, 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.

Note:

Where the Notes are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

- (a) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or
- (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

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 Notes pursuant to an offer made under Section 275 of the SFA except:

- (i) to an institutional investor or to a relevant person defined in Section 275(2) of the SFA, or to any person arising from an offer referred to in Section 275(1A) or Section 276(4)(i)(B) of the SFA;
- (ii) where no consideration is or will be given for the transfer;
- (iii) where the transfer is by operation of law; or
- (iv) as specified in Section 276(7) of the SFA.

Japan

Each of the Managers has represented and warranted that the Notes have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (the “**Financial Instruments and Exchange Act**”) and that it has not, directly or indirectly, offered or sold and will not, directly or indirectly, offer or sell any Notes in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan) or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of, a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Act and any other applicable laws and regulations of Japan.

GENERAL INFORMATION

1. **Clearing Systems:** The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg with the Common Code of 052107342. The International Securities Identification Number (ISIN) for the Notes is XS0521073428.
2. **Listing:** Approval in-principle has been received for the listing of the Notes 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.
3. **Litigation:** Neither the Issuer nor any of its subsidiaries 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, nor is the Issuer or any of its subsidiaries aware that any such proceedings are pending or threatened.
4. **Authorisations:** The Issuer has obtained all necessary consents, approvals and authorisations as may be required in connection with the issue and performance of the Notes, including, but not limited to, approval by the HKMA. The issue of the Notes was authorised by resolutions of the Committee of the Board of Directors of the Issuer passed on 23 June 2010.
5. **No Material Adverse Change:** There has been no significant change in the financial or trading position of the Issuer and the Group since 31 December 2009 and no material adverse change in the financial position or prospects of the Group since 31 December 2009.
6. **Available Documents:** Copies of the following documents may be inspected at a specified office of the Principal Paying Agent at Deutsche Bank AG, Hong Kong Branch, 48th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong:
 - (a) the Memorandum and Articles of Association of the Issuer;
 - (b) a copy of the auditors' reports of KPMG, the Issuer's external auditors, and the audited consolidated financial statements of the Issuer as at and for the years ended 31 December 2007, 2008 and 2009;
 - (c) copies of the most recent annual and interim reports (including the financial statements) published by the Issuer; and
 - (d) the Trust Deed and the Agency Agreement, each to be dated on or about 16 July 2010.

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 Issuer and interim unaudited consolidated financial statements published by the Issuer, will be made available free of charge at a specified office of the Principal Paying Agent at Deutsche Bank AG, Hong Kong Branch, 48th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

7. **Auditors:** The consolidated financial statements of the Issuer as at and for the years ended 31 December 2007, 2008 and 2009 included in this Offering Circular have been audited by KPMG, Certified Public Accountants, as stated in the auditors' report appearing in this Offering Circular in relation to such consolidated financial statements.

KPMG has given and not withdrawn its consent to the issue of this Offering Circular with references to its auditors' reports on the published annual consolidated financial statements of the Issuer for the years ended 31 December 2007, 2008 and 2009 in the form and context in which they appear.

KPMG has audited and rendered unqualified audit reports on the financial statements of the Issuer for the years ended 31 December 2007, 2008 and 2009.

8. 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 Certificate is exchanged for definitive Certificates, the Issuer 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 Certificate is exchanged for definitive Certificates, an announcement of such exchange shall be made by or on behalf of the Issuer 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.

The information set forth below has been extracted without material adjustment from the Bank's audited consolidated financial statements for the year ended 31 December 2009.

**Report of the Auditors and Audited Financial Statements of The Bank of East Asia, Limited
as at and for the Year Ended 31 December 2009**

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**Report of the Auditors and Audited Financial Statements of The Bank of East Asia, Limited
as at and for the Year Ended 31 December 2008**

| | |
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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-3 to F-106, which comprise the consolidated and the Bank statement of financial position as at 31st December 2009, and the consolidated income statement, the consolidated statement of comprehensive income, 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 accounts give a true and fair view of the state of affairs of the Bank and of the Group as at 31st December, 2009 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

11th February, 2010

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2009

| | | <u>2009</u> | <u>2008</u> |
|--|-------|----------------|-----------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| Interest income | 4 | 12,121 | 17,465 |
| Interest expense | 5 | <u>(5,374)</u> | <u>(10,672)</u> |
| Net interest income | | 6,747 | 6,793 |
| Fee and commission income | 6 | <u>2,799</u> | <u>2,618</u> |
| Fee and commission expense | | <u>(537)</u> | <u>(473)</u> |
| Net fee and commission | | 2,262 | 2,145 |
| Net trading profits/(losses) | 7 | 941 | (1,292) |
| Net result from financial instruments designated at fair value through profit or loss | 8 | (267) | (1,612) |
| Other operating income | 9 | <u>505</u> | <u>423</u> |
| Non-interest income/(expense) | | <u>3,441</u> | <u>(336)</u> |
| Operating income | | 10,188 | 6,457 |
| Operating expenses | 10 | <u>(6,129)</u> | <u>(5,779)</u> |
| Operating profit before impairment losses | | <u>4,059</u> | <u>678</u> |
| Impairment losses on loans and advances | 11 | (1,105) | (558) |
| Impairment losses on held-to-maturity investments | 27 | (9) | (44) |
| Impairment losses on available-for-sale financial assets | | (14) | (352) |
| (Charge for)/Write back of impairment losses on bank premises | 31 | <u>(13)</u> | <u>6</u> |
| Impairment losses | | <u>(1,141)</u> | <u>(948)</u> |
| Operating profit/(loss) after impairment losses | | 2,918 | (270) |
| Net (loss)/profit on sale of held-to-maturity investments | | (12) | 25 |
| Net profit on sale of available-for-sale financial assets | 12 | 102 | 197 |
| Net profit on sale of loans and receivables | | 2 | 1 |
| Net loss on sale of subsidiaries/associates | | — | (8) |
| Net profit on sale of fixed assets | | 16 | 178 |
| Valuation gains/(losses) on investment properties | 31 | 206 | (168) |
| Share of profits less losses on associates | | <u>264</u> | <u>53</u> |
| Profit for the year before taxation | | 3,496 | 8 |
| Income tax | 13 | <u>(858)</u> | <u>96</u> |
| Profit for the year after taxation | | <u>2,638</u> | <u>104</u> |
| Attributable to: | | | |
| Owners of the parent | | 2,565 | 39 |
| Minority interest | 39 | <u>73</u> | <u>65</u> |
| Profit after taxation | | <u>2,638</u> | <u>104</u> |
| Earnings per share | | HK\$ | HK\$ |
| Basic | 16 | 1.36 | 0.02 |
| Diluted | 16 | 1.36 | 0.02 |

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31ST DECEMBER, 2009

| | | <u>2009</u> | <u>2008</u> |
|---|-------|---------------------|---------------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| Net profit. | | <u>2,638</u> | <u>104</u> |
| Other comprehensive income/(expense) for the year (after taxation and reclassification adjustments): | | | |
| Premises: | | | |
| - unrealised surplus on revaluation of premises | 38(c) | 97 | 10 |
| - deferred taxes | 38(c) | (26) | 13 |
| - effect on opening balance resulting from decrease in tax rate | | — | (10) |
| - exchange differences. | | — | (1) |
| Available-for-sale investment revaluation reserve: | | | |
| - fair value changes taken to/(from) equity | 38(h) | 575 | (839) |
| - fair value changes transferred from/(to) income statement: | | | |
| - on impairment and amortisation. | 38(h) | 11 | 153 |
| - on disposal | 38(h) | (29) | (115) |
| - deferred taxes | 38(h) | (43) | 93 |
| - effect on opening balance resulting from decrease in tax rate | | — | 5 |
| Share of changes in equity of associates | 38(i) | 17 | (22) |
| Exchange differences on translation of: | | | |
| - financial statements of overseas branches, subsidiaries and associates | 38(f) | <u>163</u> | <u>356</u> |
| Other comprehensive income/(expense). | | <u>765</u> | <u>(357)</u> |
| Total comprehensive income/(expense). | | <u><u>3,403</u></u> | <u><u>(253)</u></u> |
| Total comprehensive income/(expense) attributable to: | | | |
| Owners of the parent | | 3,330 | (318) |
| Minority interest. | 39 | <u>73</u> | <u>65</u> |
| | | <u><u>3,403</u></u> | <u><u>(253)</u></u> |

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER, 2009

| | | <u>2009</u> | <u>2008</u> |
|--|-------|-------------|-------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| ASSETS | | | |
| Cash and balances with banks and other financial institutions . . | 20 | 29,712 | 28,105 |
| Placements with banks and other financial institutions | 21 | 67,945 | 96,574 |
| Trade bills | 22 | 1,847 | 1,164 |
| Trading assets | 23 | 5,722 | 3,437 |
| Financial assets designated at fair value through profit or loss . . | 24 | 10,392 | 4,130 |
| Advances to customers and other accounts | 25 | 261,803 | 243,725 |
| Available-for-sale financial assets | 26 | 30,883 | 18,560 |
| Held-to-maturity investments | 27 | 7,239 | 5,006 |
| Investments in associates | 29 | 2,615 | 2,486 |
| Fixed assets | 31 | 11,467 | 9,146 |
| - Investment properties | | 2,095 | 1,839 |
| - Other property and equipment | | 9,372 | 7,307 |
| Goodwill and intangible assets | 30 | 4,135 | 2,734 |
| Deferred tax assets | 33(b) | 322 | 187 |
| Total Assets | | 434,082 | 415,254 |
| EQUITY AND LIABILITIES | | | |
| Deposits and balances of banks and other financial institutions . | | 11,886 | 27,045 |
| Deposits from customers | | 342,528 | 323,802 |
| Trading liabilities | 34(a) | 1,455 | 2,846 |
| Certificates of deposit issued | | 2,812 | 5,491 |
| - At fair value through profit or loss | | 2,442 | 3,777 |
| - At amortised cost | | 370 | 1,714 |
| Current taxation | 33(a) | 147 | 333 |
| Debt securities issued | | 4,346 | — |
| Deferred tax liabilities | 33(b) | 520 | 77 |
| Other accounts and provisions | 34(b) | 18,506 | 12,139 |
| Loan capital | 35 | 12,359 | 11,036 |
| - At fair value through profit or loss | | 7,712 | 6,395 |
| - At amortised cost | | 4,647 | 4,641 |
| Total Liabilities | | 394,559 | 382,769 |
| Share capital | 37 | 4,623 | 4,183 |
| Reserves | 38 | 30,542 | 27,963 |
| Total equity attributable to owners of the parent | | 35,165 | 32,146 |
| Minority interest | 39 | 4,358 | 339 |
| Total Equity | | 39,523 | 32,485 |
| Total Equity and Liabilities | | 434,082 | 415,254 |

Approved and authorised for issue by the board of Directors on 11th February, 2010.

Chairman and Chief Executive

Directors

THE BANK OF EAST ASIA, LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER, 2009

| | | <u>2009</u> | <u>2008</u> |
|--|-------|-------------|-------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| ASSETS | | | |
| Cash and balances with banks and other financial institutions . . | 20 | 12,527 | 4,852 |
| Placements with banks and other financial institutions | 21 | 61,894 | 92,735 |
| Trade bills | 22 | 861 | 521 |
| Trading assets | 23 | 3,324 | 2,914 |
| Financial assets designated at fair value through profit or loss . . | 24 | 10,384 | 4,114 |
| Advances to customers and other accounts | 25 | 148,596 | 138,640 |
| Amounts due from subsidiaries | 32(a) | 12,719 | 16,398 |
| Available-for-sale financial assets | 26 | 18,935 | 10,985 |
| Held-to-maturity investments | 27 | 4,802 | 3,318 |
| Investments in subsidiaries | 28 | 13,457 | 11,673 |
| Investments in associates | 29 | 1,946 | 1,984 |
| Fixed assets | 31 | 6,220 | 5,587 |
| - Investment properties | | 1,798 | 1,819 |
| - Other property and equipment | | 4,422 | 3,768 |
| Goodwill and intangible assets | 30 | 1,460 | 1,460 |
| Deferred tax assets | 33(b) | 168 | 38 |
| Total Assets | | 297,293 | 295,219 |
| EQUITY AND LIABILITIES | | | |
| Deposits and balances of banks and other financial institutions . | | 3,521 | 1,093 |
| Deposits from customers | | 237,517 | 240,029 |
| Trading liabilities | 34(a) | 1,235 | 2,549 |
| Certificates of deposit issued | | 5,012 | 7,691 |
| - At fair value through profit or loss | | 2,442 | 3,777 |
| - At amortised cost | | 2,570 | 3,914 |
| Amounts due to subsidiaries | 32(b) | 1,642 | 1,994 |
| Current taxation | 33(a) | 18 | 60 |
| Deferred tax liabilities | 33(b) | 333 | 63 |
| Other accounts and provisions | 34(b) | 3,548 | 3,479 |
| Loan capital | 35 | 16,275 | 11,036 |
| - At fair value through profit or loss | | 11,628 | 6,395 |
| - At amortised cost | | 4,647 | 4,641 |
| Total Liabilities | | 269,101 | 267,994 |
| Share capital | 37 | 4,623 | 4,183 |
| Reserves | 38 | 23,569 | 23,042 |
| Total equity attributable to owners of the Bank | | 28,192 | 27,225 |
| Total Equity and Liabilities | | 297,293 | 295,219 |

Approved and authorised for issue by the Board of Directors on 11th February, 2010.

Chairman and Chief Executive

Directors

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31ST DECEMBER, 2009

| | Share capital | Share premium | Capital reserve—staff share options issued | Exchange revaluation reserve | Investment revaluation reserve | Revaluation reserve of bank premises | Capital reserve | General reserve | Other reserves | Retained profits | Total | Minority interest | Total 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 |
| 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 | 17 | (17) | — | — | — | — | — | 177 | — | — | 177 | — | 177 |
| Capitalisation issue | 418 | (418) | — | — | — | — | — | — | — | — | — | — | — |
| Shares issued under Staff Shares Option Schemes | 5 | 36 | — | — | — | — | — | — | — | — | 41 | — | 41 |
| Equity settled share-based transaction | — | — | 71 | — | — | — | — | — | — | — | 71 | — | 71 |
| Transfer | — | 3 | (26) | — | — | (6) | — | 55 | 285 | (311) | — | — | — |
| Dividends declared or approved during the year | — | — | — | — | — | — | — | — | — | (600) | (600) | (55) | (655) |
| Sale of interests in businesses to minority interests investors | — | — | — | — | — | — | — | — | — | — | — | 132 | 132 |
| Purchase of interests in businesses from minority interests investors | — | — | — | — | — | — | — | — | — | — | — | (10) | (10) |
| Hybrid Tier 1 note issue | — | — | — | — | — | — | — | — | — | — | — | 3,877 | 3,877 |
| Exchange adjustments | — | — | — | — | — | — | — | — | — | — | — | 2 | 2 |
| Total comprehensive income for the year | — | — | — | 163 | 514 | 71 | — | — | 17 | 2,565 | 3,330 | 73 | 3,403 |
| At 31st December, 2009 | <u>4,623</u> | <u>4,526</u> | <u>170</u> | <u>1,169</u> | <u>286</u> | <u>928</u> | <u>86</u> | <u>14,866</u> | <u>1,518</u> | <u>6,993</u> | <u>35,165</u> | <u>4,358</u> | <u>39,523</u> |
| As 1st January, 2008 | 3,936 | 1,118 | 68 | 650 | 475 | 866 | 86 | 14,004 | 22 | 8,874 | 30,099 | 347 | 30,446 |
| Changes in equity | | | | | | | | | | | | | |
| Shares issued in lieu of dividend | 38 | (38) | — | — | — | — | — | 597 | — | — | 597 | — | 597 |
| Subscription of new shares | 197 | 3,745 | — | — | — | — | — | — | — | — | 3,942 | — | 3,942 |
| Shares issued under Staff Shares Option Schemes | 12 | 88 | — | — | — | — | — | — | — | — | 100 | — | 100 |
| Equity settled share-based transaction | — | — | 66 | — | — | — | — | — | — | — | 66 | — | 66 |
| Transfer | — | 9 | (9) | — | — | (15) | — | 33 | 1,216 | (1,234) | — | — | — |
| Dividends declared or approved during the year | — | — | — | — | — | — | — | — | — | (2,340) | (2,340) | (7) | (2,347) |
| Purchase of interests in businesses from minority interests investors | — | — | — | — | — | — | — | — | — | — | — | (64) | (64) |
| Exchange adjustments | — | — | — | — | — | — | — | — | — | — | — | (2) | (2) |
| Total comprehensive income/(expense) for the year | — | — | — | 356 | (703) | 12 | — | — | (22) | 39 | (318) | 65 | (253) |
| At 31st December, 2008 | <u>4,183</u> | <u>4,922</u> | <u>125</u> | <u>1,006</u> | <u>(228)</u> | <u>863</u> | <u>86</u> | <u>14,634</u> | <u>1,216</u> | <u>5,339</u> | <u>32,146</u> | <u>339</u> | <u>32,485</u> |

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2009

| | | 2009 | 2008 |
|--|-------|--------------|--------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| OPERATING ACTIVITIES | | | |
| Profit for the year before taxation | | 3,496 | 8 |
| Adjustments for: | | | |
| Charge for impairment losses on loans and advances | 11 | 1,105 | 558 |
| Charge for impairment allowances on held-to-maturity investments, available-for-sale financial assets and associates | | 23 | 396 |
| Share of profits less losses of associates | | (264) | (53) |
| Net loss/(profit) on sale of held-to-maturity investments . . | | 12 | (25) |
| Net profit on sale of available-for-sale financial assets . . . | | (102) | (197) |
| Net loss on sale of subsidiaries, associates and equities . . | | — | 8 |
| Net profit on sale of fixed assets | | (16) | (178) |
| Interest expense on loan capital, certificates of deposit and bonds issued | | 641 | 1,014 |
| Depreciation on fixed assets | 10,31 | 512 | 437 |
| Charge for/(Write back of) impairment loss on bank premises | | 13 | (6) |
| Dividend income from available-for-sale financial assets . | | (46) | (50) |
| Amortisation of intangible assets | 10 | 13 | 3 |
| Amortisation of premium/discount on certificates of deposit and loan capital issued | | 68 | 78 |
| Revaluation losses/(gains) on certificates of deposit and loan capital issued | | 1,236 | (2,624) |
| Valuation (gains)/losses on investment properties | 31 | (206) | 168 |
| Equity-settled share-based payment expenses | | 71 | 66 |
| OPERATING PROFIT/(LOSS) BEFORE CHANGES IN WORKING CAPITAL | | 6,556 | (397) |
| (Increase)/decrease in operating assets: | | | |
| Cash and balances with banks with original maturity beyond three months | | (2,405) | (4,397) |
| Placements with banks and other financial institutions with original maturity beyond three months | | (3,875) | (18,823) |
| Trade bills | | (683) | (352) |
| Trading assets | | (2,617) | 1,410 |
| Financial assets designated at fair value through profit or loss | | (6,262) | 4,525 |
| Advances to customers | | (18,095) | (12,366) |
| Advances to banks and other financial institutions | | 172 | 1,158 |
| Held-to-maturity debt securities | | (2,056) | 5,863 |
| Available-for-sale financial assets | | (11,489) | (6,000) |
| Other accounts and accrued interest | | (1,219) | (1,323) |
| Increase/(decrease) in operating liabilities: | | | |
| Deposits and balances of banks and other financial institutions | | (15,159) | (12,015) |
| Deposits from customers | | 18,726 | 39,616 |
| Trading liabilities | | (1,391) | 474 |
| Other accounts and provisions | | 6,328 | 1,273 |
| Exchange adjustments | | (114) | 362 |

| | | 2009 | 2008 |
|--|----------|-----------------|----------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| NET CASH OUTFLOW FROM OPERATIONS | | (33,583) | (992) |
| Income tax paid | | | |
| Hong Kong profits tax paid | | (53) | (143) |
| Overseas profits tax paid | | (527) | (383) |
| NET CASH USED IN OPERATING ACTIVITIES | | <u>(34,163)</u> | <u>(1,518)</u> |
| INVESTING ACTIVITIES | | | |
| Dividends received from associates | | 190 | 163 |
| Dividends received from available-for-sale equity securities | | 46 | 50 |
| Purchase of equity securities | | (851) | (444) |
| Proceeds from sale of equity securities | | 483 | 512 |
| Purchase of intangible assets | | (1,380) | (6) |
| Purchase of fixed assets | 31 | (2,561) | (2,557) |
| Purchase of investment properties | | — | (291) |
| Proceeds from disposal of fixed assets | | 50 | 213 |
| Disposal/(Purchase) of shareholding in associates | | 36 | (18) |
| Proceeds from disposal of associates | | — | 51 |
| Purchase of subsidiaries | 43(a) | (43) | (21) |
| Proceeds from sale of interest in a subsidiary | 43(b) | 1 | — |
| Sale of interests in business to minority interest investors | | 132 | — |
| Purchase of interests in business from minority interest investors | | (10) | (64) |
| NET CASH USED IN INVESTING ACTIVITIES | | <u>(3,907)</u> | <u>(2,412)</u> |
| FINANCING ACTIVITIES | | | |
| Ordinary dividends paid | | (427) | (1,750) |
| Distribution to Hybrid Tier 1 issue holders | | (51) | — |
| Issue of ordinary share capital | 37,38(a) | 41 | 100 |
| Issue of Hybrid Tier 1 note | | 3,877 | — |
| Subscription for new shares | | — | 3,942 |
| Issue of certificates of deposit | | 594 | 4,656 |
| Issue of debt securities | | 4,334 | — |
| Redemption of certificates of deposit issued | | (3,260) | (11,434) |
| Interest paid on loan capital | | (535) | (708) |
| Interest paid on certificates of deposit issued | | (79) | (488) |
| NET CASH GENERATED FROM/(USED IN) FINANCING ACTIVITIES | | <u>4,494</u> | <u>(5,682)</u> |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | | (33,576) | (9,612) |
| CASH AND CASH EQUIVALENTS AT 1ST JANUARY | 43(c) | <u>94,106</u> | <u>103,718</u> |
| CASH AND CASH EQUIVALENTS AT 31ST DECEMBER | 43(c) | <u>60,530</u> | <u>94,106</u> |
| Cash flows from operating activities included: | | | |
| Interest received | | 12,671 | 17,514 |
| Interest paid | | 6,238 | 10,305 |
| Dividend received | | 78 | 93 |

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. Note 3 provides information on the changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these accounts.

(b) Basis of Preparation of the Accounts

The accounts for the year ended 31st December, 2009 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 major sources of estimation uncertainty are discussed in Note 49.

(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.

An investment in a subsidiary is consolidated into the consolidated accounts from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated accounts. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

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 statement of financial position and consolidated 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 income statement as an allocation of the net profit and total comprehensive income for the year between minority interests and equity holders of the Group.

In the Bank's statement of financial position, 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 and any impairment loss relating to the investment (Note 2(j) and 2(k)). The Group's share of the post-acquisition, post-tax results of the associates and any impairment losses for the year are recognised in the consolidated income statement, whereas the Group's share of the post-acquisition post-tax items of the associate's other comprehensive income is recognised in the consolidated statement of comprehensive income.

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 income statement.

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 income statement. Differences arising on translation of available-for-sale equity instruments are recognised in other comprehensive income and accumulated separately in equity in the exchange reserve.

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 other comprehensive income and accumulated separately in equity in the exchange reserve. 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**

Revenue is measured at the fair value of the consideration received or receivable. 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 income statement 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 income statement 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 income statement 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 income statement 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.

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 income statement in the period in which they arise. Upon disposal or repurchase, the difference between the net sales proceeds or the net payment and the carrying value is included in the income statement.

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.

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. Unrealised gains and losses arising from changes in the fair value are recognised in other comprehensive income and accumulated separately in equity, except for impairment losses and foreign exchange gains and losses on monetary items such as debt securities which are recognised in the income statement.

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be measured reliably, and derivatives that are linked to and must be settled by delivery of such unquoted equity securities are carried at cost less impairment losses, if any (Note 2(k)).

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 previously recognised in other comprehensive income shall be reclassified from equity to the income statement.

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 income statement on derecognition.

(v) *Offsetting*

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position 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 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 income statement.

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 in other comprehensive income and accumulated separately in equity in the hedging reserve.

(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 income statement.

The hedging instrument is measured at fair value, with fair value changes recognised in the income statement. 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 income statement 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 statement of financial position 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 income statement, 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 income statement, to the extent that a deficit on revaluation in respect of that same asset had previously been charged to the income statement.

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 HKICPA, 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).

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 income statement 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 statement of financial position 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 arising on a business combination is allocated to each cash-generating unit, or groups of cash generating units, that is expected to benefit from the synergies of the combination 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 and the investment as a whole is tested for impairment whenever there is objective evidence of impairment (Note 2(k)).

Any excess of the Group's interest in the net fair value of the 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 income statement.

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 income statement.

(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 income statement. 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 income statement. 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.

(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 in the fair value reserve is reclassified to the income statement. The amount of the cumulative loss that is recognised in the income statement 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 income statement.

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 income statement in respect of available-for-sale equity securities are not reversed through the income statement. Any subsequent increase in the fair value of such assets is recognised directly in other comprehensive income.

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 income statement.

(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 fair value less costs to sell 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 income statement 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.

Reversals of impairment losses are credited to the income statement 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 HKAS 34, 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, available-for-sale equity securities and unquoted 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. Consequently, if the fair value of an available-for-sale equity security increases in the remainder of the annual period, or in any other period subsequently, the increase is recognised in other comprehensive income and not the income statement.

(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 statement of financial position 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 statement of financial position 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 income statement 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 income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the income statement 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.

Reposessed 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 income statement.

(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 income statement except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.
- (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.

(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 income statement 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.

(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 income statement 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 resulting adjustment to the cumulative fair value recognised in prior years is charged or credited to the income statement 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 equity amount is recognised in capital reserve 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**

Operating segments, and the amounts of each segment item reported in the accounts, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

(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 ACCOUNTING POLICIES

The HKICPA has issued one new HKFRS, a number of amendments to HKFRSs and new Interpretations that are first effective for the current accounting period of the Group and the Bank. Of these, the following developments are relevant to the Group's accounts:

- HKFRS 8, *Operating segments*
- HKAS 1 (revised 2007), *Presentation of financial statements*
- Amendments to HKFRS 7, Financial instruments: *Disclosures — improving disclosures about financial instruments*
- Improvements to HKFRSs (2008)
- Amendments to HKAS 27, *Consolidated and separate financial statements — cost of an investment in a subsidiary, jointly controlled entity or associate*
- Amendments to HKFRS 2, *Share-based payment — vesting conditions and cancellations*
- HK(IFRIC) 13, *Customer loyalty programmes*

The amendments to HKFRS 2 has had no material impact on the Group's accounts as the amendments and interpretations were consistent with policies already adopted by the Group. The impact of the remainder of these developments is as follows:

- HKFRS 8 requires segment disclosure to be based on the way that the Group's chief operating decision maker regards and manages the Group, with the amounts reported for each reportable segment being the measures reported to the Group's chief operating decision maker for the purposes of assessing segment performance and making decisions about operating matters. This contrasts with the presentation of the Group's financial statements into segments based on related products and services and on geographical areas. The adoption of HKFRS 8 has resulted in the presentation of segment information in a manner that is more consistent with internal reporting provided to the Group's most senior executive management, and has resulted in additional reportable segments being identified and presented (see Note 19). Corresponding amounts have been provided on a basis consistent with the revised segment information.
- As a result of the adoption of HKAS 1 (revised 2007), details of changes in equity during the period arising from transactions with equity shareholders in their capacity as such have been presented separately from all other income and expenses in a revised consolidated statement of changes in equity. All other items of income and expense are presented

in the consolidated income statement, if they are recognised as part of profit or loss for the period, or otherwise in a new primary statement, the consolidated statement of comprehensive income. Corresponding amounts have been restated to conform to the new presentation. This change in presentation has no effect on reported profit or loss, total income and expense or net assets for any period presented.

- As a result of the adoption of the amendments to HKFRS 7, the accounts include expanded disclosures in Note 41 about the fair value measurement of the Group’s financial instruments, categorising these fair value measurements into a three-level fair value hierarchy according to the extent to which they are based on observable market data. The Group has taken advantage of the transitional provisions set out in the amendments to HKFRS 7, under which comparative information for the newly required disclosures about the fair value measurements of financial instruments has not been provided.
- The “Improvements to HKFRSs (2008)” comprise a number of minor and non-urgent amendments to a range of HKFRSs which the HKICPA has issued as an omnibus batch of amendments. The impact of these amendments are not considered to be material to the Group, except for the following, which result in changes to the Group’s accounting policies:
 - As a result of amendments to HKAS 28, *Investments in associates*, impairment losses recognised in respect of the associates carried under the equity method are no longer allocated to the goodwill inherent in that carrying value. As a result, when there has been a favourable change in the estimates used to determine the recoverable amount, the impairment loss will be reversed. Previously, the Group allocated impairment losses to goodwill and, in accordance with the accounting policy for goodwill, did not consider the loss to be reversible. In accordance with the transitional provisions in the amendment, this new policy will be applied prospectively to any impairment losses that arise in the current or future periods and previous periods have not been restated.
- The amendments to HKAS 27 have removed the requirement that dividends out of pre-acquisition profits should be recognised as a reduction in the carrying amount of the investment in the investee, rather than as income. As a result, as from 1st January, 2009, all dividends receivable from subsidiaries and associates, whether out of pre- or post-acquisitions profits, will be recognised in the Bank’s profit or loss and the carrying amount of the investment in the investee will not be reduced unless that carrying amount is assessed to be impaired as a result of the investee declaring the dividend. In such cases, in addition to recognising dividend income in profit or loss, the Bank would recognise an impairment loss. In accordance with the transitional provisions in the amendment, this new policy will be applied prospectively to any dividends receivable in the current or future periods and previous periods have not been restated.
- HK(IFRIC) 13 addresses how reporting entities that grant their customers loyalty award credits when buying goods or services should account for their obligation to provide free or discounted goods and services, if and when the customers redeem these credits. HK(IFRIC) 13 requires reporting entities to allocate some of the proceeds of the initial sales to the award credits and recognise these proceeds as revenue when they have fulfilled their obligations to provide goods or services. The effect of the adoption of HK(IFRIC) 13 was not considered to be material for the Group and therefore, the prior year figures have not been restated.

4. INTEREST INCOME

| | 2009 | 2008 |
|---|---------------|---------------|
| | HK\$ Mn | HK\$ Mn |
| Listed securities classified as held-to-maturity or available-for-sale | 264 | 261 |
| Trading assets | | |
| - listed | 13 | 2 |
| - unlisted | 28 | 8 |
| Interest rate swaps | 959 | 917 |
| Financial assets designated at fair value through profit or loss | | |
| - listed | 206 | 128 |
| - unlisted | 81 | 310 |
| Loans, deposits with banks and financial institutions, trade bills, and other unlisted securities that are not at fair value through profit or loss | <u>10,570</u> | <u>15,839</u> |
| Total interest income | <u>12,121</u> | <u>17,465</u> |

Included above is interest income accrued on impaired financial assets of HK\$79 million (2008: HK\$73 million) which includes interest income on effect of discounting of HK\$40 million (2008: HK\$12 million) (Note 25(b)) for the year ended 31st December, 2009.

5. INTEREST EXPENSE

| | <u>2009</u> | <u>2008</u> |
|---|--------------|---------------|
| | HK\$ Mn | HK\$ Mn |
| Customer deposits, deposits of banks and other financial institutions and certificates of deposit issued which are stated at amortised cost | 3,650 | 8,696 |
| Debt securities issued | 61 | — |
| Subordinated notes carried at amortised cost | 68 | 184 |
| Interest rate swaps | 1,015 | 1,062 |
| Financial instruments designated at fair value through profit or loss | 566 | 725 |
| Other borrowings | <u>14</u> | <u>5</u> |
| Total interest expense | <u>5,374</u> | <u>10,672</u> |

6. FEE AND COMMISSION INCOME

Fee and commission income arises from the following services:

| | <u>2009</u> | <u>2008</u> |
|--|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Corporate services | 806 | 818 |
| Credit cards | 554 | 462 |
| Loans, overdrafts and guarantees | 444 | 382 |
| Securities and brokerage | 320 | 255 |
| Other retail banking services | 193 | 187 |
| Trade finance | 141 | 160 |
| Trust and other fiduciary activities | 79 | 102 |
| Others | <u>262</u> | <u>252</u> |
| Total fee and commission income | <u>2,799</u> | <u>2,618</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 | 2,214 | 2,134 |
| Fee income | <u>2,680</u> | <u>2,528</u> |
| Fee expenses | <u>(466)</u> | <u>(394)</u> |

7. NET TRADING PROFITS/(LOSSES)

| | <u>2009</u> | <u>2008</u> |
|--|-------------|----------------|
| | HK\$ Mn | HK\$ Mn |
| Profit on dealing in foreign currencies | 140 | 316 |
| Profit/(Loss) on trading securities | 616 | (618) |
| Net gain/(loss) on derivatives | 153 | (1,032) |
| Loss on other dealing activities | — | (1) |
| Dividend income from listed trading securities | <u>32</u> | <u>43</u> |
| Total net trading profits/(losses) | <u>941</u> | <u>(1,292)</u> |

8. NET RESULT FROM FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

| | <u>2009</u> | <u>2008</u> |
|--|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Revaluation and disposal loss on Collateralised Debt Obligations | — | (3,549) |
| Revaluation (loss)/gain on debts issued | (1,236) | 2,624 |
| Net (loss)/profit on sale of other financial assets designated at fair value through profit or loss. | (42) | 3 |
| Revaluation gain/(loss) on other financial assets designated at fair value through profit or loss. | <u>1,011</u> | <u>(690)</u> |
| Total net result from financial instruments designated at fair value through profit or loss | <u>(267)</u> | <u>(1,612)</u> |

9. OTHER OPERATING INCOME

| | <u>2009</u> | <u>2008</u> |
|--|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Dividend income from available-for-sale financial assets | | |
| - listed | 21 | 20 |
| - unlisted. | 25 | 30 |
| Rental from safe deposit boxes | 82 | 87 |
| Net revenue from insurance activities | 180 | 99 |
| Rental income on properties | 92 | 90 |
| Others | <u>105</u> | <u>97</u> |
| Total other operating income. | <u>505</u> | <u>423</u> |

10. OPERATING EXPENSES

| | 2009 | 2008 |
|--|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Contributions to defined contribution plan* | 193 | 225 |
| Equity-settled share-based payment expenses | 71 | 66 |
| Salaries and other staff costs | 2,905 | 2,689 |
| Total staff costs | 3,169 | 2,980 |
| Premises and equipment expenses excluding depreciation | | |
| - Rental of premises | 458 | 378 |
| - Maintenance, repairs and others | 447 | 445 |
| Total premises and equipment expenses excluding depreciation | 905 | 823 |
| Depreciation on fixed assets (Note 31) | 512 | 437 |
| Amortisation of intangible assets (Note 30(b)) | 13 | 3 |
| Other operating expenses | | |
| - Stamp duty, overseas and PRC** business taxes, and value added taxes | 304 | 373 |
| - Communications, stationery and printing | 272 | 274 |
| - Legal and professional fees | 190 | 193 |
| - Advertising expenses | 179 | 287 |
| - Business promotions and business travel | 114 | 97 |
| - Card related expenses | 91 | 72 |
| - Insurance expenses | 46 | 43 |
| - Donations | 13 | 9 |
| - Audit fee | 9 | 8 |
| - Administration expenses of corporate services | 8 | 7 |
| - Membership fees | 8 | 7 |
| - Bank charges | 6 | 7 |
| - Bank licence | 4 | 4 |
| - Others | 286 | 155 |
| Total other operating expenses | 1,530 | 1,536 |
| Total operating expenses*** | 6,129 | 5,779 |

* Forfeited contributions totalling HK\$4 million (2008: HK\$10 million) 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 (2008: Nil).

** PRC denotes the People's Republic of China.

*** Included in operating expenses are direct operating expenses of HK\$37 million (2008: \$19 million) in respect of investment properties which generated rental income during the year.

11. IMPAIRMENT LOSSES ON LOANS AND ADVANCES

| | 2009 | 2008 |
|--|--------------|------------|
| | HK\$ Mn | HK\$ Mn |
| Net charge for impairment losses on loans and advances | | |
| Individual impairment loss | | |
| - new provisions (Note 25(b)) | 827 | 596 |
| - releases (Note 25(b)) | (75) | (81) |
| - recoveries (Note 25(b)) | (66) | (140) |
| | 686 | 375 |
| Collective impairment loss | | |
| - new provisions (Note 25(b)) | 419 | 183 |
| - releases (Note 25(b)) | — | — |
| Net charge to income statement | 1,105 | 558 |

12. NET PROFIT ON SALE OF AVAILABLE-FOR-SALE FINANCIAL ASSETS

| | <u>2009</u> | <u>2008</u> |
|---|-------------------|-------------------|
| | HK\$ Mn | HK\$ Mn |
| Net revaluation gain transferred from reserves (Note 38(h)) | 29 | 115 |
| Profit arising in current year | <u>73</u> | <u>82</u> |
| | <u><u>102</u></u> | <u><u>197</u></u> |

13. INCOME TAX

(a) Taxation in the consolidated income statement represents:

| | <u>2009</u> | <u>2008</u> |
|--|-------------------|--------------------|
| | HK\$ Mn | HK\$ Mn |
| Current tax - provision for Hong Kong profits tax (Note 33(a)) | <u>73</u> | <u>64</u> |
| Current tax — overseas | | |
| Tax for the year | 479 | 601 |
| Write back of over-provision in respect of prior years | <u>(25)</u> | <u>(35)</u> |
| | <u>454</u> | <u>566</u> |
| Deferred tax (Note 33(b)) | | |
| Origination and reversal of temporary differences | 297 | (712) |
| Movements in the value of investment properties | <u>34</u> | <u>(14)</u> |
| | <u>331</u> | <u>(726)</u> |
| | <u><u>858</u></u> | <u><u>(96)</u></u> |

The provision for Hong Kong profits tax is calculated at 16.5% (2008: 16.5%) 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/(credit) and accounting profit at applicable tax rates:

| | <u>2009</u> | <u>2008</u> |
|---|-------------------|--------------------|
| | HK\$ Mn | HK\$ Mn |
| Profit before tax | <u>3,496</u> | <u>8</u> |
| Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned | 661 | 149 |
| Tax effect of non-deductible expenses | 339 | 389 |
| Tax effect of non-taxable revenue | (115) | (607) |
| Tax effect of tax losses not recognised | 10 | 32 |
| Recognition of deferred tax assets on prior year tax losses | (14) | (14) |
| 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 | (25) | (35) |
| Tax benefits derived from leasing partnerships | (12) | (6) |
| Others | <u>14</u> | <u>18</u> |
| Actual tax expense/(credit) | <u><u>858</u></u> | <u><u>(96)</u></u> |

14. PROFIT/(LOSS) ATTRIBUTABLE TO OWNERS OF THE PARENT

The consolidated profit/(loss) attributable to owners of the parent includes a profit/(loss) of HK\$995 million (2008: (HK\$882) million) which has been dealt with in the accounts of the Bank.

Reconciliation of the above amount to the Bank's profit/(loss) for the year

| | <u>2009</u> | <u>2008</u> |
|---|-------------------|---------------------|
| | HK\$ Mn | HK\$ Mn |
| Amount of consolidated profit/(loss) attributable to equity holders dealt with in the Bank's accounts | 974 | (924) |
| Final dividends from subsidiaries and associates attributable to the profits of the previous financial year and general reserves, approved and paid during the year | <u>21</u> | <u>42</u> |
| Bank's profit/(loss) for the year | <u><u>995</u></u> | <u><u>(882)</u></u> |

15. DIVIDENDS

(a) Dividends attributable to the year

| | <u>2009</u> | <u>2008</u> |
|--|---------------------|-------------------|
| | HK\$ Mn | HK\$ Mn |
| Interim dividend declared and paid of HK\$0.28 per share on 1,842 million shares (2008: HK\$0.23 per share on 1,671 million shares, or HK\$0.21 per share on 1,838 million shares after adjusting for the bonus issue in 2009) (Note 38(j)) | 516 | 384 |
| 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\$0.02 per share (2008: HK\$1.18 per share or HK\$1.07 per share after adjusting for the bonus issue in 2009) | — | 98 |
| Final dividend proposed after the balance sheet date of HK\$0.48 per share on 2,016 million shares (2008: HK\$0.02 per share on 1,673 million shares or HK\$0.02 per share on 1,841 million shares after adjusting for the bonus issue in 2009) | <u>968</u> | <u>33</u> |
| | <u><u>1,484</u></u> | <u><u>515</u></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>2009</u> | <u>2008</u> |
|---|-------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Final dividend in respect of the previous financial year, approved and paid during the year, of HK\$0.02 per share on 1,673 million shares or HK\$0.02 per share on 1,841 million shares after adjusting for the bonus issue in 2009 (2008: HK\$1.18 per share on 1,574 million shares or HK\$1.07 per share on 1,732 million shares after adjusting for the bonus issue in 2009) | <u>33</u> | <u>1,858</u> |

(c) **Distribution to holders of Hybrid Tier 1 capital instruments**

| | <u>2009</u> | <u>2008</u> |
|---|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Interest payable on the Hybrid Tier 1 capital instruments, the details of which are disclosed in Note 35. | <u>51</u> | <u>—</u> |

16. EARNINGS PER SHARE

(a) **Basic earnings per share**

The calculation of basic earnings per share is based on earnings of HK\$2,514 million (2008: HK\$39 million) after the distribution of HK\$51 million (2008: Nil) to Hybrid Tier 1 issue holders and on the weighted average of 1,843 million (2008: 1,833 million after adjusting for the bonus issue in 2009) ordinary shares outstanding during the year, calculated as follows:

Weighted average number of ordinary shares

| | <u>2009</u> | <u>2008</u> |
|--|---|---|
| | <u>Number of shares million</u> | <u>Number of shares million</u> |
| Issued ordinary shares at 1st January. | 1,841 | 1,732 |
| Effect of share options exercised and shares issued in lieu of dividends | <u>2</u> | <u>101</u> |
| Weighted average number of ordinary shares at 31st December. | <u>1,843</u> | <u>1,833</u> |

(b) **Diluted earnings per share**

The calculation of diluted earnings per share is based on earnings of HK\$2,514 million (2008: HK\$39 million) after the distribution of HK\$51 million (2008: Nil) to Hybrid Tier 1 issue holders and on 1,844 million (2008: 1,837 million after adjusting for the bonus issue in 2009) 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>2009</u> | <u>2008</u> |
|--|--------------------------------|--------------------------------|
| | Number of shares million | Number of shares million |
| Weighted average number of ordinary shares at 31st December | 1,843 | 1,833 |
| Effect of deemed issue of ordinary shares under the Bank's share option scheme for nil consideration | <u>1</u> | <u>4</u> |
| Weighted average number of ordinary shares (diluted) at 31st December | <u><u>1,844</u></u> | <u><u>1,837</u></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 | 2009 Total |
|---|--------------------|--|--------------------------|------------------|---------------------------------------|---------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Chairman and Chief Executive | | | | | | |
| Dr. The Hon. Sir David LI Kwok-po | 0.3 | 8.4 | 25.4 | 23.0 | 0.5 | 57.6 |
| Executive Director | | | | | | |
| Mr. Joseph PANG Yuk-wing * | — | 1.0 | — | 4.5 | — | 5.5 |
| Non-executive Directors | | | | | | |
| Prof. Arthur LI Kwok-cheung | 0.2 | — | — | — | — | 0.2 |
| 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-size | 0.2 | — | — | — | — | 0.2 |
| Dr. Isidro Faine Casas | 0.1 | — | — | — | — | 0.1 |
| Independent Non-executive Directors | | | | | | |
| Dr. Allan WONG Chi-yun | 0.3 | — | — | — | — | 0.3 |
| Mr. WONG Chung-hin | 0.3 | — | — | — | — | 0.3 |
| Dr. LEE Shau-kee | 0.2 | — | — | — | — | 0.2 |
| Mr. Winston LO Yau-lai | 0.3 | — | — | — | — | 0.3 |
| Mr. Thomas KWOK Ping-kwong | 0.2 | — | — | — | — | 0.2 |
| Mr. Kenneth LO Chin-ming | 0.3 | — | — | — | — | 0.3 |
| Mr. William Doo Wai-hoi | 0.3 | — | — | — | — | 0.3 |
| Mr. Kuok Khoon-ean | 0.3 | — | — | — | — | 0.3 |
| Mr. Valiant CHEUNG Kin-piu | 0.3 | — | — | — | — | 0.3 |
| | <u>4.5</u> | <u>9.4</u> | <u>25.4</u> | <u>27.5</u> | <u>0.5</u> | <u>67.3</u> |

* The remuneration of Mr. Joseph Pang Yuk-wing is only for his service being an Executive Director from 1st January, 2009 to 15th April, 2009 (including the fair value of share option).

| | Directors' fees | Salaries, allowances and benefits in kind | Discretionary bonuses | Share options | Retirement scheme contributions HK\$ Mn | 2008 Total |
|---|-----------------|---|-----------------------|---------------|---|-------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Chairman and Chief Executive | | | | | | |
| Dr. The Hon. Sir David LI Kwok-po | 0.3 | 8.3 | — | 24.1 | 0.8 | 33.5 |
| Executive Directors | | | | | | |
| Mr. Joseph PANG Yuk-wing | 0.2 | 3.6 | — | 12.0 | 0.3 | 16.1 |
| Non-executive Directors | | | | | | |
| 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 |
| Independent Non-executive Directors | | | | | | |
| 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. William Doo Wai-hoi. | 0.3 | — | — | — | — | 0.3 |
| Mr. Kuok Khoon-ean | 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> |

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 36.

18. FIVE TOP-PAID EMPLOYEES

| | 2009 | 2008 |
|---|------------|-----------|
| | HK\$ Mn | HK\$ Mn |
| Salaries and other emoluments | 20 | 21 |
| Performance-related bonuses | 39 | 3 |
| Share options | 50 | 52 |
| Pension contributions | 1 | 2 |
| | <u>110</u> | <u>78</u> |

The remuneration of the five top-paid employees is within the following bands:

| | <u>2009</u> | <u>2008</u> |
|-----------------------------------|--------------------------------|--------------------------------|
| | Number of employees | Number of employees |
| HK\$ | | |
| 8,500,001 - 9,000,000 | — | 2 |
| 10,500,001 - 11,000,000 | — | 1 |
| 12,000,001 - 12,500,000 | 2 | — |
| 13,500,001 - 14,000,000 | 2 | — |
| 16,000,001 - 16,500,000 | — | 1 |
| 33,500,001 - 34,000,000 | — | 1 |
| 57,500,001 - 58,000,000 | 1 | — |

Included in the emoluments of the five top-paid employees were the emoluments of 1 (2008: 2) Director. Their respective directors' emoluments have been included in Note 17 above.

19. SEGMENT REPORTING

The Group manages its businesses by divisions, which are organized by a mixture of both business lines and geography. In a manner consistent with the way in which information is reported internally to the Group's most senior executive management for the purposes of resource allocation and performance assessment, the Group has presented the following seven reportable segments. No operating segments have been aggregated to form the following reportable segments.

(a) Business segments

The Group has identified the following seven reportable segments.

Personal banking, which includes branch operations, personal internet banking, consumer finance, property loans and credit card business in Hong Kong.

Corporate banking, which includes corporate lending and loan syndication, asset based lending, commercial lending and securities lending in Hong Kong.

Treasury markets, which include treasury operations and securities dealing in Hong Kong.

Wealth management, which includes private banking business and related assets in Hong Kong.

China operations include all branches and subsidiaries in China, except those subsidiaries carrying out corporate services and associates operated in China.

Overseas operations include overseas branches and subsidiaries, except those subsidiaries carrying out corporate services and associates operated in overseas.

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, supporting units of Hong Kong operation, investment properties, bank premises, the net results of associates and other subsidiaries in Hong Kong.

For the purposes of assessing segment performance and allocating resources between segments, the Group's senior executive management monitors the results, assets and liabilities attributable to each reportable segment on the following bases:

Segment assets include all tangible except for properties, intangible assets and financial assets with the exception of interests in associates, deferred tax assets and other corporate assets. Segment liabilities include deposits, financial liabilities and other liabilities attributable to the banking activities of the individual segments.

Revenue and expenses are allocated to the reportable segments with reference to interest and fee and commission income generated by those segments and the expenses incurred by those segments or which otherwise arise from the depreciation or amortisation of assets attributable to those segments. Segment revenue and expenses do not include the Group's share of revenue and expenses arising from the activities of the Group's associates. Other than reporting inter-segment income, assistance provided by one segment to another, including sharing of assets, is not measured.

In addition to receiving segment information concerning profit before taxation, management is provided with segment information concerning revenue (including inter segment lending), interest expense, depreciation, amortisation and impairment losses and additions to non-current segment assets used by the segments in their operations.

| 2009 | | | | | | | | | | | |
|---|---------------------|----------------------|---------------------|----------------------|---------------------|------------------------|-----------------------|---------------------------------|---------|----------------------------------|---------|
| Hong Kong banking operations | | | | | | | | | | | |
| | Personal banking | Corporate banking | Treasury markets | Wealth management | China operations | Overseas operations | Corporate services | Total reportable segments | Others | Inter- segment 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) . . . | 1,972 | 763 | 377 | 147 | 2,974 | 731 | 1 | 6,965 | (337) | 119 | 6,747 |
| Non-interest income/(expense) . . . | 463 | 647 | (247) | 195 | 498 | 346 | 816 | 2,718 | 1,573 | (850) | 3,441 |
| Operating income | 2,435 | 1,410 | 130 | 342 | 3,472 | 1,077 | 817 | 9,683 | 1,236 | (731) | 10,188 |
| Operating expenses | (1,341) | (114) | (129) | (107) | (1,997) | (514) | (512) | (4,714) | (1,877) | 462 | (6,129) |
| Operating profit/(loss) before impairment losses | 1,094 | 1,296 | 1 | 235 | 1,475 | 563 | 305 | 4,969 | (641) | (269) | 4,059 |
| (Charge for)/Write back of impairment losses on loans and advances and other accounts | (70) | (46) | (3) | (12) | 21 | (977) | (6) | (1,093) | (12) | — | (1,105) |
| Impairment losses on available-for-sale financial assets and held-to-maturity investments | — | — | (9) | — | — | — | — | (9) | (14) | — | (23) |
| Impairment losses on bank premises | — | — | — | — | — | — | — | — | (13) | — | (13) |
| Operating profit/(loss) after impairment losses | 1,024 | 1,250 | (11) | 223 | 1,496 | (414) | 299 | 3,867 | (680) | (269) | 2,918 |
| Profit/(Loss) on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments, loans and receivables and subsidiaries/ associates | (3) | — | 16 | — | 22 | 1 | — | 36 | 73 | (1) | 108 |
| Valuation gains/ (losses) on investment properties | — | — | — | — | 7 | (3) | — | 4 | 235 | (33) | 206 |
| Share of profits less losses of associates | — | — | — | — | — | — | — | — | 264 | — | 264 |
| Profit/(Loss) before taxation . . . | 1,021 | 1,250 | 5 | 223 | 1,525 | (416) | 299 | 3,907 | (108) | (303) | 3,496 |
| Depreciation for the year | (70) | (1) | (3) | (2) | (189) | (29) | (17) | (311) | (198) | (3) | (512) |
| Segment assets | 44,005 | 66,998 | 132,107 | 7,359 | 154,030 | 50,764 | 4,144 | 459,407 | 19,395 | (47,335) | 431,467 |
| Investments in associates | — | — | — | — | — | — | — | — | 2,615 | — | 2,615 |
| Total assets | 44,005 | 66,998 | 132,107 | 7,359 | 154,030 | 50,764 | 4,144 | 459,407 | 22,010 | (47,335) | 434,082 |
| Total liabilities | 208,366 | 582 | 24,824 | 14,719 | 138,531 | 40,873 | 1,645 | 429,540 | 6,821 | (41,802) | 394,559 |
| Capital expenditure incurred during the year | 54 | — | 4 | 1 | 3,182 | 624 | 32 | 3,897 | 66 | — | 3,963 |

| Hong Kong banking operations | | | | | | | | | | | |
|---|---------------------|----------------------|---------------------|----------------------|---------------------|------------------------|-----------------------|---------------------------------|---------|----------------------------------|---------|
| | Personal banking | Corporate banking | Treasury markets | Wealth management | China operations | Overseas operations | Corporate services | Total reportable segments | Others | Inter- segment 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) . . . | 1,404 | 571 | 1,200 | 15 | 2,967 | 722 | — | 6,879 | (154) | 68 | 6,793 |
| Non-interest income/(expense) . . . | 539 | (487) | (2,206) | 237 | 410 | (49) | 816 | (740) | 1,131 | (727) | (336) |
| Operating income/ (expense) | 1,943 | 84 | (1,006) | 252 | 3,377 | 673 | 816 | 6,139 | 977 | (659) | 6,457 |
| Operating expenses | (1,306) | (114) | (74) | (92) | (1,824) | (528) | (504) | (4,442) | (1,756) | 419 | (5,779) |
| Operating profit/(loss) before impairment losses | 637 | (30) | (1,080) | 160 | 1,553 | 145 | 312 | 1,697 | (779) | (240) | 678 |
| (Charge for)/Write back of impairment losses on loans and advances and other accounts | (74) | (110) | — | (48) | (98) | (211) | (10) | (551) | (13) | 6 | (558) |
| Impairment losses on available-for-sale financial assets and held-to-maturity investments | — | — | (264) | — | — | — | — | (264) | (132) | — | (396) |
| Write back of impairment losses on bank premises | — | — | — | — | — | — | — | — | 6 | — | 6 |
| Operating profit/(loss) after impairment losses | 563 | (140) | (1,344) | 112 | 1,455 | (66) | 302 | 882 | (918) | (234) | (270) |
| Profit/(Loss) on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments, loans and receivables and subsidiaries/ associates | — | — | 206 | — | (1) | 181 | (1) | 385 | 4 | 4 | 393 |
| Valuation gains/ (losses) on investment properties | — | — | — | — | (1) | (20) | — | (21) | (181) | 34 | (168) |
| Share of profits less losses of associates | — | — | — | — | — | — | — | — | 53 | — | 53 |
| Profit/(Loss) before taxation | 563 | (140) | (1,138) | 112 | 1,453 | 95 | 301 | 1,246 | (1,042) | (196) | 8 |
| Depreciation for the year | (64) | (3) | (2) | (3) | (128) | (26) | (17) | (243) | (191) | (3) | (437) |
| Segment assets | 40,869 | 60,239 | 143,582 | 5,656 | 139,736 | 40,215 | 4,056 | 434,353 | 18,583 | (40,168) | 412,768 |
| Investments in associates | — | — | — | — | — | — | — | — | 2,486 | — | 2,486 |
| Total assets | 40,869 | 60,239 | 143,582 | 5,656 | 139,736 | 40,215 | 4,056 | 434,353 | 21,069 | (40,168) | 415,254 |
| Total liabilities | 213,785 | 561 | 21,014 | 14,723 | 128,728 | 35,552 | 1,653 | 416,016 | 5,355 | (38,602) | 382,769 |
| Capital expenditure incurred during the year | 126 | — | 7 | 5 | 2,028 | 47 | 72 | 2,285 | 330 | — | 2,615 |

(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.

| | 2009 | | | | | Consolidated |
|--|-----------|----------------------------|-----------------------|---------|---------------------------|--------------|
| | Hong Kong | People's Republic of China | Other Asian Countries | Others | Inter-segment elimination | |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| The Group | | | | | | |
| Operating income | 6,461 | 3,527 | 585 | 883 | (1,268) | 10,188 |
| Profit/(Loss) before taxation | 1,931 | 1,598 | 163 | (196) | — | 3,496 |
| Total assets | 287,184 | 155,920 | 19,369 | 34,708 | (63,099) | 434,082 |
| Total liabilities | 255,572 | 138,697 | 16,210 | 26,904 | (42,824) | 394,559 |
| Contingent liabilities and commitments | 57,919 | 23,262 | 3,111 | 2,946 | — | 87,238 |
| Capital expenditure during the year | 157 | 3,182 | 618 | 6 | — | 3,963 |

| | 2008 (restated) | | | | | Consolidated |
|--|-----------------|----------------------------|-----------------------|---------|---------------------------|--------------|
| | Hong Kong | People's Republic of China | Other Asian Countries | Others | Inter-segment elimination | |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| The Group | | | | | | |
| Operating income | 2,962 | 3,447 | 525 | 492 | (969) | 6,457 |
| Profit/(Loss) before taxation | (1,876) | 1,484 | 381 | 19 | — | 8 |
| Total assets | 285,121 | 141,036 | 18,735 | 27,890 | (57,528) | 415,254 |
| Total liabilities | 255,902 | 129,147 | 15,778 | 24,329 | (42,387) | 382,769 |
| Contingent liabilities and commitments | 53,162 | 15,944 | 3,818 | 3,244 | — | 76,168 |
| Capital expenditure during the year | 541 | 2,027 | 8 | 39 | — | 2,615 |

20. CASH AND BALANCES WITH BANKS AND OTHER FINANCIAL INSTITUTIONS (NOTE 43(C))

| | The Group | | The Bank | |
|--|---------------|---------------|---------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Cash in hand | 1,101 | 1,083 | 706 | 698 |
| Balances with central banks | 15,813 | 17,911 | 736 | 167 |
| Balances with banks and other financial institutions | 12,798 | 9,111 | 11,085 | 3,987 |
| | <u>29,712</u> | <u>28,105</u> | <u>12,527</u> | <u>4,852</u> |

21. PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

| | The Group | | The Bank | |
|---|---------------|---------------|---------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Placements with banks and authorised institutions | 67,638 | 96,458 | 61,894 | 92,735 |
| Placements with other financial institutions | 307 | 116 | — | — |
| | <u>67,945</u> | <u>96,574</u> | <u>61,894</u> | <u>92,735</u> |
| Maturing | | | | |
| - within one month | 35,006 | 46,714 | 31,895 | 43,009 |
| - between one month and one year | 32,939 | 49,860 | 29,999 | 49,726 |
| | <u>67,945</u> | <u>96,574</u> | <u>61,894</u> | <u>92,735</u> |

22. TRADE BILLS

| | The Group | | The Bank | |
|-----------------------------|--------------|--------------|------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Gross trade bills | <u>1,847</u> | <u>1,164</u> | <u>861</u> | <u>521</u> |

23. TRADING ASSETS

| | The Group | | The Bank | |
|--|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Treasury bills (including Exchange Fund Bills) | 34 | 400 | — | 400 |
| Debt securities | 3,090 | 126 | 904 | 126 |
| Equity securities | 1,429 | 989 | 1,374 | 949 |
| Investment funds | 201 | 188 | 201 | 188 |
| Trading securities | 4,754 | 1,703 | 2,479 | 1,663 |
| Positive fair values of derivatives (Note 42(b)) | 968 | 1,734 | 845 | 1,251 |
| | <u>5,722</u> | <u>3,437</u> | <u>3,324</u> | <u>2,914</u> |
| Issued by: | | | | |
| Central governments and central banks | 1,857 | 400 | — | 400 |
| Public sector entities | 299 | 13 | 299 | 13 |
| Banks and other financial institutions | 1,093 | 443 | 716 | 433 |
| Corporate entities | 1,492 | 840 | 1,451 | 810 |
| Other entities | 13 | 7 | 13 | 7 |
| | <u>4,754</u> | <u>1,703</u> | <u>2,479</u> | <u>1,663</u> |
| Analysed by place of listing: | | | | |
| Listed in Hong Kong | 1,484 | 825 | 1,428 | 785 |
| Listed outside Hong Kong | 574 | 294 | 574 | 294 |
| | 2,058 | 1,119 | 2,002 | 1,079 |
| Unlisted | 2,696 | 584 | 477 | 584 |
| | <u>4,754</u> | <u>1,703</u> | <u>2,479</u> | <u>1,663</u> |

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

| | The Group | | The Bank | |
|--|---------------|--------------|---------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Debt securities | 10,043 | 4,130 | 10,035 | 4,114 |
| Equity securities | 349 | — | 349 | — |
| | <u>10,392</u> | <u>4,130</u> | <u>10,384</u> | <u>4,114</u> |
| Issued by: | | | | |
| Central governments and central banks | 235 | — | 235 | — |
| Public sector entities | 177 | 142 | 177 | 142 |
| Banks and other financial institutions | 4,338 | 1,642 | 4,330 | 1,634 |
| Corporate entities | 5,642 | 2,346 | 5,642 | 2,338 |
| | <u>10,392</u> | <u>4,130</u> | <u>10,384</u> | <u>4,114</u> |
| Analysed by place of listing: | | | | |
| Listed in Hong Kong | 2,946 | 1,325 | 2,946 | 1,325 |
| Listed outside Hong Kong | 4,003 | 1,178 | 3,995 | 1,161 |
| | 6,949 | 2,503 | 6,941 | 2,486 |
| Unlisted | 3,443 | 1,627 | 3,443 | 1,628 |
| | <u>10,392</u> | <u>4,130</u> | <u>10,384</u> | <u>4,114</u> |

25. ADVANCES TO CUSTOMERS AND OTHER ACCOUNTS
(a) Advances to customers and other accounts

| | The Group | | The Bank | |
|--|----------------|----------------|----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| (i) Advances to customers | 247,654 | 230,339 | 143,374 | 131,123 |
| Less: Impairment allowances | | | | |
| - Individual | (534) | (523) | (499) | (438) |
| - Collective | (811) | (521) | (678) | (392) |
| | <u>246,309</u> | <u>229,295</u> | <u>142,197</u> | <u>130,293</u> |
| (ii) Other accounts | | | | |
| Advances to banks and other financial institutions * | 678 | 850 | 583 | 205 |
| Notes and bonds | 65 | 129 | 61 | 125 |
| Certificates of deposit held | 39 | 39 | 39 | 39 |
| Accrued interest | 1,313 | 1,863 | 951 | 1,119 |
| Bankers acceptances | 7,976 | 2,989 | 203 | 272 |
| Other accounts | 5,463 | 8,592 | 4,565 | 6,587 |
| | <u>15,534</u> | <u>14,462</u> | <u>6,402</u> | <u>8,347</u> |
| Less: Impairment allowances | | | | |
| - Individual | (31) | (23) | (3) | — |
| - Collective | (9) | (9) | — | — |
| | <u>15,494</u> | <u>14,430</u> | <u>6,399</u> | <u>8,347</u> |
| | <u>261,803</u> | <u>243,725</u> | <u>148,596</u> | <u>138,640</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, 2009, the fair value of financial assets accepted as collateral that the Group is permitted to sell or re-pledge under such terms is Nil (2008: HK\$155 million).

(b) **Impairment allowances against advances and other accounts for 2009**

| | The Group | | | | | |
|--|------------------------------|-------------------|-----------------------|-------------------|-------------------|-------------------|
| | Advances to customers | | Other accounts | | Total | |
| | Individual | Collective | Individual | Collective | Individual | Collective |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 523 | 521 | 23 | 9 | 546 | 530 |
| New provisions charged to income statement (Note 11) | 813 | 420 | 14 | (1) | 827 | 419 |
| Net provisions released back to income statement (Note 11) | (98) | — | (3) | — | (101) | — |
| Amounts written off | (743) | (138) | (4) | — | (747) | (138) |
| Recoveries (Note 11) | 65 | — | 1 | — | 66 | — |
| Additions through acquisition of subsidiaries | — | — | — | 1 | — | 1 |
| Effect of discounting (Note 4) | (40) | — | — | — | (40) | — |
| Exchange adjustments | 14 | 8 | — | — | 14 | 8 |
| At 31st December | <u>534</u> | <u>811</u> | <u>31</u> | <u>9</u> | <u>565</u> | <u>820</u> |

| | The Bank | | | | | |
|--|------------------------------|-------------------|-----------------------|-------------------|-------------------|-------------------|
| | Advances to customers | | Other accounts | | Total | |
| | Individual | Collective | Individual | Collective | Individual | Collective |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 438 | 392 | — | — | 438 | 392 |
| New provisions charged to income statement | 752 | 407 | 3 | — | 755 | 407 |
| Net provisions released back to income statement | (81) | — | — | — | (81) | — |
| Amounts written off | (641) | (128) | — | — | (641) | (128) |
| Recoveries | 57 | — | — | — | 57 | — |
| Effect of discounting | (38) | — | — | — | (38) | — |
| Exchange adjustments | 12 | 7 | — | — | 12 | 7 |
| At 31st December | <u>499</u> | <u>678</u> | <u>3</u> | <u>—</u> | <u>502</u> | <u>678</u> |

(b) Impairment allowances against advances and other accounts for 2008

| | The Group | | | | | |
|--|------------------------------|-------------------|-----------------------|-------------------|-------------------|-------------------|
| | Advances to customers | | Other accounts | | Total | |
| | Individual | Collective | Individual | Collective | Individual | Collective |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 264 | 433 | 25 | 6 | 289 | 439 |
| New provisions charged to income statement (Note 11) | 583 | 183 | 13 | — | 596 | 183 |
| Net provisions released back to income statement (Note 11) | (204) | — | (5) | — | (209) | — |
| Amounts written off | (245) | (96) | (10) | — | (255) | (96) |
| Recoveries (Note 11) | 140 | — | — | — | 140 | — |
| Additions through acquisition of subsidiaries | — | — | — | 3 | — | 3 |
| Effect of discounting (Note 4) | (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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 79 | 332 | — | — | 79 | 332 |
| New provisions charged to income statement | 460 | 149 | 6 | — | 466 | 149 |
| Net provisions released back to income statement | (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> |

(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.

| | 2009 | | 2008 | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | Gross advances | % of secured advances | Gross advances | % of secured advances |
| | HK\$ Mn | % | HK\$ Mn | % |
| The Group | | | | |
| Loans for use in Hong Kong Industrial, commercial and financial | | | | |
| - Property development | 9,411 | 73.43 | 8,855 | 61.25 |
| - Property investment | 29,766 | 91.11 | 27,431 | 86.88 |
| - Financial concerns | 2,699 | 75.10 | 2,542 | 69.94 |
| - Stockbrokers | 1,190 | 50.35 | 550 | 99.75 |
| - Wholesale and retail trade | 3,265 | 68.46 | 2,405 | 64.60 |
| - Manufacturing | 2,177 | 57.94 | 2,055 | 52.54 |
| - Transport and transport equipment | 3,794 | 79.39 | 3,642 | 74.80 |
| - Recreational activities | 45 | 47.90 | 285 | 91.11 |
| - Information technology | 8 | 38.02 | 4 | 49.13 |
| - Others | 13,006 | 77.87 | 9,954 | 71.52 |
| - Sub-total | <u>65,361</u> | 81.57 | <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 | 1,529 | 100.00 | 1,318 | 100.00 |
| - Loans for the purchase of other residential properties | 25,220 | 99.87 | 24,297 | 99.74 |
| - Credit card advances | 2,675 | 0.00 | 2,997 | 0.00 |
| - Others | 8,839 | 68.17 | 6,553 | 74.35 |
| - Sub-total | <u>38,263</u> | 85.57 | <u>35,165</u> | 86.52 |
| Total loans for use in Hong Kong | 103,624 | 83.05 | 92,888 | 80.47 |
| Trade finance | 2,652 | 53.27 | 2,905 | 59.03 |
| Loans for use outside Hong Kong* | <u>141,378</u> | 75.75 | <u>134,546</u> | 76.56 |
| Total advances to customers | <u><u>247,654</u></u> | 78.56 | <u><u>230,339</u></u> | 77.91 |

* Loans for use outside Hong Kong include the following loans for use in the PRC.

| | 2009 | | 2008 | |
|--------------------------------------|----------------|-----------------------|----------------|-----------------------|
| | Gross advances | % of secured advances | Gross advances | % of secured advances |
| | HK\$ Mn | % | HK\$ Mn | % |
| Property development | 14,156 | 72.70 | 14,351 | 78.64 |
| Property investment | 22,441 | 88.36 | 24,215 | 87.95 |
| Wholesale and retail trade | 18,574 | 95.28 | 19,021 | 88.93 |
| Manufacturing | 7,299 | 48.78 | 9,547 | 63.58 |
| Others | 41,180 | 69.34 | 31,906 | 69.99 |
| | <u>103,650</u> | 77.12 | <u>99,040</u> | 78.66 |

| | 2009 | | 2008 | |
|---|----------------|-----------------------|----------------|-----------------------|
| | Gross advances | % of secured advances | Gross advances | % of secured advances |
| | HK\$ Mn | % | HK\$ Mn | % |
| The Bank | | | | |
| Loans for use in Hong Kong Industrial, commercial and financial | | | | |
| - Property development | 9,401 | 73.50 | 8,844 | 61.32 |
| - Property investment | 29,650 | 91.08 | 27,345 | 86.84 |
| - Financial concerns | 2,699 | 75.11 | 2,542 | 69.95 |
| - Stockbrokers | 1,190 | 50.35 | 550 | 99.75 |
| - Wholesale and retail trade | 3,220 | 68.02 | 2,353 | 63.82 |
| - Manufacturing | 2,157 | 57.55 | 2,055 | 52.54 |
| - Transport and transport equipment | 3,794 | 79.39 | 3,642 | 74.80 |
| - Recreational activities | 45 | 47.90 | 285 | 91.11 |
| - Information technology | 8 | 38.02 | 4 | 49.13 |
| - Others | 12,732 | 77.39 | 9,830 | 71.16 |
| - Sub-total | <u>64,896</u> | 81.46 | <u>57,450</u> | 76.69 |
| Individuals | | | | |
| - Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | 1,529 | 100.00 | 1,318 | 100.00 |
| - Loans for the purchase of other residential properties | 25,180 | 99.87 | 24,273 | 99.75 |
| - Credit card advances | 2,675 | 0.00 | 2,997 | 0.00 |
| - Others | 8,046 | 67.44 | 6,147 | 74.92 |
| - Sub-total | <u>37,430</u> | 85.76 | <u>34,735</u> | 86.76 |
| Total loans for use in Hong Kong | 102,326 | 83.03 | 92,185 | 80.49 |
| Trade finance | 2,322 | 52.35 | 2,684 | 58.87 |
| Loans for use outside Hong Kong * | <u>38,726</u> | 56.01 | <u>36,254</u> | 57.35 |
| Total advances to customers | <u>143,374</u> | 75.24 | <u>131,123</u> | 73.65 |

* Loans for use outside Hong Kong include the following loans for use in the PRC.

| | 2009 | | 2008 | |
|--------------------------------------|----------------|-----------------------|----------------|-----------------------|
| | Gross advances | % of secured advances | Gross advances | % of secured advances |
| | HK\$ Mn | % | HK\$ Mn | % |
| Property development | 3,075 | 12.30 | 2,310 | 0.00 |
| Property investment | 866 | 100.00 | 951 | 98.95 |
| Wholesale and retail trade | 111 | 9.88 | 12 | 99.97 |
| Manufacturing | 1,531 | 53.61 | 1,878 | 74.86 |
| Others | 3,271 | 3.48 | 2,733 | 8.17 |
| | <u>8,854</u> | <u>24.74</u> | <u>7,884</u> | <u>32.75</u> |

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 | |
|--|-----------|---------|----------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| (i) Property development | | | | |
| a. Individually impaired loans | 805 | 207 | 771 | 171 |
| b. Individual impairment allowance | 50 | 8 | 37 | 2 |
| c. Collective impairment allowance | 83 | 36 | 69 | 20 |
| d. Provision charged to income statement | | | | |
| - individual impairment loss | 324 | 2 | 315 | 2 |
| - collective impairment loss | 59 | 12 | 54 | 7 |
| e. Written off | 272 | 84 | 271 | — |
| (ii) Property investment | | | | |
| a. Individually impaired loans | 334 | 145 | 168 | 6 |
| b. Individual impairment allowance | 25 | 29 | 11 | — |
| c. Collective impairment allowance | 193 | 96 | 138 | 62 |
| d. Provision charged to income statement | | | | |
| - individual impairment loss | 56 | 29 | 35 | — |
| - collective impairment loss | 111 | 24 | 78 | 16 |
| e. Written off | 52 | — | 22 | — |
| (iii) Loans for purchase of residential properties | | | | |
| a. Individually impaired loans | 137 | 117 | 127 | 108 |
| b. Individual impairment allowance | — | 2 | — | 2 |
| c. Collective impairment allowance | 32 | 30 | 30 | 21 |
| d. Provision charged to income statement | | | | |
| - individual impairment loss | 1 | 5 | 1 | 5 |
| - collective impairment loss | 23 | 6 | 22 | 3 |
| e. Written off | 1 | 3 | 1 | 3 |
| (iv) Wholesale and retail trade | | | | |
| a. Individually impaired loans | 327 | 222 | 290 | 181 |
| b. Individual impairment allowance | 162 | 129 | 162 | 120 |
| c. Collective impairment allowance | 56 | 48 | 38 | 24 |
| d. Provision charged to income statement | | | | |
| - individual impairment loss | 185 | 133 | 184 | 116 |
| - collective impairment loss | 18 | 21 | 16 | 12 |
| e. Written off | 131 | 4 | 121 | 4 |

(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.

| The Group | | | | | |
|---|--|---|---|--|--|
| 2009 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Hong Kong | 121,538 | 217 | 407 | 103 | 299 |
| People's Republic of China | 93,084 | 177 | 373 | 34 | 86 |
| Other Asian Countries | 10,103 | 213 | 382 | 247 | 178 |
| Others | 22,929 | 284 | 1,286 | 150 | 248 |
| Total | <u>247,654</u> | <u>891</u> | <u>2,448</u> | <u>534</u> | <u>811</u> |
| % of total advances to customers | | | <u>0.99%</u> | | |
| Market value of security held against impaired advances to customers | | | <u>4,839</u> | | |

| The Group | | | | | |
|---|--|---|---|--|--|
| 2008 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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> | | |

| The Bank | | | | | |
|---|--|---|---|--|--|
| 2009 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Hong Kong | 103,784 | 185 | 357 | 87 | 278 |
| People's Republic of China | 16,419 | 23 | 207 | 33 | 26 |
| Other Asian Countries | 9,021 | 213 | 381 | 246 | 177 |
| Others | 14,150 | 270 | 1,166 | 133 | 197 |
| Total | 143,374 | 691 | 2,111 | 499 | 678 |
| % of total advances to customers | | | 1.48% | | |
| Market value of security held against impaired advances to customers | | | 3,048 | | |

| The Bank | | | | | |
|---|--|---|---|--|--|
| 2008 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | 131,123 | 437 | 1,274 | 438 | 392 |
| % of total advances to customers | | | 0.97% | | |
| Market value of security held against impaired advances to customers | | | 2,168 | | |

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, 2009 and 31st December, 2008, 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 | | | | | |
|--|--|---|-------------------------------------|--|---|-------------------------------------|
| | 2009 | | | 2008 | | |
| | 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 |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| Amounts receivable: | | | | | | |
| Within one year | 1,004 | 116 | 1,120 | 1,280 | 152 | 1,432 |
| After one year but within five years | 1,100 | 186 | 1,286 | 1,512 | 206 | 1,718 |
| After five years. | <u>1,729</u> | <u>265</u> | <u>1,994</u> | <u>1,468</u> | <u>246</u> | <u>1,714</u> |
| | 3,833 | <u>567</u> | <u>4,400</u> | 4,260 | <u>604</u> | <u>4,864</u> |
| Less: Individual impairment allowances | <u>(10)</u> | | | <u>(21)</u> | | |
| Net investment in finance leases | <u>3,823</u> | | | <u>4,239</u> | | |

The net investment in finance leases is carried on the statement of financial position 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 | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Treasury bills (including Exchange Fund Bills) | 5,425 | 10,391 | 5,364 | 4,558 |
| Certificates of deposit held | 972 | 762 | 595 | 508 |
| Debt securities | 22,599 | 6,398 | 11,990 | 5,210 |
| Equity securities | 1,810 | 899 | 909 | 611 |
| Investment funds | 77 | 110 | 77 | 98 |
| | <u>30,883</u> | <u>18,560</u> | <u>18,935</u> | <u>10,985</u> |
| Issued by: | | | | |
| Central governments and central banks | 12,787 | 10,419 | 6,416 | 4,558 |
| Public sector entities | 236 | 231 | — | 126 |
| Banks and other financial institutions | 14,199 | 5,773 | 10,649 | 4,759 |
| Corporate entities | 3,584 | 2,027 | 1,793 | 1,444 |
| Other entities | 77 | 110 | 77 | 98 |
| | <u>30,883</u> | <u>18,560</u> | <u>18,935</u> | <u>10,985</u> |
| Analysed by place of listing: | | | | |
| Listed in Hong Kong | 1,957 | 397 | 1,495 | 197 |
| Listed outside Hong Kong | 5,512 | 9,329 | 3,986 | 2,619 |
| | 7,469 | 9,726 | 5,481 | 2,816 |
| Unlisted | 23,414 | 8,834 | 13,454 | 8,169 |
| | <u>30,883</u> | <u>18,560</u> | <u>18,935</u> | <u>10,985</u> |

27. HELD-TO-MATURITY INVESTMENTS

| | The Group | | The Bank | |
|--|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Treasury bills (including Exchange Fund Bills) | 189 | 180 | 112 | 180 |
| Certificates of deposit held. | 2,245 | 1,717 | 1,584 | 1,056 |
| Debt securities | 4,843 | 3,216 | 3,144 | 2,189 |
| | 7,277 | 5,113 | 4,840 | 3,425 |
| Less: Impairment allowances. | (38) | (107) | (38) | (107) |
| | <u>7,239</u> | <u>5,006</u> | <u>4,802</u> | <u>3,318</u> |
| Issued by: | | | | |
| Central governments and central banks | 1,510 | 243 | 1,506 | 239 |
| Public sector entities | 621 | 318 | 276 | 231 |
| Banks and other financial institutions. | 4,328 | 3,344 | 2,629 | 2,117 |
| Corporate entities | 780 | 1,101 | 391 | 731 |
| | <u>7,239</u> | <u>5,006</u> | <u>4,802</u> | <u>3,318</u> |
| Analysed by place of listing: | | | | |
| Listed in Hong Kong | 952 | 287 | 848 | 268 |
| Listed outside Hong Kong | 2,984 | 1,863 | 2,263 | 1,477 |
| | 3,936 | 2,150 | 3,111 | 1,745 |
| Unlisted | 3,303 | 2,856 | 1,691 | 1,573 |
| | <u>7,239</u> | <u>5,006</u> | <u>4,802</u> | <u>3,318</u> |
| Fair value: | | | | |
| Listed securities. | 3,998 | 2,028 | 3,150 | 1,640 |
| Unlisted securities | 3,320 | 2,870 | 1,696 | 1,569 |
| | <u>7,318</u> | <u>4,898</u> | <u>4,846</u> | <u>3,209</u> |

Movement of impairment allowances

| | The Group | | The Bank | |
|---|-----------|------------|-----------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 107 | 42 | 107 | 42 |
| Charge for the year | 9 | 44 | 9 | 44 |
| Write-off. | (78) | — | (78) | — |
| Exchange and other adjustments. | — | 21 | — | 21 |
| At 31st December | <u>38</u> | <u>107</u> | <u>38</u> | <u>107</u> |

Reclassification of Available-for-sale Financial Assets

On 1st January, 2009, the management have assessed the intention and ability to hold to maturity the Group's available-for-sale financial assets. Based on this assessment, the management concluded that they have the positive intention ability hold them to maturity and therefore have reclassified the portfolio from the available-for-sale category to held-to-maturity. The amount reclassified on the date of reclassification is as follows:

| | Carrying amount on 1st January, 2009 |
|--|---|
| | HK\$ Mn |
| Reclassified from available-for-sale debt securities | |
| Listed in Hong Kong | (83) |
| Listed outside Hong Kong | (229) |
| Unlisted | (364) |
| | <u>(676)</u> |
| Reclassified to held-to-maturity securities | |
| Listed in Hong Kong | 83 |
| Listed outside Hong Kong | 229 |
| Unlisted | 364 |
| | <u>676</u> |

There are no unrealised gains and losses arising from changes in fair value recognised in the investment revaluation reserve during the year.

The net unamortised revaluation deficit was HK\$19 million as at 31st December, 2009.

| | HK\$ Mn |
|---|----------------|
| Reclassification | 16 |
| Amortisation during the year | 3 |
| Balance as at 31st December, 2009 | <u>19</u> |

The unamortised revaluation surplus or deficit of individual investments reclassified shall be amortised to the income statement over the respective remaining life of investment using the effective interest method.

28. INVESTMENTS IN SUBSIDIARIES

| | The Bank | |
|---------------------------------------|-----------------|----------------|
| | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn |
| Unlisted shares, at cost | 13,690 | 11,906 |
| Less: Impairment allowances | (233) | (233) |
| | <u>13,457</u> | <u>11,673</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 | |
| Ample Delight Limited | Hong Kong | HK\$450,000,000 | | 100% | Investment holding |
| 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\$374,580,000 | 51% | | Asset management |
| BEA Wealth Management Services (Taiwan) Limited | Taiwan, Republic of China | NTD218,000,000 | | 100% | Wealth management services |
| CCSL St. Lucia Limited | St. Lucia | US\$1,200 | | 60.49% | Holding company |
| Central Town Limited | Hong Kong | HK\$2 | 100% | | Property investment |
| Century Able Limited | Hong Kong | HK\$866,951,045 | | 100% | Investment holding |
| Corona Light Limited | BVI | HK\$866,951,045 | | 100% | Investment holding |
| Credit Gain Finance Company Limited | Hong Kong | HK\$1 | 100% | | Money lenders |
| Crystal Gleaming Limited | BVI | HK\$866,951,045 | 100% | | Investment holding |
| East Asia Corporate Services (BVI) Limited | BVI | US\$250,000 | | 75.61% | Registered agent and trustee services |
| 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. | 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% | | Investment Holding |
| East Asia Investments Holdings (BVI) Ltd. | BVI | HK\$186,038,725 | 100% | | Investment holding |
| East Asia Marketing Limited | BVI | US\$1 | | 75.61% | Marketing services to related companies |
| East Asia Property Agency Company Limited | Hong Kong | HK\$1,000,000 | 100% | | Property agency |
| East Asia Properties Holding Company Limited | Hong Kong | HK\$10,000 | 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 | | 75.61% | 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 |

| Name of company | Place of incorporation and operation | Issued and paid-up capital | % Held by | | Nature of business |
|--|--------------------------------------|----------------------------|-----------|-----------|---|
| | | | The Bank | The Group | |
| Innovate Holdings Limited | BVI | US\$1 | 100% | | Special purpose vehicle 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 (Note 1) | PRC | CNY8,000,000,000 | 100% | | Banking and related financial services |
| * The Bank of East Asia (U.S.A.) N.A. | U.S.A. | US\$4,500 | | 100% | Banking |
| Tricor Consultancy (Beijing) Limited (Note 1) | 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. Ltd. | Singapore | S\$2 | | 75.61% | Investment holding |
| Tricor Investor Services Limited | Hong Kong | HK\$2 | | 75.61% | Investor services |
| Tricor Services Limited | Hong Kong | HK\$2 | | 75.61% | Business, corporate and investor services |
| Tricor Services (BVI) Limited | BVI | US\$250,000 | | 75.61% | Registered agent and trustee services |
| Tricor Services (Malaysia) Sdn. Bhd. | Malaysia | RM5,672,484 | | 60.49% | Investment holding |
| 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 6.3% and 2.1% respectively of the related consolidated totals.

29. INVESTMENTS IN ASSOCIATES

| | The Group | | The Bank | |
|---------------------------------------|-----------|---------|----------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Listed shares, at cost | — | — | 1,781 | 1,743 |
| Unlisted shares, at cost | — | — | 196 | 271 |
| Share of net assets | 2,389 | 2,260 | — | — |
| Goodwill | 226 | 226 | — | — |
| | 2,615 | 2,486 | 1,977 | 2,014 |
| Less: Impairment allowances | — | — | (31) | (30) |
| | 2,615 | 2,486 | 1,946 | 1,984 |

Loans to associates amounting to HK\$497 million (2008: HK\$76 million) are included under advances to customers.

Share of associates' taxation for the year amounted to HK\$81 million (2008: HK\$59 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 | |
| Listed | | | | |
| Affin Holdings Berhad | Malaysia | 21.095% | | Investment holding |
| Unlisted | | | | |
| 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% | | Inactive |

Notes: BVI denotes the British Virgin Islands and PRC denotes the People's Republic of China.

Summary financial information on associates

| | Assets | Liabilities | Equity | Revenue | Profit |
|-------------------------------------|---------------|---------------|--------------|------------|------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 2009 | | | | | |
| 100 per cent. | 102,075 | 89,071 | 13,004 | 3,506 | 1,052 |
| Group's effective interest. | <u>21,425</u> | <u>19,036</u> | <u>2,389</u> | <u>762</u> | <u>264</u> |
| 2008 | | | | | |
| 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> |

30. 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 | |
|--------------------------------------|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Goodwill | 2,738 | 2,705 | 1,460 | 1,460 |
| Acquired intangible assets | 1,397 | 29 | — | — |
| | <u>4,135</u> | <u>2,734</u> | <u>1,460</u> | <u>1,460</u> |

(a) Goodwill

| | The Group | | The Bank | |
|---|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 2,705 | 2,656 | 1,460 | 1,460 |
| Additions through acquisition of subsidiaries | 22 | 52 | — | — |
| Exchange adjustments | 11 | (3) | — | — |
| At 31st December | <u>2,738</u> | <u>2,705</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 segments as follows:

| | 2009 | 2008 |
|------------------------------|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Personal banking | 849 | 849 |
| Corporate banking | 453 | 453 |
| Treasury markets | 158 | 158 |
| Corporate services | 1,100 | 1,067 |
| Others | 178 | 178 |
| | <u>2,738</u> | <u>2,705</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 14.37% (2008: 8.28%) and the long-term growth rate is 3% (2008: 4%).

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 internal forecasts.

(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 income statement 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 | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Cost | | | | |
| At 1st January | 38 | 16 | — | — |
| Additions | 1,380 | 6 | — | — |
| Exchange and other adjustments. | — | 16 | — | — |
| At 31st December | <u>1,418</u> | <u>38</u> | <u>—</u> | <u>—</u> |
| Accumulated amortisation | | | | |
| At 1st January | (9) | (4) | — | — |
| Amortisation charge for the year (Note 10) | (13) | (3) | — | — |
| Exchange adjustments | 1 | (2) | — | — |
| At 31st December | <u>(21)</u> | <u>(9)</u> | <u>—</u> | <u>—</u> |
| Carrying amount at 31st December | <u>1,397</u> | <u>29</u> | <u>—</u> | <u>—</u> |

31. FIXED ASSETS

| | 2009 | | | | |
|--|--------------------------|------------------|---|---------------|---------------|
| | 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, 2009 | 1,839 | 6,293 | 3,507 | 9,800 | 11,639 |
| Additions | — | 2,264 | 297 | 2,561 | 2,561 |
| Additions through acquisition | — | — | 16 | 16 | 16 |
| Revaluation surplus | 206 | — | — | — | 206 |
| Revaluation of bank premises transferred to investment properties | — | 97 | — | 97 | 97 |
| Transfer from bank premises to investment properties | 61 | (61) | — | (61) | — |
| Disposals | (14) | (24) | (162) | (186) | (200) |
| Exchange adjustments | 3 | 3 | 15 | 18 | 21 |
| At 31st December, 2009 | <u>2,095</u> | <u>8,572</u> | <u>3,673</u> | <u>12,245</u> | <u>14,340</u> |
| Accumulated depreciation and amortisation | | | | | |
| At 1st January, 2009 | — | 675 | 1,818 | 2,493 | 2,493 |
| Additions through acquisition | — | — | 7 | 7 | 7 |
| Charge for the year (Note 10) | — | 99 | 413 | 512 | 512 |
| Impairment loss | — | 13 | — | 13 | 13 |
| Written back on disposals | (12) | (154) | (166) | (166) | — |
| Exchange adjustments | — | — | 14 | 14 | 14 |
| At 31st December, 2009 | <u>—</u> | <u>775</u> | <u>2,098</u> | <u>2,873</u> | <u>2,873</u> |
| Net book value at 31st December, 2009 | <u>2,095</u> | <u>7,797</u> | <u>1,575</u> | <u>9,372</u> | <u>11,467</u> |
| The gross amounts of the above assets are stated: | | | | | |
| At cost | — | 7,745 | 3,673 | 11,418 | 11,418 |
| At Directors' valuation | | | | | |
| - 1989 | — | 827 | — | 827 | 827 |
| At professional valuation | | | | | |
| - 2009 | 2,095 | — | — | — | 2,095 |
| | <u>2,095</u> | <u>8,572</u> | <u>3,673</u> | <u>12,245</u> | <u>14,340</u> |

| The Bank | | | | | |
|--|----------------------|--|------------------|----------------|--------------|
| 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 | 1,819 | 3,135 | 2,246 | 5,381 | 7,200 |
| Additions | — | 602 | 135 | 737 | 737 |
| Revaluation surplus | 205 | — | — | — | 205 |
| Transfer from investment properties to bank premises | (212) | 212 | — | 212 | — |
| Disposals | (14) | — | (133) | (133) | (147) |
| Exchange adjustments | — | — | 7 | 7 | 7 |
| At 31st December, 2009 | <u>1,798</u> | <u>3,949</u> | <u>2,255</u> | <u>6,204</u> | <u>8,002</u> |
| Accumulated depreciation and amortisation | | | | | |
| At 1st January, 2009 | — | 323 | 1,290 | 1,613 | 1,613 |
| Charge for the year | — | 46 | 232 | 278 | 278 |
| Impairment loss | — | 13 | — | 13 | 13 |
| Written back on disposals | — | — | (128) | (128) | (128) |
| Exchange adjustments | — | — | 6 | 6 | 6 |
| At 31st December, 2009 | <u>—</u> | <u>382</u> | <u>1,400</u> | <u>1,782</u> | <u>1,782</u> |
| Net book value at 31st December, 2009 | <u>1,798</u> | <u>3,567</u> | <u>855</u> | <u>4,422</u> | <u>6,220</u> |
| The gross amounts of the above assets are stated: | | | | | |
| At cost | — | 3,122 | 2,255 | 5,377 | 5,377 |
| At Directors' valuation | | | | | |
| - 1989 | — | 827 | — | 827 | 827 |
| At professional valuation | | | | | |
| - 2009 | 1,798 | — | — | — | 1,798 |
| | <u>1,798</u> | <u>3,949</u> | <u>2,255</u> | <u>6,204</u> | <u>8,002</u> |

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 10) | — | 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> |

| The Bank | | | | | |
|---|----------------------|--|------------------|----------------|--------------|
| 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 | 1,829 | 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>1,819</u> | <u>2,812</u> | <u>956</u> | <u>3,768</u> | <u>5,587</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>1,819</u> | <u>3,135</u> | <u>2,246</u> | <u>5,381</u> | <u>7,200</u> |

The net book value of bank premises and investment properties comprises:

| | The Group | | | |
|--|----------------------------------|--------------------------|----------------------------------|--------------------------|
| | 2009 | | 2008 | |
| | Investment properties | Bank premises | Investment properties | Bank premises |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Freeholds — Held outside Hong Kong | 79 | 3,841 | 78 | 1,748 |
| Leaseholds | | | | |
| Held in Hong Kong | | | | |
| On long lease (over 50 years) | 1,489 | 1,586 | 1,449 | 1,477 |
| On medium-term lease (10 - 50 years) | 209 | 1,428 | 303 | 1,354 |
| Held outside Hong Kong | | | | |
| On long lease (over 50 years) | — | 161 | — | 193 |
| On medium-term lease (10 - 50 years) | 318 | 781 | 9 | 846 |
| | <u>2,095</u> | <u>7,797</u> | <u>1,839</u> | <u>5,618</u> |

| | The Bank | | | |
|--|----------------------------------|--------------------------|----------------------------------|--------------------------|
| | 2009 | | 2008 | |
| | Investment properties | Bank premises | Investment properties | Bank premises |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Freeholds — Held outside Hong Kong | — | 748 | — | 150 |
| Leaseholds | | | | |
| Held in Hong Kong | | | | |
| On long lease (over 50 years) | 1,391 | 1,503 | 1,365 | 1,391 |
| On medium-term lease (10 - 50 years) | 407 | 1,313 | 454 | 1,267 |
| Held outside Hong Kong | | | | |
| On long lease (over 50 years) | — | 3 | — | 3 |
| On medium-term lease (10 - 50 years) | — | — | — | 1 |
| | <u>1,798</u> | <u>3,567</u> | <u>1,819</u> | <u>2,812</u> |

The carrying amount of the bank premises of the Group and the Bank would have been HK\$6,933 million (2008: HK\$4,624 million) and HK\$2,498 million (2008: HK\$1,929 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\$1,698 million as at 31st December, 2009 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, 2009 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\$92 million in 2009 (2008: HK\$90 million). There was no contingent rental recognised during the year 2009 (2008: 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 | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Within one year | 78 | 74 | 67 | 69 |
| After one year but within five years | 81 | 62 | 62 | 47 |
| | <u>159</u> | <u>136</u> | <u>129</u> | <u>116</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 | |
|----------------------------------|-----------------|----------------|
| | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn |
| Financial institutions | 11,781 | 15,454 |
| Others | 938 | 944 |
| | <u>12,719</u> | <u>16,398</u> |

(b) Amounts due to subsidiaries

| | The Bank | |
|----------------------------------|-----------------|----------------|
| | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn |
| Financial institutions | 17 | 47 |
| Others | 1,625 | 1,947 |
| | <u>1,642</u> | <u>1,994</u> |

33. INCOME TAX IN THE STATEMENT OF FINANCIAL POSITION

(a) Current taxation in the statement of financial position represents:

| | The Group | | The Bank | |
|--|------------|------------|-----------|-----------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Provision for Hong Kong profits tax for the year (Note 13(a)) | 73 | 64 | — | — |
| Provisional profits tax paid | (49) | (51) | — | — |
| | 24 | 13 | — | — |
| Balance of profits tax provision relating to prior years | 9 | (1) | (14) | (14) |
| Overseas taxation | 114 | 321 | 32 | 74 |
| | <u>147</u> | <u>333</u> | <u>18</u> | <u>60</u> |

(b) 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 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 |
| Deferred tax arising from: | | | | | | | |
| At 1st January, 2009 | 361 | 257 | (49) | (4) | (661) | (14) | (110) |
| Charged/(credited) to income statement (Note 13(a)) | (56) | 34 | (33) | — | 447 | (61) | 331 |
| Credited to reserves (Notes 38(c) and (h)) | — | 26 | — | 43 | — | — | 69 |
| Exchange and other adjustments | — | 32 | 105 | — | (2) | (227) | (92) |
| At 31st December, 2009 | <u>305</u> | <u>349</u> | <u>23</u> | <u>39</u> | <u>(216)</u> | <u>(302)</u> | <u>198</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 |
| Deferred tax arising from: | | | | | | | |
| At 1st January, 2008 . . . | 321 | 274 | 58 | 94 | (59) | 114 | 802 |
| Charged/(credited) to income statement (Note 13(a)) | 26 | (14) | (114) | — | (601) | (23) | (726) |
| Credited to reserves (Notes 38(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 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 |
| Deferred tax arising from: | | | | | | | |
| At 1st January, 2009 . . . | 347 | 257 | (44) | (5) | (528) | (2) | 25 |
| Charged/(credited) to income statement . . . | (58) | 34 | (83) | — | 421 | 7 | 321 |
| Credited to reserves (Notes 38(c) and (h)) . . . | — | (2) | — | 49 | — | — | 47 |
| Exchange and other adjustments | — | — | 1 | — | (3) | (226) | (228) |
| At 31st December, 2009 . . | <u>289</u> | <u>289</u> | <u>(126)</u> | <u>44</u> | <u>(110)</u> | <u>(221)</u> | <u>165</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 |
| Deferred tax arising from: | | | | | | | |
| At 1st January, 2008 . . . | 313 | 274 | (43) | 94 | (9) | 113 | 742 |
| Charged/(credited) to income statement . . . | 34 | (14) | (1) | — | (519) | (11) | (511) |
| Credited to reserves (Notes 38(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 Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Net deferred tax assets recognised on the statement of financial position | (322) | (187) | (168) | (38) |
| Net deferred tax liabilities recognised on the statement of financial position | <u>520</u> | <u>77</u> | <u>333</u> | <u>63</u> |
| | <u>198</u> | <u>(110)</u> | <u>165</u> | <u>25</u> |

(c) **Deferred tax assets not recognised**

The Group has not recognised deferred tax assets in respect of cumulative tax losses of HK\$744 million (2008: HK\$737 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:

| | 2009 | 2008 |
|--------------------------------------|----------------|----------------|
| | HK\$ Mn | HK\$ Mn |
| Expiring within 5 years | 34 | 57 |
| Expiring more than 5 years | 52 | 7 |
| No expiry date | <u>658</u> | <u>673</u> |
| | <u>744</u> | <u>737</u> |

34. OTHER LIABILITIES

| | The Group | | The Bank | |
|---|---------------|---------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| (a) Trading liabilities | | | | |
| Exchange fund bills sold | — | 330 | — | 330 |
| Shares sold | 6 | — | 6 | — |
| | 6 | 330 | 6 | 330 |
| Negative fair value of derivatives (Note 42(b)) | 1,449 | 2,516 | 1,229 | 2,219 |
| | <u>1,455</u> | <u>2,846</u> | <u>1,235</u> | <u>2,549</u> |
| (b) Other accounts and provisions | | | | |
| Accrued interest payable | 1,089 | 1,953 | 595 | 1,035 |
| Acceptance draft payable | 7,976 | 2,989 | 203 | 272 |
| Other accounts | 9,441 | 7,197 | 2,750 | 2,172 |
| | <u>18,506</u> | <u>12,139</u> | <u>3,548</u> | <u>3,479</u> |

35. LOAN CAPITAL

| | The Group | | The Bank | |
|---|---------------|---------------|---------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| USD550 million 5.625% subordinated notes, measured at fair value through profit or loss | 4,281 | 3,644 | 4,281 | 3,644 |
| GBP300 million 6.125% step-up perpetual subordinated notes, measured at fair value through profit or loss | 3,431 | 2,751 | 3,431 | 2,751 |
| USD600 million floating rate step-up subordinated notes, measured at amortised cost | 4,647 | 4,641 | 4,647 | 4,641 |
| USD500 million Hybrid Tier 1 | — | — | 3,916 | — |
| | <u>12,359</u> | <u>11,036</u> | <u>16,275</u> | <u>11,036</u> |

Loan capital of face value of HK\$4,265 million (USD550 million) and carrying amount of HK\$4,281 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\$3,749 million (GBP300 million) and carrying amount of HK\$3,431 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 for the Group as at 31st December, 2009 was HK\$303 million (2008: HK\$1,232 million) and for the Bank was HK\$264 million (2008: HK\$1,232 million) lower than the contractual amount at maturity. The difference in the accumulated amount of the changes in fair value attributable to changes in credit risk for the Group were HK\$618 million (2008: HK\$1,858 million) and for the Bank were HK\$689 million (2008: HK\$1,858 million). The change for the year ended 31st December, 2009 for the Group was HK\$1,240 million (2008: HK\$2,183 million) and for the Bank was HK\$1,169 million (2008: HK\$2,183 million).

Loan capital of face value of HK\$4,653 million (USD600 million) and carrying amount of HK\$4,647 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, 2009 was HK\$4,211 million (USD543 million) (2008: HK\$3,953 million) (USD510 million).

Hybrid Tier 1 capital instruments comprising step-up subordinated notes (“Notes”) of face value HK\$3,878 million (USD500 million) and carrying amount of HK\$3,916 million and HK\$3,878 million (USD500 million) non-cumulative preference shares

("Innovate Preference Shares") were issued respectively by the Bank and by Innovate Holdings Limited, a wholly owned subsidiary of the Bank, on 5th November, 2009. The Notes bear a fixed interest rate of 8.5% per annum and will mature on 5th November, 2059. The Innovate Preference Shares are perpetual securities on which no dividend is payable. The Notes and the Innovate Preference Shares are listed, and traded together as units, on the Singapore Stock Exchange. The Hybrid Tier 1 capital instruments are qualified as tier 1 capital of the Bank and the Group. In the consolidated accounts, the Notes are eliminated and the Innovate Preference Shares are classified as minority interest.

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

| <u>Date of grant</u> | <u>Vesting period</u> | <u>Exercise period</u> | <u>Exercise price per share HK\$</u> |
|----------------------|-----------------------|------------------------|--------------------------------------|
| 22/4/2004 | 22/4/2004 - 21/4/2005 | 22/4/2005 - 22/4/2009 | 21.11* |
| 03/5/2005 | 03/5/2005 - 02/5/2006 | 03/5/2006 - 03/5/2010 | 20.86* |
| 03/5/2006 | 03/5/2006 - 02/5/2007 | 03/5/2007 - 03/5/2011 | 30.04* |
| 10/5/2007 | 10/5/2007 - 09/5/2008 | 10/5/2008 - 10/5/2012 | 42.84* |
| 05/5/2008 | 05/5/2008 - 04/5/2009 | 05/5/2009 - 05/5/2013 | 40.09* |
| 05/5/2009 | 05/5/2009 - 04/5/2010 | 05/5/2010 - 05/5/2014 | 21.25 |

(b) The number and weighted average exercise prices of share options are as follows:

| | <u>2009</u> | | <u>2008</u> | |
|--|--|--------------------------|---|---------------------------|
| | <u>Weighted average exercise price</u> | <u>Number of options</u> | <u>Weighted average exercise Price*</u> | <u>Number of options*</u> |
| | <u>HK\$</u> | <u>Mn</u> | <u>HK\$</u> | <u>Mn</u> |
| Outstanding at the beginning of the year | 30.53 | 22 | 24.73 | 21 |
| Exercised during the year. | 20.86 | (2) | 18.56 | (5) |
| Granted during the year. | 21.25 | 6 | 40.09 | 6 |
| Lapsed during the year | 25.67 | (4) | 21.11 | — |
| Outstanding at the end of the year | 29.55 | <u>22</u> | 30.53 | <u>22</u> |
| Exercisable at the end of the year | 33.04 | 16 | 26.86 | 16 |

The weighted average share price at the date of exercise for shares options exercised during the year was HK\$23.60 (2008: HK\$33.72 or HK\$30.65 after adjusting for the bonus issue in 2009).

The options outstanding at 31st December, 2009 had an exercise price from HK\$20.86 to HK\$42.84 (2008: from HK\$22.95 to HK\$47.13 or from HK\$20.86 to HK\$42.84 after adjusting for the bonus issue in 2009) and a weighted average remaining contractual life of 2.63 years (2008: 2.44 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.

| | <u>2009</u> | <u>2008</u> |
|--|-------------|-------------|
| Fair value at measurement date | HK\$9.66 | HK\$13.88* |
| Share price | HK\$21.25 | HK\$40.09* |
| Exercise price. | HK\$21.25 | HK\$40.09* |
| Expected volatility (expressed as weighted average volatility used in the modelling under trinomial lattice model) | 59.96% | 48.88% |
| Option life | 5 years | 5 years |
| Expected dividends | 2.35% | 4.64% |
| Risk-free interest rate (based on Exchange Fund Notes) | 1.64% | 2.48% |

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.

* The Bank made a one for 10 bonus issue of shares on 17th April, 2009 (the “Bonus Issue”). For share options remained exercisable on 17th April, 2009, adjustments for the Bonus Issue were made to the effect that the number of share options have been increased by 10% and the exercise prices have been decreased accordingly. These adjustments were made in accordance with the Rules of the relevant share option schemes.

37. SHARE CAPITAL

| | <u>2009</u> | | <u>2008</u> | |
|--|----------------------|----------------------|----------------------|----------------------|
| | <u>No. of shares</u> | <u>Nominal value</u> | <u>No. of shares</u> | <u>Nominal value</u> |
| | <u>million</u> | | <u>million</u> | |
| Authorised: | | | | |
| Ordinary shares of HK\$2.50 each | <u>2,600</u> | <u>HK\$6,500Mn</u> | <u>2,600</u> | <u>HK\$6,500Mn</u> |
| Substitute preference shares of US\$1,000 each | <u>0.5</u> | <u>US\$500Mn</u> | <u>—</u> | <u>—</u> |
| | | <u>HK\$ Mn</u> | | <u>HK\$ Mn</u> |
| Issued and fully paid: | | | | |
| At 1st January. | 1,673 | 4,183 | 1,574 | 3,936 |
| Shares issued under Staff Share Option Schemes | 2 | 5 | 5 | 12 |
| Subscription for new shares. | — | — | 79 | 197 |
| Capitalisation issue. | 167 | 418 | — | — |
| Shares issued in lieu of dividends | <u>7</u> | <u>17</u> | <u>15</u> | <u>38</u> |
| At 31st December. | <u>1,849</u> | <u>4,623</u> | <u>1,673</u> | <u>4,183</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 2 million ordinary shares in the Bank at a consideration of HK\$41 million of which HK\$5 million was credited to share capital and the balance of HK\$36 million was credited to the share premium account (Note 38). HK\$3 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**

| Date of options granted | Option price | 2009 | 2008 |
|-------------------------|--------------|-------------------|--------------------|
| | | No. of shares | No. of shares |
| 22/4/2004 | HK\$21.11* | — | 3,041,500* |
| 03/5/2005 | HK\$20.86* | 4,737,000 | 6,715,500* |
| 03/5/2006 | HK\$30.04* | 2,695,000 | 2,970,000* |
| 10/5/2007 | HK\$42.84* | 2,750,000 | 3,025,000* |
| 05/5/2008 | HK\$40.09* | 5,500,000 | 6,050,000* |
| 05/5/2009 | HK\$21.25* | 6,600,000 | — |
| | | <u>22,282,000</u> | <u>21,802,000*</u> |

* After adjusting for the bonus issue in 2009.

38. RESERVES

| | 2009 | |
|--|---------------|---------------|
| | The Group | The Bank |
| | HK\$ Mn | HK\$ Mn |
| (a) Share premium (undistributable) | | |
| At 1st January | 4,922 | 4,922 |
| Net premium on shares issued under Staff Share Option Schemes | 36 | 36 |
| Transfer of the fair value of options from capital reserve — share options issued. | 3 | 3 |
| Shares issued in lieu of dividends | (17) | (17) |
| Capitalisation issue | <u>(418)</u> | <u>(418)</u> |
| At 31st December | <u>4,526</u> | <u>4,526</u> |
| (b) General reserve | | |
| At 1st January | 14,634 | 14,369 |
| Transfer from retained profits | 49 | — |
| Shares issued in lieu of dividends | 177 | 177 |
| Realised surplus on disposals transferred from property revaluation reserve | <u>6</u> | <u>6</u> |
| At 31st December | <u>14,866</u> | <u>14,552</u> |
| (c) Revaluation reserve on bank premises (undistributable) | | |
| At 1st January | 863 | 899 |
| Recognition of net deferred tax liabilities (Note 33(b)). | (26) | 2 |
| Revaluation surplus on bank premises transferred to investment properties | 97 | — |
| Realised surplus on disposals transferred to general reserve | <u>(6)</u> | <u>(6)</u> |
| At 31st December | <u>928</u> | <u>895</u> |

| | <u>The Group</u> | <u>The Bank</u> |
|--|------------------|-----------------|
| | HK\$ Mn | HK\$ Mn |
| (d) Statutory reserves (undistributable) | | |
| At 1st January | 1,216 | — |
| Transfer from retained profits | 285 | 7 |
| At 31st December | <u>1,501</u> | <u>7</u> |
| (e) Capital reserve (undistributable) | | |
| At 1st January and 31st December | <u>86</u> | <u>—</u> |
| (f) Exchange revaluation reserve (undistributable) | | |
| At 1st January | 1,006 | 48 |
| Exchange adjustments | 163 | 7 |
| At 31st December | <u>1,169</u> | <u>55</u> |
| (g) Capital reserve — staff share options issued (undistributable) | | |
| At 1st January | 125 | 125 |
| Transfer of the fair value of options to share premium | (3) | (3) |
| Forfeited options transfer to retained profits | (23) | (23) |
| Additions | 71 | 71 |
| At 31st December | <u>170</u> | <u>170</u> |
| (h) Investment revaluation reserve (undistributable) | | |
| At 1st January | (228) | (45) |
| Changes in fair value of securities | 575 | 267 |
| Reversal upon disposal (Note 12) | (29) | 5 |
| Recognition of deferred tax liabilities (Note 33(b)) | (43) | (49) |
| Impairment loss and amortisation | 11 | — |
| At 31st December | <u>286</u> | <u>178</u> |
| (i) Other reserves | | |
| At 1st January | — | — |
| Share of changes in equity of associates | 17 | — |
| At 31st December | <u>17</u> | <u>—</u> |
| (j) Retained profits | | |
| At 1st January | 5,339 | 2,724 |
| Net profit for the year | 2,565 | 995 |
| Transfer to general reserve | (49) | — |
| Transfer to statutory reserve | (285) | (7) |
| Forfeited options transfer to retained profits | 23 | 23 |
| Dividends (Note 15) | | |
| - Interim dividend | (516) | (516) |
| - Final dividend in respect of previous year | (33) | (33) |
| - Hybrid Tier 1 USD500M | (51) | — |
| At 31st December | <u>6,993</u> | <u>3,186</u> |
| (k) Total reserves | <u>30,542</u> | <u>23,569</u> |

| | <u>The Group</u> | <u>The Bank</u> |
|---|------------------|-----------------|
| | HK\$ Mn | HK\$ Mn |
| (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 |
| At 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 33(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> |
| (e) Capital reserve (undistributable) | | |
| At 1st January and 31st December | <u>86</u> | <u>—</u> |
| (f) Exchange revaluation reserve (undistributable) | | |
| At 1st January | 650 | 80 |
| Exchange adjustments | 356 | (32) |
| At 31st December | <u>1,006</u> | <u>48</u> |
| (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 | <u>125</u> | <u>125</u> |
| (h) Investment revaluation reserve (undistributable) | | |
| At 1st January | 475 | 422 |
| Changes in fair value of securities | (830) | (472) |
| Reversal upon disposal (Note 12) | (115) | (114) |
| Recognition of deferred tax liabilities (Note 33(b)) | 98 | 99 |
| Impairment loss | 153 | 20 |
| Exchange adjustments | (9) | — |
| At 31st December | <u>(228)</u> | <u>(45)</u> |

| | | 2008 | |
|-----|---|------------------|-----------------|
| | | <u>The Group</u> | <u>The Bank</u> |
| | | HK\$ Mn | HK\$ Mn |
| (i) | Other reserves | | |
| | At 1st January | 22 | — |
| | Share of changes in equity of associates. | (22) | — |
| | At 31st December | <u>—</u> | <u>—</u> |
| (j) | 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 15) | | |
| | - Interim dividend | (384) | (384) |
| | - Final dividend in respect of previous year. | (1,956) | (1,956) |
| | At 31st December | <u>5,339</u> | <u>2,724</u> |
| (k) | Total reserves. | <u>27,963</u> | <u>23,042</u> |

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 recognized 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).

Other reserve represents share of changes in equity of associates of investment revaluation reserve and revaluation reserve of bank premises.

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, 2009, HK\$1,857 million (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.

At 31st December, 2009 the aggregate amount of reserves available for distribution to equity holders of the Bank was HK\$17,738 million (2008: HK\$17,093 million). After the balance sheet date the directors proposed a final dividend of HK\$0.48 per ordinary share (2008: HK\$0.02 per share), amounting to HK\$968 million (2008: HK\$33 million). The dividend has not been recognised as a liability at the balance sheet date.

39. MINORITY INTERESTS

| | <u>2009</u> | <u>2008</u> |
|---|---------------------|-------------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| At 1st January | 339 | 347 |
| - sale of interests in businesses to minority interests investors. | 132 | — |
| - purchase of interests in businesses from minority interests investors | (10) | (64) |
| - Hybrid Tier 1 note issue. | 3,877 | — |
| - final dividend in respect of previous year | (55) | (7) |
| - exchange adjustments | 2 | (2) |
| Profit for the year | <u>73</u> | <u>65</u> |
| At 31st December | <u><u>4,358</u></u> | <u><u>339</u></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, strategic risk, legal risk and reputation risk of the Group are reviewed regularly by the Management and specialised risk management committees, and recommendations are made by the Risk Management Committee, which comprises the Group's Chairman and Chief Executive, Senior Advisors, Deputy Chief Executives and the Group Chief Risk Officer, for the approval of the Board of Directors. There is an independent centralised risk management unit, Risk Management Division, 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. Credit Risk Management Department under Risk Management Division 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 Specialised 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 being 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 statement of financial position after deducting any impairment allowance. A summary of the maximum exposure is as follows:

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Cash and balances with banks, central banks and other financial institutions | 28,611 | 27,022 | 11,821 | 4,154 |
| Placements with banks, central banks and other financial institutions | 67,945 | 96,574 | 61,894 | 92,735 |
| Trade bills | 1,847 | 1,164 | 861 | 521 |
| Trading assets | 4,092 | 2,260 | 1,749 | 1,777 |
| Financial assets designated at fair value through profit or loss . . | 10,043 | 4,130 | 10,035 | 4,114 |
| Loans and advances to customers | 246,309 | 229,295 | 142,197 | 130,293 |
| Available-for-sale financial assets | 28,996 | 17,551 | 17,949 | 10,276 |
| Held-to-maturity investments | 7,239 | 5,006 | 4,802 | 3,318 |
| Other assets | 14,369 | 11,478 | 5,491 | 7,376 |
| Financial guarantees and other credit related contingent liabilities | 9,965 | 10,088 | 7,616 | 9,138 |
| Loan commitments and other credit related commitments | <u>77,273</u> | <u>66,080</u> | <u>59,169</u> | <u>53,283</u> |
| | <u>496,689</u> | <u>470,648</u> | <u>323,584</u> | <u>316,985</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, 2009 and 2008, 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 | |
|---|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Gross loans and advances to customers | | | | |
| - neither past due nor impaired | 245,149 | 228,479 | 141,219 | 129,683 |
| - past due but not impaired | 57 | 274 | 44 | 166 |
| - impaired | <u>2,448</u> | <u>1,586</u> | <u>2,111</u> | <u>1,274</u> |
| | <u>247,654</u> | <u>230,339</u> | <u>143,374</u> | <u>131,123</u> |

Of which:

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Gross loans and advances to customers that are neither past due nor impaired | | | | |
| - Pass | 242,617 | 226,550 | 139,187 | 128,219 |
| - Special mention | <u>2,532</u> | <u>1,929</u> | <u>2,032</u> | <u>1,464</u> |
| | <u>245,149</u> | <u>228,479</u> | <u>141,219</u> | <u>129,683</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 | |
|--|-----------|---------|----------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | 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 | 57 | 274 | 44 | 166 |

Loans and advances that would be past due or impaired had the terms not been renegotiated amounted to HK\$234 million as at 31st December, 2009 (2008: HK\$239 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 | |
|-------------------------|-----------|---------|----------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Aaa | 4,783 | 1,790 | 4,571 | 1,608 |
| Aa1 to Aa3 | 11,672 | 5,706 | 10,395 | 4,604 |
| A1 to A3 | 7,616 | 2,706 | 6,384 | 2,029 |
| Lower than A3 | 1,967 | 1,121 | 1,462 | 851 |
| | 26,038 | 11,323 | 22,812 | 9,092 |
| P-1 | 10,176 | — | — | — |
| Unrated | 4,323 | 2,440 | 3,223 | 2,440 |
| Total | 40,537 | 13,763 | 26,035 | 11,532 |

(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 | |
|--|-----------|---------|----------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | 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 | 192,357 | 178,200 | 106,004 | 95,567 |
| - past due but not impaired | 57 | 210 | 42 | 147 |
| | 192,414 | 178,410 | 106,046 | 95,714 |

(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 statement of financial position 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

| | 2009 | | | | 2008 | | | |
|--|-----------------|------------------|--------------------------------|------------------|-----------------|------------------|--------------------------------|------------------|
| | 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 |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 2,241 | 17,427 | 1,453 | 21,121 | 2,425 | 23,215 | 1,263 | 26,903 |
| Placements with banks and other financial institutions | 14,832 | 4,169 | 24,609 | 43,610 | 28,670 | 1,252 | 18,795 | 48,717 |
| Trade bills | 1,782 | 8 | 44 | 1,834 | 1,078 | — | 72 | 1,150 |
| Trading assets | 836 | 2,327 | 312 | 3,475 | 652 | 438 | 160 | 1,250 |
| Financial assets designated at fair value through profit or loss | 6,709 | — | 908 | 7,617 | 2,158 | — | 631 | 2,789 |
| Advances to customers and other accounts | 44,193 | 83,346 | 19,252 | 146,791 | 42,442 | 75,119 | 17,419 | 134,980 |
| Available-for-sale financial assets | 7,324 | 9,650 | 5,233 | 22,207 | 3,261 | 6,184 | 3,594 | 13,039 |
| Held-to-maturity investments . | 3,088 | — | 2,106 | 5,194 | 1,941 | — | 1,864 | 3,805 |
| Investment in associates . . . | 360 | — | — | 360 | 292 | — | — | 292 |
| Fixed assets | 190 | 4,805 | 879 | 5,874 | 211 | 3,083 | 267 | 3,561 |
| Goodwill and intangible assets | 239 | 20 | 404 | 663 | 241 | 20 | 386 | 647 |
| Deferred tax assets | 230 | — | 80 | 310 | 161 | — | 8 | 169 |
| Spot assets | <u>82,024</u> | <u>121,752</u> | <u>55,280</u> | <u>259,056</u> | <u>83,532</u> | <u>109,311</u> | <u>44,459</u> | <u>237,302</u> |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | (4,715) | (4,582) | (1,949) | (11,246) | (1,456) | (25,020) | (297) | (26,773) |
| Deposits from customers . . . | (60,630) | (97,918) | (48,141) | (206,689) | (59,678) | (73,464) | (41,000) | (174,142) |
| Trading liabilities | (1,042) | (26) | (59) | (1,127) | (1,595) | (148) | (199) | (1,942) |
| Certificates of deposit issued. | (1,639) | — | — | (1,639) | (2,452) | — | (426) | (2,878) |
| Current taxation | 13 | (58) | (70) | (115) | (27) | (192) | (31) | (250) |
| Debt securities issued | — | (4,346) | — | (4,346) | — | — | — | — |
| Deferred tax liabilities | (4) | (82) | (42) | (128) | (4) | — | — | (4) |
| Other accounts and provisions | (2,716) | (9,333) | (1,394) | (13,443) | (2,176) | (4,524) | (966) | (7,666) |
| Loan capital | <u>(8,928)</u> | <u>—</u> | <u>(3,431)</u> | <u>(12,359)</u> | <u>(8,285)</u> | <u>—</u> | <u>(2,751)</u> | <u>(11,036)</u> |
| Spot liabilities | <u>(79,661)</u> | <u>(116,345)</u> | <u>(55,086)</u> | <u>(251,092)</u> | <u>(75,673)</u> | <u>(103,348)</u> | <u>(45,670)</u> | <u>(224,691)</u> |
| Forward purchases | 59,917 | 27,419 | 11,016 | 98,352 | 51,244 | 18,872 | 11,843 | 81,959 |
| Forward sales | (57,946) | (27,850) | (8,726) | (94,522) | (55,976) | (18,781) | (8,713) | (83,470) |
| Net option position | <u>(45)</u> | <u>—</u> | <u>34</u> | <u>(11)</u> | <u>3</u> | <u>—</u> | <u>(4)</u> | <u>(1)</u> |
| Net long non-structural position | <u>4,289</u> | <u>4,976</u> | <u>2,518</u> | <u>11,783</u> | <u>3,130</u> | <u>6,054</u> | <u>1,915</u> | <u>11,099</u> |
| Net structural position . . . | <u>2,432</u> | <u>6,605</u> | <u>1,012</u> | <u>10,049</u> | <u>2,179</u> | <u>6,602</u> | <u>940</u> | <u>9,721</u> |

The Bank

| | 2009 | | | | 2008 | | | |
|--|---------------|--------------|--------------------------|----------------|---------------|--------------|--------------------------|----------------|
| | 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 |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 1,220 | 1,946 | 1,055 | 4,221 | 1,107 | 1,373 | 962 | 3,442 |
| Placements with banks and other financial institutions | 13,504 | — | 24,506 | 38,010 | 26,730 | — | 18,795 | 45,525 |
| Trade bills | 838 | — | 10 | 848 | 454 | — | 55 | 509 |
| Trading assets | 819 | 1 | 311 | 1,131 | 611 | 1 | 159 | 771 |
| Financial assets designated at fair value through profit or loss | 6,701 | — | 908 | 7,609 | 2,141 | — | 631 | 2,772 |
| Advances to customers and other accounts | 19,052 | 21 | 15,385 | 34,458 | 20,184 | 18 | 14,602 | 34,804 |
| Available-for-sale financial assets | 5,638 | 135 | 4,991 | 10,764 | 2,178 | 428 | 3,511 | 6,117 |
| Amounts due from subsidiaries | 7,525 | 730 | 695 | 8,950 | 12,663 | 549 | — | 13,212 |
| Held-to-maturity investments | 1,788 | — | 1,985 | 3,773 | 1,098 | — | 1,738 | 2,836 |
| Investment in subsidiaries and associates | 2,075 | — | 361 | 2,436 | 1,786 | — | 361 | 2,147 |
| Fixed assets | 7 | — | 807 | 814 | 9 | — | 203 | 212 |
| Deferred tax assets | 91 | — | 77 | 168 | 33 | — | 5 | 38 |
| Spot assets | <u>59,258</u> | <u>2,833</u> | <u>51,091</u> | <u>113,182</u> | <u>68,994</u> | <u>2,369</u> | <u>41,022</u> | <u>112,385</u> |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | (1,227) | — | (1,654) | (2,881) | (620) | — | (202) | (822) |
| Deposits from customers | (42,215) | (2,614) | (45,959) | (90,788) | (48,260) | (2,488) | (39,107) | (89,855) |
| Trading liabilities | (861) | — | (46) | (907) | (1,464) | — | (181) | (1,645) |
| Certificates of deposit issued | (1,639) | — | — | (1,639) | (2,452) | — | (426) | (2,878) |
| Amounts due to subsidiaries | (543) | — | (26) | (569) | (552) | — | (198) | (750) |
| Current taxation | 2 | — | (35) | (33) | (29) | — | (45) | (74) |
| Other accounts and provisions | (455) | (6) | (1,248) | (1,709) | (821) | (6) | (829) | (1,656) |
| Loan capital | (12,844) | — | (3,431) | (16,275) | (8,285) | — | (2,751) | (11,036) |
| Spot liabilities | (59,782) | (2,620) | (52,399) | (114,801) | (62,483) | (2,494) | (43,739) | (108,716) |
| Forward purchases | 72,537 | 161 | 10,725 | 83,423 | 44,169 | 15 | 11,820 | 56,004 |
| Forward sales | (71,256) | (153) | (8,429) | (79,838) | (49,326) | (19) | (8,184) | (57,529) |
| Net option position | (45) | — | 34 | (11) | 3 | — | (4) | (1) |
| Net long/(short) non-structural position | <u>712</u> | <u>221</u> | <u>1,022</u> | <u>1,955</u> | <u>1,357</u> | <u>(129)</u> | <u>915</u> | <u>2,143</u> |
| Net structural position | <u>2,432</u> | <u>6,605</u> | <u>1,012</u> | <u>10,049</u> | <u>2,179</u> | <u>6,602</u> | <u>940</u> | <u>9,721</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 Markets Division 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

| | 2009 | | | |
|---|---------------------|---------|---------|---------|
| | At 31st December | Maximum | Minimum | Mean |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| VaR for total trading activities | 45 | 76 | 43 | 59 |
| VaR for foreign exchange trading positions* | 7 | 21 | 5 | 11 |
| VaR for interest rate trading positions | 3 | 4 | 1 | 3 |
| VaR for equity trading positions | 37 | 61 | 35 | 46 |

| | 2008 | | | |
|---|---------------------|---------|---------|---------|
| | At 31st December | Maximum | Minimum | Mean |
| | 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 |

* 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 centralised 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. Operational Risk Management Department under Risk Management Division 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, Operational Risk Management Department under Risk Management Division 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 had been reviewed independently by 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 capitalise 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 Markets Division within the limits approved by the Board of Directors. Asset and Liability Management Department under Risk Management Division of the Group is responsible for monitoring the activities of Treasury Markets Division 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 analyse 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

2009

| | Repayable on demand | Within 1 month | 3 months or less but over 1 month | 1 year or less but over 3 months | 5 years or less but over 1 year | Over 5 years | Undated or overdue | Total |
|---|------------------------|-------------------|--|---|---------------------------------------|-----------------|-----------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 18,156 | 26 | 48 | — | — | — | 11,482 | 29,712 |
| Placements with banks and other financial institutions | — | 35,006 | 15,471 | 17,468 | — | — | — | 67,945 |
| Trade bills | 38 | 332 | 1,028 | 443 | — | — | 6 | 1,847 |
| Trading assets | — | — | 126 | 949 | 1,949 | 100 | 2,598 | 5,722 |
| Financial assets designated at fair value through profit or loss | — | — | 15 | 108 | 7,835 | 2,085 | 349 | 10,392 |
| Advances to customers and other accounts | 4,410 | 26,242 | 14,803 | 50,376 | 100,562 | 61,317 | 4,093 | 261,803 |
| Available-for-sale financial assets | — | 1,438 | 3,639 | 9,241 | 13,012 | 1,666 | 1,887 | 30,883 |
| Held-to-maturity investments | — | 729 | 602 | 1,306 | 4,011 | 591 | — | 7,239 |
| Undated assets | — | — | — | — | — | — | 18,539 | 18,539 |
| Total assets | 22,604 | 63,773 | 35,732 | 79,891 | 127,369 | 65,759 | 38,954 | 434,082 |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | 291 | 5,774 | 4,155 | 1,613 | 20 | — | 33 | 11,886 |
| Deposits from customers | 129,231 | 104,732 | 53,276 | 44,222 | 11,067 | — | — | 342,528 |
| - Demand deposits and current accounts | 46,380 | — | — | — | — | — | — | 46,380 |
| - Savings deposit | 81,711 | — | — | — | — | — | — | 81,711 |
| - Time, call and notice deposits | 1,140 | 104,732 | 53,276 | 44,222 | 11,067 | — | — | 214,437 |
| Trading liabilities | — | — | — | — | — | — | 1,455 | 1,455 |
| Certificates of deposit issued | — | — | 295 | 1,119 | 1,094 | 304 | — | 2,812 |
| Current taxation | — | — | — | 147 | — | — | — | 147 |
| Debt securities issued | — | — | — | — | 4,346 | — | — | 4,346 |
| Loan capital | — | — | — | 4,281 | 8,078 | — | — | 12,359 |
| Other liabilities | 590 | 2,391 | 2,522 | 4,940 | 873 | — | 7,710 | 19,026 |
| Total liabilities | 130,112 | 112,897 | 60,248 | 56,322 | 25,478 | 304 | 9,198 | 394,559 |
| Net gap | (107,508) | (49,124) | (24,516) | 23,569 | 101,891 | 65,455 | | |

The Group

2008

| | Repayable on demand | Within 1 month | 3 months or less but over 1 month | 1 year or less but over 3 months | 5 years or less but over 1 year | Over 5 years | Undated or overdue | Total |
|---|------------------------|-------------------|--|---|---------------------------------------|-----------------|-----------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 19,099 | 42 | 25 | — | — | — | 8,939 | 28,105 |
| Placements with banks and other financial institutions | — | 46,714 | 35,910 | 13,950 | — | — | — | 96,574 |
| Trade bills | 18 | 371 | 620 | 139 | — | — | 16 | 1,164 |
| Trading assets | — | 400 | — | 2 | 81 | 43 | 2,911 | 3,437 |
| Financial assets designated at fair value through profit or loss | — | 23 | 117 | 448 | 3,104 | 438 | — | 4,130 |
| Advances to customers and other accounts | 4,431 | 25,229 | 18,521 | 42,249 | 86,169 | 55,285 | 11,841 | 243,725 |
| Available-for-sale financial assets | — | 2,523 | 2,918 | 5,651 | 5,510 | 949 | 1,009 | 18,560 |
| Held-to-maturity investments | — | 483 | 497 | 1,546 | 2,160 | 320 | — | 5,006 |
| Undated assets | — | — | — | — | — | — | 14,553 | 14,553 |
| Total assets | 23,548 | 75,785 | 58,608 | 63,985 | 97,024 | 57,035 | 39,269 | 415,254 |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | 871 | 7,105 | 11,045 | 7,644 | 362 | 10 | 8 | 27,045 |
| Deposits from customers | 86,109 | 121,332 | 70,761 | 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 | 121,332 | 70,761 | 35,341 | 9,237 | 1,022 | — | 241,689 |
| Trading liabilities | — | 100 | 30 | 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 |
| Other liabilities | 714 | 539 | 1,645 | 2,237 | — | — | 7,081 | 12,216 |
| Total liabilities | 87,694 | 129,076 | 85,422 | 46,636 | 22,663 | 1,673 | 9,605 | 382,769 |
| Net gap | (64,146) | (53,291) | (26,814) | 17,349 | 74,361 | 55,362 | | |

The Bank

2009

| | Repayable on demand | Within 1 month | 3 months or less but over 1 month | 1 year or less but over 3 months | 5 years or less but over 1 year | Over 5 years | Undated or overdue | Total |
|---|------------------------|-------------------|--|---|---------------------------------------|-----------------|-----------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 11,767 | — | — | — | — | — | 760 | 12,527 |
| Placements with banks and other financial institutions | — | 31,895 | 13,313 | 16,686 | — | — | — | 61,894 |
| Trade bills | 36 | 132 | 528 | 159 | — | — | 6 | 861 |
| Trading assets | — | — | 1 | 1 | 802 | 100 | 2,420 | 3,324 |
| Financial assets designated at fair value through profit or loss | — | — | 15 | 108 | 7,827 | 2,085 | 349 | 10,384 |
| Advances to customers and other accounts | 4,078 | 19,841 | 7,398 | 17,595 | 59,910 | 35,731 | 4,043 | 148,596 |
| Available-for-sale financial assets | — | 1,421 | 3,061 | 3,692 | 8,979 | 796 | 986 | 18,935 |
| Held-to-maturity investments | — | 613 | 563 | 820 | 2,805 | 1 | — | 4,802 |
| Undated assets | — | — | — | — | — | — | 35,970 | 35,970 |
| Total assets | 15,881 | 53,902 | 24,879 | 39,061 | 80,323 | 38,713 | 44,534 | 297,293 |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | 277 | 1,300 | 1,557 | 354 | — | — | 33 | 3,521 |
| Deposits from customers | 93,026 | 87,296 | 37,746 | 18,685 | 764 | — | — | 237,517 |
| - Demand deposits and current accounts | 14,860 | — | — | — | — | — | — | 14,860 |
| - Savings deposit | 78,024 | — | — | — | — | — | — | 78,024 |
| - Time, call and notice deposits | 142 | 87,296 | 37,746 | 18,685 | 764 | — | — | 144,633 |
| Trading liabilities | — | — | — | — | — | — | 1,235 | 1,235 |
| Certificates of deposit issued | — | — | 295 | 1,119 | 1,094 | 2,504 | — | 5,012 |
| Current taxation | — | — | — | 18 | — | — | — | 18 |
| Loan capital | — | — | — | 4,281 | 8,078 | 3,916 | — | 16,275 |
| Other liabilities | — | 686 | 115 | 39 | 18 | — | 4,665 | 5,523 |
| Total liabilities | 93,303 | 89,282 | 39,713 | 24,496 | 9,954 | 6,420 | 5,933 | 269,101 |
| Net gap | (77,422) | (35,380) | (14,834) | 14,565 | 70,369 | 32,293 | | |

The Bank

2008

| | Repayable on demand | Within 1 month | 3 months or less but over 1 month | 1 year or less but over 3 months | 5 years or less but over 1 year | Over 5 years | Undated or overdue | Total |
|---|------------------------|-------------------|--|---|---------------------------------------|-----------------|-----------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 4,189 | — | — | — | — | — | 663 | 4,852 |
| Placements with banks and other financial institutions | — | 43,010 | 35,777 | 13,948 | — | — | — | 92,735 |
| Trade bills | 14 | 182 | 174 | 135 | — | — | 16 | 521 |
| Trading assets | — | 400 | — | 2 | 81 | 43 | 2,388 | 2,914 |
| Financial assets designated at fair value through profit or loss | — | 23 | 117 | 448 | 3,088 | 438 | — | 4,114 |
| Advances to customers and other accounts | 4,319 | 19,054 | 8,034 | 16,085 | 51,694 | 31,570 | 7,884 | 138,640 |
| Available-for-sale financial assets | — | 574 | 562 | 3,947 | 5,067 | 126 | 709 | 10,985 |
| Held-to-maturity investments | — | 315 | 147 | 1,092 | 1,653 | 111 | — | 3,318 |
| Undated assets | — | — | — | — | — | — | 37,140 | 37,140 |
| Total assets | 8,522 | 63,558 | 44,811 | 35,657 | 61,583 | 32,288 | 48,800 | 295,219 |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | 329 | 327 | 422 | 7 | — | — | 8 | 1,093 |
| Deposits from customers | 54,219 | 110,232 | 56,082 | 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 | 110,232 | 56,082 | 18,439 | 1,057 | — | — | 186,495 |
| Trading liabilities | — | 100 | 30 | 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 |
| Other liabilities | — | 153 | 142 | 28 | — | — | 5,213 | 5,536 |
| Total liabilities | 54,548 | 110,812 | 58,617 | 19,615 | 14,121 | 2,841 | 7,440 | 267,994 |
| Net gap | (46,026) | (47,254) | (13,806) | 16,042 | 47,462 | 29,447 | | |

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

| 2009 | | | | | | | | |
|--|--------------------------|---------------------------|------------------------------|---|----------------------------------|----------------------------|--------------|--------------|
| 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| Deposits and balances of banks and other financial institutions | 11,886 | 12,213 | 291 | 9,966 | 1,869 | 54 | — | 33 |
| Deposits from customers | 342,528 | 343,883 | 129,350 | 158,358 | 44,627 | 11,548 | — | — |
| - Demand deposits and current accounts | 46,380 | 46,380 | 46,380 | — | — | — | — | — |
| - Savings deposit | 81,711 | 81,730 | 81,730 | — | — | — | — | — |
| - Time, call and notice deposits | 214,437 | 215,773 | 1,240 | 158,358 | 44,627 | 11,548 | — | — |
| Trading liabilities | 1,455 | 1,455 | — | — | — | — | — | 1,455 |
| Certificates of deposit issued | 2,812 | 2,854 | — | 314 | 1,136 | 1,100 | 304 | — |
| Current taxation | 147 | 147 | — | — | 147 | — | — | — |
| Debt securities issued | 4,346 | 4,600 | — | 65 | 62 | 4,473 | — | — |
| Loan capital | 12,359 | 13,266 | — | 124 | 4,664 | 8,478 | — | — |
| Interest rate swaps | 4,364 | 4,364 | — | 266 | 863 | 2,206 | 1,029 | — |
| Other liabilities | 19,026 | 19,026 | 590 | 4,913 | 4,940 | 873 | — | 7,710 |
| Total | 398,923 | 401,808 | 130,231 | 174,006 | 58,308 | 28,732 | 1,333 | 9,198 |

The Group

| 2008 | | | | | | | | |
|--|--------------------------|---------------------------|------------------------------|---|----------------------------------|----------------------------|--------------|--------------|
| 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\$ Mn | 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 | 714 | 2,184 | 2,237 | — | — | 7,081 |
| Total | 384,561 | 389,518 | 87,874 | 216,218 | 48,456 | 25,334 | 2,031 | 9,605 |

The Bank

2009

| | 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\$ Mn | HK\$ Mn | HK\$ Mn | |
| Deposits and balances of banks and other financial institutions | 3,521 | 3,523 | 277 | 2,859 | 354 | — | — | 33 |
| Deposits from customers | 237,517 | 237,777 | 93,026 | 125,202 | 18,782 | 767 | — | — |
| - Demand deposits and current accounts | 14,860 | 14,860 | 14,860 | — | — | — | — | — |
| - Savings deposit | 78,024 | 78,024 | 78,024 | — | — | — | — | — |
| - Time, call and notice deposits | 144,633 | 144,893 | 142 | 125,202 | 18,782 | 767 | — | — |
| Trading liabilities | 1,235 | 1,235 | — | — | — | — | — | 1,235 |
| Certificates of deposit issued | 5,012 | 5,054 | — | 314 | 1,136 | 1,100 | 2,504 | — |
| Current taxation | 18 | 18 | — | — | 18 | — | — | — |
| Loan capital | 16,275 | 20,478 | — | 124 | 4,993 | 9,797 | 5,564 | — |
| Interest rate swaps | 3,639 | 3,639 | — | 166 | 540 | 1,959 | 974 | — |
| Other liabilities | 5,523 | 5,762 | — | 801 | 39 | 18 | — | 4,904 |
| Total | 272,740 | 277,486 | 93,303 | 129,466 | 25,862 | 13,641 | 9,042 | 6,172 |

The Bank

2008

| | 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\$ 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 | — | 305 | 51 | 68 | 58 | 5,213 |
| Total | 269,279 | 272,330 | 54,548 | 170,581 | 20,768 | 16,024 | 2,969 | 7,440 |

(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 Markets Division within the limit approved by the Board of Directors. Asset and Liability Management Department under Risk Management Division of the Group is responsible for monitoring the activities of Treasury Markets Division 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:

| | 2009 | | | 2008 | | |
|--|---------|---------|---------|---------|---------|---------|
| | HKD | USD | CNY | HKD | USD | CNY |
| | HK\$ Mn |
| Impact on earnings over the next 12 months if interest rates rise by 200 basis points. | (112) | (72) | (25) | 64 | (26) | 185 |
| Impact on economic value if interest rates rise by 200 basis points | (231) | (312) | (152) | (98) | (203) | 113 |

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 are 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

| | 2009 | | | | | |
|--|-----------------------------|--|---------------------------------------|-------------------------|---------------------------------|----------------|
| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| Cash and balances with banks and other financial institutions | 27,130 | 22 | — | — | 2,560 | 29,712 |
| Placements with banks and other financial institutions | 50,477 | 17,468 | — | — | — | 67,945 |
| Trade bills | 1,359 | 443 | — | — | 45 | 1,847 |
| Trading assets | 126 | 949 | 1,949 | 100 | 2,598 | 5,722 |
| Financial assets designated at fair value through profit or loss | 653 | 192 | 7,113 | 2,085 | 349 | 10,392 |
| Advances to customers | 191,994 | 39,853 | 8,875 | 3,033 | 2,554 | 246,309 |
| Other accounts | 786 | 146 | — | — | 14,562 | 15,494 |
| Available-for-sale financial assets | 11,350 | 8,257 | 8,156 | 1,233 | 1,887 | 30,883 |
| Held-to-maturity investments | 2,383 | 1,050 | 3,215 | 591 | — | 7,239 |
| Non-interest bearing assets | — | — | — | — | 18,539 | 18,539 |
| Total assets | <u>286,258</u> | <u>68,380</u> | <u>29,308</u> | <u>7,042</u> | <u>43,094</u> | <u>434,082</u> |
| Liabilities | | | | | | |
| Deposits and balances of banks and other financial institutions | 11,217 | 589 | 33 | 10 | 37 | 11,886 |
| Deposits from customers | 277,844 | 47,220 | 4,227 | — | 13,237 | 342,528 |
| Trading liabilities | 6 | — | — | — | 1,449 | 1,455 |
| Certificates of deposit issued | 798 | 999 | 711 | 304 | — | 2,812 |
| Debt securities issued | — | — | 4,346 | — | — | 4,346 |
| Loan capital | 4,647 | 4,281 | 3,431 | — | — | 12,359 |
| Non-interest bearing liabilities | — | — | — | — | 19,173 | 19,173 |
| Total liabilities | <u>294,512</u> | <u>53,089</u> | <u>12,748</u> | <u>314</u> | <u>33,896</u> | <u>394,559</u> |
| Interest rate sensitivity gap | <u>(8,254)</u> | <u>15,291</u> | <u>16,560</u> | <u>6,728</u> | | |

The Group

2008

| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|--|---------------------|-------------------------------|------------------------------|-----------------|-------------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 | 181,640 | 36,159 | 6,237 | 2,680 | 2,579 | 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 |
| Total assets | <u>303,072</u> | <u>58,525</u> | <u>12,467</u> | <u>4,375</u> | <u>36,815</u> | <u>415,254</u> |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | <u>296,257</u> | <u>47,834</u> | <u>12,023</u> | <u>1,363</u> | <u>25,292</u> | <u>382,769</u> |
| Interest rate sensitivity gap | <u>6,815</u> | <u>10,691</u> | <u>444</u> | <u>3,012</u> | | |

The Bank

2009

| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|--|---------------------|-------------------------------|------------------------------|-----------------|-------------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| Cash and balances with banks and other financial institutions | 11,233 | — | — | — | 1,294 | 12,527 |
| Placements with banks and other financial institutions | 45,208 | 16,686 | — | — | — | 61,894 |
| Trade bills | 657 | 159 | — | — | 45 | 861 |
| Trading assets | 1 | 1 | 802 | 100 | 2,420 | 3,324 |
| Financial assets designated at fair value through profit or loss | 653 | 192 | 7,105 | 2,085 | 349 | 10,384 |
| Advances to customers | 133,403 | 4,198 | 1,689 | 521 | 2,386 | 142,197 |
| Other accounts | 655 | 126 | — | — | 5,618 | 6,399 |
| Available-for-sale financial assets | 10,816 | 2,647 | 4,122 | 364 | 986 | 18,935 |
| Held-to-maturity investments | 2,228 | 563 | 2,010 | 1 | — | 4,802 |
| Non-interest bearing assets | — | — | — | — | 35,970 | 35,970 |
| Total assets | <u>204,854</u> | <u>24,572</u> | <u>15,728</u> | <u>3,071</u> | <u>49,068</u> | <u>297,293</u> |
| Liabilities | | | | | | |
| Deposits and balances of banks and other financial institutions | 3,130 | 354 | — | — | 37 | 3,521 |
| Deposits from customers | 205,842 | 18,685 | 764 | — | 12,226 | 237,517 |
| Trading liabilities | 6 | — | — | — | 1,229 | 1,235 |
| Certificates of deposit issued | 798 | 999 | 711 | 2,504 | — | 5,012 |
| Loan capital | 4,647 | 4,281 | 3,431 | 3,916 | — | 16,275 |
| Non-interest bearing liabilities | — | — | — | — | 5,541 | 5,541 |
| Total liabilities | <u>214,423</u> | <u>24,319</u> | <u>4,906</u> | <u>6,420</u> | <u>19,033</u> | <u>269,101</u> |
| Interest rate sensitivity gap | <u>(9,569)</u> | <u>253</u> | <u>10,822</u> | <u>(3,349)</u> | | |

The Bank

2008

| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|--|---------------------|-------------------------------|------------------------------|-----------------|-------------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 | 118,503 | 5,034 | 3,106 | 1,120 | 2,530 | 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 |
| Total assets | <u>208,440</u> | <u>24,757</u> | <u>8,370</u> | <u>1,779</u> | <u>51,873</u> | <u>295,219</u> |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | <u>220,086</u> | <u>19,260</u> | <u>8,466</u> | <u>3,520</u> | <u>16,662</u> | <u>267,994</u> |
| Interest rate sensitivity gap | <u>(11,646)</u> | <u>5,497</u> | <u>(96)</u> | <u>(1,741)</u> | | |

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 | |
|---|------------|------------|------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| | % | % | % | % |
| Assets | | | | |
| Cash and short-term funds and placements with banks and other financial institutions | 0-6.46 | 0-10.28 | 0-6.46 | 0-10.28 |
| Trade bills, advances to customers and advances to banks and other financial institutions | 0-45.70 | 0.50-36.10 | 0-18.52 | 0.60-18.33 |
| Securities (<i>Note</i>) | 0.01-7.75 | 0.04-8.23 | 0.01-7.75 | 0.04-8.23 |
| Liabilities | | | | |
| Deposits and balances of banks and other financial institutions | 0-9.17 | 0.02-13.21 | 0-9.17 | 0.02-13.21 |
| Deposits from customers | 0-10.50 | 0-9.00 | 0-8.90 | 0-9.00 |
| Certificates of deposit issued and loan capital | 0.01-10.01 | 0.92-10.14 | 0.01-10.01 | 0.92-10.14 |

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 that the Group's reputation is damaged by one or more than one reputation event, as reflected from negative publicity about the Group's business practices, conduct or financial condition. Such negative publicity, whether true or not, may impair public confidence in the Group, result in costly litigation, or lead to a decline in the customer base, business or revenue.

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.

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.

The capital adequacy ratios as at 31st December, 2009 and 31st December, 2008 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, 2009 and 31st December, 2008 and are well above the minimum required ratio set by the HKMA.

41. FAIR VALUES OF FINANCIAL INSTRUMENTS

(a) Financial instruments carried at fair value

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. The Group measures fair values using the following hierarchy of methods:

Level 1 — Quoted market price in an active market for an identical instrument.

Level 2 — Valuation techniques based on observable input. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3 — Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs could have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or counterparty quotations. For all other financial instruments the Group determines fair values using valuation techniques. Valuation techniques include net present value and discounted cash flow models and various market widely recognised option pricing models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, equity prices, foreign currency exchange rates, index prices, historical or implied volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date, that would have been determined by market participants acting at arm's length.

The Group uses widely recognised valuation models for determining the fair value of common and simpler financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over-the-counter (OTC) derivatives like interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Group uses valuation models, which usually are developed from recognised valuation methodologies. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determination of fair value. Management judgement and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of probability of counterparty default and prepayments and selection of appropriate discount rates.

The Group has an established control framework with respect to the measurement of fair values. This framework includes a valuation control function, namely Financial Instruments Valuation Group (“FIVG”) which comprises control units independent of front office management. Procedures for price verification have been established. Any pricing models to be used would be subject to a rigorous validation and approval process.

The table below analyses financial instruments carried at fair value, by valuation method:

| | 2009 | | | | | | | |
|---|---------------|---------------|-------------|---------------|---------------|---------------|-------------|---------------|
| | The Group | | | | The Bank | | | |
| | Level One | Level Two | Level Three | Total | Level One | Level Two | Level Three | Total |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Trading assets | 4,467 | 1,154 | 101 | 5,722 | 2,193 | 1,110 | 21 | 3,324 |
| Financial assets designated at fair value through profit or loss | 5,290 | 5,102 | — | 10,392 | 5,281 | 5,103 | — | 10,384 |
| Available-for-sale financial assets | 21,922 | 8,568 | 393 | 30,883 | 10,845 | 7,749 | 341 | 18,935 |
| | <u>31,679</u> | <u>14,824</u> | <u>494</u> | <u>46,997</u> | <u>18,319</u> | <u>13,962</u> | <u>362</u> | <u>32,643</u> |
| Liabilities | | | | | | | | |
| Trading liabilities | 6 | 1,357 | 92 | 1,455 | 6 | 1,139 | 90 | 1,235 |
| Financial liabilities designated at fair value through profit or loss | 7,712 | 2,442 | — | 10,154 | 11,628 | 2,442 | — | 14,070 |
| | <u>7,718</u> | <u>3,799</u> | <u>92</u> | <u>11,609</u> | <u>11,634</u> | <u>3,581</u> | <u>90</u> | <u>15,305</u> |

During the year there were no significant transfers of financial instruments between Level 1 and Level 2 of the fair value hierarchy.

(1) Valuation of financial instruments with significant unobservable inputs

Movements in the recognised fair values of instruments with significant unobservable inputs were as follows:

Assets

| | The Group | | |
|--|--|--|----------------|
| | Trading assets — Positive fair value of derivatives | Available-for-sale financial assets | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January, 2009 | 169 | 471 | 640 |
| Purchases. | — | 44 | 44 |
| Sales | — | (31) | (31) |
| Settlements. | (154) | — | (154) |
| Changes in fair value recognised in the income statement | 86 | — | 86 |
| Changes in fair value recognised in the other comprehensive income. | — | (91) | (91) |
| At 31st December, 2009 | <u>101</u> | <u>393</u> | <u>494</u> |
| Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the balance sheet date | <u>—</u> | <u>(91)</u> | <u>(91)</u> |
| Total gains or losses for the year included in the income statement for assets held at the balance sheet date recorded in net trading income | <u>86</u> | <u>—</u> | <u>86</u> |

Assets

| | The Bank | | |
|--|--|--|----------------|
| | Trading assets — Positive fair value of derivatives | Available-for-sale financial assets | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January, 2009 | 7 | 420 | 427 |
| Purchases. | — | 43 | 43 |
| Sales | — | (31) | (31) |
| Settlements. | (1) | — | (1) |
| Changes in fair value recognised in the income statement | 15 | — | 15 |
| Changes in fair value recognised in the other comprehensive income. | — | (91) | (91) |
| At 31st December, 2009 | <u>21</u> | <u>341</u> | <u>362</u> |
| Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the balance sheet date | <u>—</u> | <u>(91)</u> | <u>(91)</u> |
| Total gains or losses for the year included in the income statement for assets held at the balance sheet date recorded in net trading income | <u>15</u> | <u>—</u> | <u>15</u> |

Liabilities

| | <u>The Group</u> | <u>The Bank</u> |
|---|---|---|
| | Trading liabilities — Negative fair value of derivatives | Trading liabilities — Negative fair value of derivatives |
| | HK\$ Mn | HK\$ Mn |
| At 1st January, 2009 | 169 | 168 |
| Settlements | (155) | (154) |
| Changes in fair value recognised in the income statement | 78 | 76 |
| At 31st December, 2009 | <u>92</u> | <u>90</u> |
| Total gains or losses for the year included in the income statement for liabilities held at the balance sheet date recorded in net trading income | <u>78</u> | <u>76</u> |

(2) *Effects of changes in significant unobservable assumptions to reasonably possible alternative assumptions*

| | 2009 | | | |
|---|--|-----------------------|---|-----------------------|
| | <u>Effect recorded in profit or loss</u> | | <u>Effect recorded directly in equity</u> | |
| | <u>Favourable</u> | <u>(Unfavourable)</u> | <u>Favourable</u> | <u>(Unfavourable)</u> |
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Trading assets | 8 | (8) | — | — |
| Available-for-sale financial assets | — | — | 33 | (33) |
| | <u>8</u> | <u>(8)</u> | <u>33</u> | <u>(33)</u> |
| Trading liabilities | <u>8</u> | <u>(8)</u> | <u>—</u> | <u>—</u> |

The fair values of financial instruments are in certain circumstances, measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data. The table above shows the sensitivity of fair values due to parallel movement of plus or minus 10 per cent of change in fair value to reasonably possible alternative assumptions.

(b) **Fair values of financial instruments carried at other than fair value**

The following methods and significant assumptions have been applied in determining the fair values of financial instruments presented below:

- (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 be approximated by 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 amortised 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 the applicable dividend discount model, or share of net asset value in the investment, or applying a discount to the market value of investment with lock-up period.

- (v) The fair value of unlisted open-ended investment funds is estimated using the net asset value per share as reported by the managers of such funds.
- (vi) The fair value of financial guarantees issued is determined by reference to fees charged in an arm's length transaction for similar services, when such information is obtainable, or is otherwise estimated by reference to interest rate differentials, by comparing the actual rates charted by lenders when the guarantee is made available with the estimated rates that lenders would have charged, had the guarantees not been available, where reliable estimates of such information can be made.

The carrying amounts of the Group's and the Bank's financial instruments carried at cost or amortised cost are not materially different from their fair values as at 31st December, 2009 and 2008 except as follows:

The Group

| | 2009 | | 2008 | |
|--|-----------------|------------|-----------------|------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Financial assets | | | | |
| Held-to-maturity investments | 7,239 | 7,318 | 5,006 | 4,898 |
| Financial liabilities | | | | |
| Debt securities issued | 4,346 | 4,601 | — | — |
| Subordinated liabilities | 4,647 | 4,211 | 4,641 | 3,953 |

The Bank

| | 2009 | | 2008 | |
|--|-----------------|------------|-----------------|------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Financial assets | | | | |
| Held-to-maturity investments | 4,802 | 4,846 | 3,318 | 3,209 |
| Financial liabilities | | | | |
| Subordinated liabilities | 4,647 | 4,211 | 4,641 | 3,953 |

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 | |
|---|---------------|---------------|---------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Direct credit substitutes | 7,341 | 7,272 | 5,792 | 6,888 |
| Transaction-related contingencies | 1,293 | 1,771 | 1,024 | 1,529 |
| Trade-related contingencies | 1,331 | 1,045 | 800 | 721 |
| Commitments that are unconditionally cancellable without prior notice | 41,555 | 41,692 | 40,386 | 38,683 |
| Other commitments | | | | |
| - up to 1 year | 21,606 | 5,651 | 6,097 | 3,049 |
| - over 1 year | 14,112 | 18,737 | 12,686 | 11,551 |
| | <u>87,238</u> | <u>76,168</u> | <u>66,785</u> | <u>62,421</u> |
| Credit risk weighted amounts | <u>27,305</u> | <u>20,642</u> | <u>16,441</u> | <u>14,002</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 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:

| | The Group | | | | | |
|--------------------------------|---------------|---------------|----------------|---------------|---------------|---------------|
| | 2009 | | | 2008 | | |
| | Trading | Non-trading | Total | Trading | Non-trading | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Exchange rate contracts | | | | | | |
| Forwards and futures | 19,590 | — | 19,590 | 23,860 | — | 23,860 |
| Swaps | 12,140 | 4,664 | 16,804 | 1,633 | 12,863 | 14,496 |
| Options purchased | 1,885 | 1,209 | 3,094 | 919 | 151 | 1,070 |
| Options written | 3,085 | 1,236 | 4,321 | 1,075 | 151 | 1,226 |
| Interest rate contracts | | | | | | |
| Forwards and futures | — | 88 | 88 | 25 | — | 25 |
| Swaps | — | 70,669 | 70,669 | — | 44,699 | 44,699 |
| Equity contracts | | | | | | |
| Options purchased | 261 | 1,638 | 1,899 | 82 | 1,638 | 1,720 |
| Options written | 177 | 975 | 1,152 | 427 | 1,039 | 1,466 |
| | <u>37,138</u> | <u>80,479</u> | <u>117,617</u> | <u>28,021</u> | <u>60,541</u> | <u>88,562</u> |

The Bank

| | 2009 | | | 2008 | | |
|--------------------------------|---------------|---------------|----------------|---------------|---------------|---------------|
| | Trading | Non-trading | Total | Trading | Non-trading | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Exchange rate contracts | | | | | | |
| Forwards and futures | 8,390 | — | 8,390 | 10,842 | — | 10,842 |
| Swaps | 11,137 | 4,664 | 15,801 | 1,311 | 12,253 | 13,564 |
| Options purchased | 1,885 | 1,209 | 3,094 | 971 | 151 | 1,122 |
| Options written | 3,085 | 1,236 | 4,321 | 1,075 | 151 | 1,226 |
| Interest rate contracts | | | | | | |
| Forwards and futures | — | 88 | 88 | 25 | — | 25 |
| Swaps | — | 67,505 | 67,505 | — | 42,684 | 42,684 |
| Equity contracts | | | | | | |
| Options purchased | 261 | 1,638 | 1,899 | 82 | 2,307 | 2,389 |
| Options written | 177 | 1,638 | 1,815 | 427 | 1,039 | 1,466 |
| | <u>24,935</u> | <u>77,978</u> | <u>102,913</u> | <u>14,733</u> | <u>58,585</u> | <u>73,318</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

| | 2009 | | 2008 | |
|-------------------------------------|------------|--------------|--------------|--------------|
| | Assets | Liabilities | Assets | Liabilities |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Fair value (Notes 23 and 34) | | | | |
| Exchange rate contracts | 317 | 139 | 488 | 505 |
| Interest rate contracts | 587 | 1,279 | 1,012 | 1,928 |
| Options purchased/written | | | | |
| - exchange rate contracts | 9 | 9 | 3 | 5 |
| - equity contracts | 55 | 22 | 231 | 78 |
| | <u>968</u> | <u>1,449</u> | <u>1,734</u> | <u>2,516</u> |

The Bank

| | 2009 | | 2008 | |
|-------------------------------------|------------|--------------|--------------|--------------|
| | Assets | Liabilities | Assets | Liabilities |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Fair value (Notes 23 and 34) | | | | |
| Exchange rate contracts | 275 | 114 | 262 | 365 |
| Interest rate contracts | 506 | 1,084 | 755 | 1,771 |
| Options purchased/written | | | | |
| - exchange rate contracts | 9 | 9 | 3 | 5 |
| - equity contracts | 55 | 22 | 231 | 78 |
| | <u>845</u> | <u>1,229</u> | <u>1,251</u> | <u>2,219</u> |

| | The Group | | The Bank | |
|---|--------------|------------|--------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Credit risk weighted amounts* | | | | |
| Exchange rate contracts | 567 | 391 | 549 | 340 |
| Interest rate contracts | 350 | 225 | 408 | 321 |
| Equity contracts | 90 | 181 | 184 | 248 |
| Debt security & other commodity | 6 | 22 | 11 | 38 |
| | <u>1,013</u> | <u>819</u> | <u>1,152</u> | <u>947</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, 2009.

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 | | | | | | | |
| | 2009 | | | | 2008 | | | |
| | 1 year 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| Interest rate derivatives | 46,714 | 15,727 | 8,316 | 70,757 | 26,641 | 14,193 | 3,890 | 44,724 |
| Currency derivatives | 37,856 | 5,953 | — | 43,809 | 35,145 | 5,507 | — | 40,652 |
| Other derivatives | 2,387 | 268 | 396 | 3,051 | 2,514 | 8 | 664 | 3,186 |
| | <u>86,957</u> | <u>21,948</u> | <u>8,712</u> | <u>117,617</u> | <u>64,300</u> | <u>19,708</u> | <u>4,554</u> | <u>88,562</u> |

| | The Bank | | | | | | | |
|-------------------------------------|---|------------------------|--------------|----------------|----------------|------------------------|--------------|---------------|
| | Notional amounts with remaining life of | | | | | | | |
| | 2009 | | | | 2008 | | | |
| | 1 year 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| Interest rate derivatives | 46,123 | 13,162 | 8,308 | 67,593 | 26,341 | 12,384 | 3,984 | 42,709 |
| Currency derivatives | 25,811 | 5,795 | — | 31,606 | 21,247 | 5,507 | — | 26,754 |
| Other derivatives | 2,387 | 535 | 792 | 3,714 | 3,183 | 8 | 664 | 3,855 |
| | <u>74,321</u> | <u>19,492</u> | <u>9,100</u> | <u>102,913</u> | <u>50,771</u> | <u>17,899</u> | <u>4,648</u> | <u>73,318</u> |

(c) **Capital commitments**

Capital commitments outstanding at 31st December and not provided for in the accounts were as follows:

| | The Group | | The Bank | |
|---|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Expenditure authorised and contracted for | 338 | 1,611 | 100 | 608 |
| Expenditure authorised but not contracted for | 65 | 107 | 48 | 98 |
| | <u>403</u> | <u>1,718</u> | <u>148</u> | <u>706</u> |

(d) **Operating lease commitments**

At 31st December, 2009, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Properties | | | | |
| Within one year | 365 | 338 | 127 | 135 |
| After one year but within five years | 736 | 684 | 117 | 117 |
| After five years | 249 | 358 | — | — |
| | <u>1,350</u> | <u>1,380</u> | <u>244</u> | <u>252</u> |

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Equipment | | | | |
| Within one year | 6 | 7 | 2 | 2 |
| After one year but within five years | 11 | 10 | 4 | 2 |
| After five years | — | — | — | — |
| | <u>17</u> | <u>17</u> | <u>6</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.

(e) **Litigation**

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 the Bank 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 the Bank acting as the client relationship manager.

The Bank intends to defend these proceedings rigorously and is in the course of preparing the relevant court documents. If the Bank is unsuccessful in defending the claim, the Bank estimates the maximum amount of exposure is approximately HK\$150 million. As these proceedings are in the preliminary stage and based on the evidence available, the Bank's external lawyers are optimistic on mounting a successful defence to both proceedings, no provisions have been made by the Bank as at 31st December, 2009.

43. NOTES ON CONSOLIDATED CASH FLOW STATEMENT

(a) Purchase of subsidiaries

| | <u>2009</u> | <u>2008</u> |
|---|-------------|-------------|
| | HK\$ Mn | HK\$ Mn |
| Net assets acquired | | |
| Cash and balances with banks and other financial institutions | 23 | 12 |
| Advances and other accounts less provisions | 24 | 10 |
| Fixed assets | 9 | 4 |
| Goodwill | — | 25 |
| Other accounts and provisions | (12) | (45) |
| | <u>44</u> | <u>6</u> |
| Goodwill arising on consolidation | 22 | 27 |
| Total purchase price | 66 | 33 |
| Less: cash and cash equivalents acquired | (23) | (12) |
| Cash flow on acquisition net of cash acquired | <u>43</u> | <u>21</u> |

(b) Disposal of subsidiary

| | <u>2009</u> | <u>2008</u> |
|---|-------------|-------------|
| | HK\$ Mn | HK\$ Mn |
| Advances and other accounts less provisions | 1 | — |
| Taxation | — | — |
| Other accounts and provisions | — | — |
| | <u>1</u> | <u>—</u> |
| Add: gain on disposal | — | — |
| Cash flow on disposal of subsidiary | <u>1</u> | <u>—</u> |

(c) Cash and cash equivalents

(i) Components of cash and cash equivalents in the consolidated cash flow statement

| | <u>2009</u> | <u>2008</u> |
|---|---------------|---------------|
| | HK\$ Mn | HK\$ Mn |
| Cash and balances with banks and other financial institutions | 19,244 | 20,042 |
| Placements with banks and other financial institutions with original maturity within three months | 37,938 | 70,442 |
| Treasury bills with original maturity within three months | 2,814 | 3,251 |
| Certificates of deposit held with original maturity within three months | 534 | 371 |
| | <u>60,530</u> | <u>94,106</u> |

(ii) *Reconciliation with the consolidated statement of financial position*

| | 2009 | 2008 |
|---|----------------------|----------------------|
| | HK\$ Mn | HK\$ Mn |
| Cash and balances with banks and other financial institutions (Note 20) | 29,712 | 28,105 |
| Placements with banks and other financial institutions (Note 21) | 67,945 | 96,574 |
| Treasury bills and certificates of deposit held | | |
| - trading assets (Note 23) | 34 | 400 |
| - advances and other accounts (Note 25) | 39 | 39 |
| - available-for-sale (Note 26) | 6,397 | 11,153 |
| - held-to-maturity (Note 27) | 2,434 | 1,897 |
| | <u>8,904</u> | <u>13,489</u> |
| Amounts shown in the consolidated statement of financial position | 106,561 | 138,168 |
| Less: Amounts with an original maturity of beyond three months | (35,563) | (35,999) |
| Cash balance with central bank subject to regulatory restriction | <u>(10,468)</u> | <u>(8,063)</u> |
| Cash and cash equivalents in the consolidated cash flow statement | <u><u>60,530</u></u> | <u><u>94,106</u></u> |

44. ASSETS PLEDGED AS SECURITY

The following assets have been pledged as collateral for own liabilities at the balance sheet date:

| | The Group | | The Bank | |
|---|-------------------|-------------------|------------------|------------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Secured liabilities | <u>1,514</u> | <u>1,161</u> | <u>810</u> | <u>1,102</u> |
| Assets pledged: | | | | |
| Available-for-sale financial assets | 736 | 76 | — | — |
| Held-to-maturity investments | <u>96</u> | <u>96</u> | <u>96</u> | <u>96</u> |
| | <u><u>832</u></u> | <u><u>172</u></u> | <u><u>96</u></u> | <u><u>96</u></u> |

The following balances with banks have been pledged as collateral for securities borrowings and margin deposits of derivatives.

| | The Group | | The Bank | |
|--|-------------------|-------------------|-------------------|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Cash collateral for borrowed securities | 18 | 7 | 18 | 7 |
| Margin accounts for open futures and forward contracts | <u>921</u> | <u>912</u> | <u>876</u> | <u>912</u> |
| | <u><u>939</u></u> | <u><u>919</u></u> | <u><u>894</u></u> | <u><u>919</u></u> |
| Capital equivalency deposit | <u>39</u> | <u>39</u> | <u>39</u> | <u>39</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:

| | <u>2009</u> | <u>2008</u> |
|--|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Aggregate amount of relevant loans outstanding at 31st December | | |
| By the Bank | 3,711 | 4,169 |
| By subsidiaries | <u>1,261</u> | <u>1,073</u> |
| | <u>4,972</u> | <u>5,242</u> |
| The maximum aggregate amount of relevant loans outstanding during the year | | |
| By the Bank | 5,543 | 4,573 |
| By subsidiaries | <u>1,656</u> | <u>1,492</u> |
| | <u>7,199</u> | <u>6,065</u> |

There was no interest due but unpaid nor any impairment allowance made against these loans at 31st December, 2009 and 31st December, 2008.

46. MATERIAL RELATED PARTY TRANSACTIONS

The Group maintains certain retirement benefit schemes for its staff as per Note 2(q)(iii). In 2009, the total amount of contributions the Group made to the schemes was HK\$65 million (2008: HK\$107 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. 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 | |
|------------------------------------|-------------------------------------|----------------|---------------------|----------------|-------------------|----------------|
| | <u>2009</u> | <u>2008</u> | <u>2009</u> | <u>2008</u> | <u>2009</u> | <u>2008</u> |
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Interest income | 125 | 264 | 588 | 1,079 | 3 | 8 |
| Interest expense | 25 | 88 | 560 | 148 | — | — |
| Amounts due from | 6,971 | 8,209 | 12,719 | 16,398 | 626 | 124 |
| Amounts due to | 5,147 | 3,696 | 1,642 | 1,994 | 4 | 7 |
| Maximum amounts due from | 10,443 | 12,429 | 15,953 | 22,072 | 924 | 446 |
| Maximum amounts due to | 9,826 | 8,527 | 2,295 | 2,850 | 14 | 34 |

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\$ |
|---------------|-----------------------|-----------------------|-------------------------------|
| 22/4/2004 | 22/4/2004 - 21/4/2005 | 22/4/2005 - 22/4/2009 | 21.11* |
| 03/5/2005 | 03/5/2005 - 02/5/2006 | 03/5/2006 - 03/5/2010 | 20.86* |
| 03/5/2006 | 03/5/2006 - 02/5/2007 | 03/5/2007 - 03/5/2011 | 30.04* |
| 10/5/2007 | 10/5/2007 - 09/5/2008 | 10/5/2008 - 10/5/2012 | 42.84* |
| 05/5/2008 | 05/5/2008 - 04/5/2009 | 05/5/2009 - 05/5/2013 | 40.09* |
| 05/5/2009 | 05/5/2009 - 04/5/2010 | 05/5/2010 - 05/5/2014 | 21.25* |

(b) Movement of share options

2009

| Date of grant | Number of share options | | | | | Outstanding at 31/12/2009 |
|---------------|-------------------------|---|------------------|------------------|------------------|---------------------------|
| | Outstanding at 1/1/2009 | Additional share options for bonus issue* | Granted | Exercised | Lapsed | |
| 22/4/2004 | 2,765,000 | 276,500 | — | — | 3,041,500 | — |
| 03/5/2005 | 6,105,000 | 610,500 | — | 1,978,500 | — | 4,737,000 |
| 03/5/2006 | 2,700,000 | 270,000 | — | — | 275,000 | 2,695,000 |
| 10/5/2007 | 2,750,000 | 275,000 | — | — | 275,000 | 2,750,000 |
| 05/5/2008 | 5,500,000 | 550,000 | — | — | 550,000 | 5,500,000 |
| 05/5/2009 | — | — | 6,600,000 | — | — | 6,600,000 |
| Total | <u>19,820,000</u> | <u>1,982,000</u> | <u>6,600,000</u> | <u>1,978,500</u> | <u>4,141,500</u> | <u>22,282,000</u> |

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 | — | — |
| 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> |

* After adjusting for the bonus issue in 2009.

(c) No share options were cancelled during the years ended 31st December, 2009 and 2008.

(d) Details of share options exercised

| Exercise period | Date of grant | Number of share options | |
|---------------------|---------------|-------------------------|------------------|
| | | 2009 | 2008 |
| January | 02/5/2003 | — | 1,005,000 |
| | 22/4/2004 | — | 130,000 |
| | 03/5/2005 | — | 75,000 |
| February | 02/5/2003 | — | 20,000 |
| | 22/4/2004 | — | 20,000 |
| | 03/5/2005 | — | 25,000 |
| March | 02/5/2003 | — | 1,060,000 |
| | 22/4/2004 | — | 665,000 |
| | 03/5/2005 | — | 715,000 |
| | 03/5/2006 | — | 500,000 |
| April | 02/5/2003 | — | 30,000 |
| | 22/4/2004 | — | 165,000 |
| | 03/5/2005 | — | 110,000 |
| May | 02/5/2003 | — | 90,000 |
| | 22/4/2004 | — | 20,000 |
| | 03/5/2005 | 190,500 | 75,000 |
| June | 22/4/2004 | — | 25,000 |
| | 03/5/2005 | 208,500 | 25,000 |
| July | 22/4/2004 | — | 5,000 |
| | 03/5/2005 | 14,000 | 55,000 |
| August | 22/4/2004 | — | 30,000 |
| | 03/5/2005 | 79,000 | 45,000 |
| September | 22/4/2004 | — | 20,000 |
| | 03/5/2005 | 243,500 | — |
| October | 03/5/2005 | 292,500 | — |
| November | 03/5/2005 | 755,500 | — |
| December | 03/5/2005 | 195,000 | — |
| | | <u>1,978,500</u> | <u>4,910,000</u> |

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 30th December, 2009, the Bank entered into a subscription agreement with Negocio de Finanzas e Inversiones I, SLU, a subsidiary of Criteria Caixa Corp., SA and Sumitomo Mitsui Banking Corporation respectively in relation to the subscription as principal of an aggregate of 167,104,200 shares in the share capital of the Bank at HK\$30.60 per new share subject to regulatory approval. These 167,104,200 shares represent approximately 8.29% of the entire issued share capital of the Bank as enlarged by the subscriptions. The subscription price represents a discount of approximately 2.08% to the closing price of HK\$31.25 per share quoted on the Stock Exchange on 30th December, 2009. Following with a regulatory approval, shares issued and proceeds are received on 14th January, 2010.

In June 2009, BEA signed a Sale and Purchase Agreement with the Industrial and Commercial Bank of China Limited (“ICBC”) to sell a 70% interest in its banking subsidiary in Canada, The Bank of East Asia (Canada), to ICBC. The transaction closed on 28th January, 2010.

49. 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 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.

50. COMPARATIVE FIGURES

As a result of the application of HKAS 1 (revised 2007), *Presentation of financial statement*, and HKFRS 8, *Operating segments*, certain comparative figures have been adjusted to conform to current year's presentation and to provide comparative amounts in respect of items disclosed for the first time in 2009. Further details of these developments are disclosed in Note 3.

The Group has reviewed the disclosures in the financial statements and has made a number of presentation changes in Note 40. In such case, comparative figures in the notes have been amended to ensure consistency with the current year.

51. PROPOSED IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31ST DECEMBER, 2009

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, 2009 and which have not been adopted in these accounts.

| | <u>Effective for accounting periods beginning on or after</u> |
|---|---|
| HKFRS 3 (Revised), <i>Business combinations</i> | 1st July, 2009 |
| Amendment to HKAS 27, <i>Consolidated and separate financial statements</i> | 1st July, 2009 |
| Amendment to HKAS 39, <i>Financial instruments: Recognition and measurement</i> — | |
| <i>Eligible hedged items</i> | 1st July, 2009 |
| HK(IFRIC) 17, <i>Distributions of non-cash assets to owners</i> | 1st July, 2009 |
| Improvements to HKFRSs 2009 | 1st July, 2009 or 1st January, 2010 |
| HKFRS 9, <i>Financial instruments</i> | 1st January, 2013 |

The Group is in the process of making an assessment of what the impact of these amendments 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 Group's results of operations and financial position except for HKFRS 9, Financial instruments, which may have an impact on the Group's results and financial position arising from changes in the Group's classification and measurement of financial instruments.

**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-108 to F-203, 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

| | | <u>2008</u> | <u>2007</u> |
|---|-------|-----------------|-----------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| Interest income | 3 | 17,465 | 18,309 |
| Interest expense | 4 | <u>(10,672)</u> | <u>(12,332)</u> |
| Net interest income | | <u>6,793</u> | <u>5,977</u> |
| Fee and commission income | 5 | <u>2,618</u> | <u>2,608</u> |
| Fee and commission expense | | <u>(473)</u> | <u>(471)</u> |
| 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 | | <u>(336)</u> | <u>2,837</u> |
| Operating income | | 6,457 | 8,814 |
| Operating expenses | 9 | <u>(5,779)</u> | <u>(4,691)</u> |
| Operating profit before impairment losses | | <u>678</u> | <u>4,123</u> |
| 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 | | <u>(948)</u> | <u>(395)</u> |
| 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 | | <u>104</u> | <u>4,221</u> |
| Attributable to: | | | |
| Equity holders of the Group | | 39 | 4,144 |
| Minority interests | 38 | 65 | 77 |
| Profit after taxation | | <u>104</u> | <u>4,221</u> |
| 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-114 to F-203 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED BALANCE SHEET
AS AT 31ST DECEMBER, 2008

| | | <u>2008</u> | <u>2007</u> |
|--|-------|-------------|-------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| ASSETS | | | |
| 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 |
| Total Assets | | 415,254 | 393,979 |
| EQUITY AND LIABILITIES | | | |
| 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 |
| Total Liabilities | | 382,769 | 363,533 |
| Share capital | 36 | 4,183 | 3,936 |
| Reserves | 37 | 27,963 | 26,163 |
| Total equity attributable to equity holders of the Group | | 32,146 | 30,099 |
| Minority interests | 38 | 339 | 347 |
| Total Equity | | 32,485 | 30,446 |
| Total Equity and Liabilities | | 415,254 | 393,979 |

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-114 to F-203 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
BALANCE SHEET
AS AT 31ST DECEMBER, 2008

| | | <u>2008</u> | <u>2007</u> |
|--|-------|-------------|-------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| ASSETS | | | |
| 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 |
| Total Assets | | 295,219 | 298,473 |
| EQUITY AND LIABILITIES | | | |
| 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 |
| Total Liabilities | | 267,994 | 272,292 |
| Share capital | 36 | 4,183 | 3,936 |
| Reserves | 37 | 23,042 | 22,245 |
| Total equity attributable to equity holders of the Bank | | 27,225 | 26,181 |
| Total Equity and Liabilities | | 295,219 | 298,473 |

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-114 to F-203 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

| | Notes | 2008 HK\$ Mn | 2007 HK\$ Mn |
|---|------------------------|-----------------|-----------------|
| 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-114 to F-203 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2008

| | | <u>2008</u> | <u>2007</u> |
|--|-------|-------------------|-------------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| OPERATING ACTIVITIES | | | |
| 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 |
| | | <u> </u> | <u> </u> |
| OPERATING (LOSS)/PROFIT BEFORE CHANGES IN WORKING CAPITAL | | (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 |
| | | <u> </u> | <u> </u> |

| | | 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 | | (383) | (306) |
| 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 | | (64) | (15) |
| 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 | | (488) | (224) |
| 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>94,106</u> | <u>103,718</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-114 to F-203 form part of these accounts.

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.

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 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.

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.

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 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).

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(1).

- (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.

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.

(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.

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.

(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.

(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.

(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> |
|---|----------------------|----------------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| 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><u>17,465</u></u> | <u><u>18,309</u></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> |
|---|----------------------|----------------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| 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><u>10,672</u></u> | <u><u>12,332</u></u> |

5. FEE AND COMMISSION INCOME

Fee and commission income arises from the following services:

| | <u>2008</u> | <u>2007</u> |
|--|---------------------|---------------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>252</u> | <u>238</u> |
| Total fee and commission income | <u><u>2,618</u></u> | <u><u>2,608</u></u> |

6. NET TRADING (LOSSES)/PROFITS

| | <u>2008</u> | <u>2007</u> |
|--|-----------------------|---------------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>43</u> | <u>38</u> |
| Total net trading (losses)/profits | <u><u>(1,292)</u></u> | <u><u>1,417</u></u> |

7. NET RESULT FROM FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

| | <u>2008</u> | <u>2007</u> |
|---|-----------------------|-----------------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>(690)</u> | <u>17</u> |
| Total net result from financial instruments designated at fair value through profit or loss | <u><u>(1,612)</u></u> | <u><u>(1,154)</u></u> |

8. OTHER OPERATING INCOME

| | <u>2008</u> | <u>2007</u> |
|--|-------------|-------------|
| | 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

| | <u>2008</u> | <u>2007</u> |
|--|--------------|--------------|
| | 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

| | <u>2008</u> | <u>2007</u> |
|--|----------------|----------------|
| | HK\$ Mn | HK\$ Mn |
| 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)) | <u>(140)</u> | <u>(107)</u> |
| | 375 | 151 |
| Collective impairment loss | | |
| - new provisions (Note 24(b)) | 183 | 68 |
| - releases (Note 24(b)) | <u>—</u> | <u>(3)</u> |
| Net charge to profit and loss account | <u>558</u> | <u>216</u> |

11. NET PROFIT ON SALE OF AVAILABLE-FOR-SALE FINANCIAL ASSETS

| | <u>2008</u> | <u>2007</u> |
|--|----------------|----------------|
| | HK\$ Mn | HK\$ Mn |
| 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:**

| | <u>2008</u> | <u>2007</u> |
|--|----------------|----------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>—</u> | <u>(7)</u> |
| | 64 | 258 |
| Current tax - overseas | | |
| Tax for the year | 601 | 347 |
| Write back of over-provision in respect of prior years | <u>(35)</u> | <u>(16)</u> |
| | 566 | 331 |
| Deferred tax (Note 32(b)) | | |
| Origination and reversal of temporary differences | (712) | 318 |
| Movements in the value of investment properties | <u>(14)</u> | <u>57</u> |
| | <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:**

| | <u>2008</u> | <u>2007</u> |
|--|-------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Profit before tax | <u>8</u> | <u>5,185</u> |
| 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 | <u>18</u> | <u>(10)</u> |
| Actual tax (credit)/expense | <u>(96)</u> | <u>964</u> |

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

| | <u>2008</u> | <u>2007</u> |
|---|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>42</u> | <u>128</u> |
| Bank's (loss)/profit for the year | <u>(882)</u> | <u>3,004</u> |

14. DIVIDENDS

(a) Dividends attributable to the year

| | <u>2008</u> | <u>2007</u> |
|--|-------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| 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> |
|---|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| 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> |
|--|----------------------|----------------------|
| | Number of Shares | Number of Shares |
| 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> |
|--|-------------------------|-------------------------|
| | <u>Number of Shares</u> | <u>Number of Shares</u> |
| 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 | 3,217,376 | 9,483,952 |
| Weighted average number of ordinary shares (diluted) at 31st December | <u>1,669,663,642</u> | <u>1,574,625,151</u> |

16. DIRECTORS' REMUNERATION

Directors' remuneration disclosed pursuant to Section 161 of the Hong Kong Companies Ordinance is as follows:

| | <u>Directors' fees</u> | <u>Salaries, allowances and benefits in kind</u> | <u>Discretionary bonuses</u> | <u>Share options</u> | <u>Retirement scheme contributions</u> | <u>2008 Total</u> |
|---|------------------------|--|------------------------------|----------------------|--|-------------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Chairman and Chief Executive | | | | | | |
| Dr. The Hon. Sir David LI Kwok-po | 0.3 | 8.3 | — | 24.1 | 0.8 | 33.5 |
| Executive Directors | | | | | | |
| Mr. Joseph PANG Yuk-wing | 0.2 | 3.6 | — | 12.0 | 0.3 | 16.1 |
| Non-executive Directors | | | | | | |
| 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 |
| Independent Non-executive Directors | | | | | | |
| 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 |
|---|-----------------|---|-----------------------|---------------|---------------------------------|-------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Chairman and Chief Executive | | | | | | |
| Dr. The Hon. Sir David LI Kwok-po | 0.3 | 7.9 | 15.4 | 9.6 | 0.7 | 33.9 |
| Executive Directors | | | | | | |
| 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 |
| Non-executive Directors | | | | | | |
| 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 |
| Independent Non-executive Directors | | | | | | |
| 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 |
|---|-----------|-----------|
| | HK\$ Mn | HK\$ M |
| 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:

| | <u>2008</u> | <u>2007</u> |
|-----------------------------------|--------------------------------|--------------------------------|
| | Number of Employees | Number of Employees |
| 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.

| | 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 |
| The Group | | | | | | | | |
| 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 |

| | 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 |
| The Group | | | | | | | | |
| 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 | | | | | Consolidated |
|--|-----------|----------------------------|-----------------------|---------|---------------------------|--------------|
| | Hong Kong | People's Republic of China | Other Asian Countries | Others | Inter-segment elimination | |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| The Group | | | | | | |
| 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 | | | | | Consolidated |
|--|-----------|----------------------------|-----------------------|---------|---------------------------|--------------|
| | Hong Kong | People's Republic of China | Other Asian Countries | Others | Inter-segment elimination | |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| The Group | | | | | | |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | 14,462 | 14,284 | 8,347 | 7,245 |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | % |
| The Group | | | | |
| 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 | <u>57,723</u> | 76.78 | <u>55,405</u> | 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 | <u>35,165</u> | 86.52 | <u>45,355</u> | 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* | <u>134,546</u> | 76.56 | <u>113,710</u> | 72.67 |
| Total advances to customers | <u>230,339</u> | 77.91 | <u>218,184</u> | 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 |
| | HK\$Mn | % | HK\$Mn | % |
| 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 |
| The Bank | | | | |
| 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* | <u>36,254</u> | 57.35 | <u>31,330</u> | 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.

| The Group | | | | | |
|---|--|---|---|--|--|
| 2008 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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> | | |

| The Group | | | | | |
|---|--|---|---|--|--|
| 2007 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| Total | <u>218,184</u> | <u>468</u> | <u>1,242</u> | <u>264</u> | <u>433</u> |
| % of total advances to customers | | | <u>0.57%</u> | | |
| Market value of security held against impaired advances to customers | | | <u>3,647</u> | | |

| The Bank | | | | | |
|---|--|---|---|--|--|
| 2008 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | 131,123 | 437 | 1,274 | 438 | 392 |
| % of total advances to customers | | | 0.97% | | |
| Market value of security held against impaired advances to customers | | | 2,168 | | |

| The Bank | | | | | |
|---|--|---|---|--|--|
| 2007 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | 134,858 | 264 | 897 | 79 | 332 |
| % of total advances to customers | | | 0.67% | | |
| Market value of security held against impaired advances to customers | | | 2,282 | | |

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 | |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| 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 |
| | <u>4,260</u> | <u>604</u> | <u>4,864</u> | <u>4,421</u> | <u>1,235</u> | <u>5,656</u> |
| Less: Individual impairment allowances | <u>(21)</u> | | | <u>(4)</u> | | |
| Net investment in finance leases | <u>4,239</u> | | | <u>4,417</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.

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 |
| | <u>9,726</u> | <u>3,573</u> | <u>2,816</u> | <u>2,379</u> |
| 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 |
| Carribbean 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 |

| Name of company | Place of incorporation and operation | Issued and paid-up capital | % Held by | | Nature of business |
|--|--------------------------------------|----------------------------|-----------|-----------|--|
| | | | The Bank | The Group | |
| 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 |
| 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 | |
| Listed | | | | |
| Affin Holdings Berhad | Malaysia | 20.507% | | Investment holding |
| Unlisted | | | | |
| 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 |
| 2008 | | | | | |
| 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> |
| 2007 | | | | | |
| 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 | <u>29</u> | <u>12</u> | <u>—</u> | <u>—</u> |
| | <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 (Note2(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>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 | — | 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>1,839</u> | <u>6,293</u> | <u>3,507</u> | <u>9,800</u> | <u>11,639</u> |

| The Bank | | | | | |
|---|--------------------------|--|------------------|----------------|--------------|
| 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 | 1,829 | 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>1,819</u> | <u>2,812</u> | <u>956</u> | <u>3,768</u> | <u>5,587</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>1,819</u> | <u>3,135</u> | <u>2,246</u> | <u>5,381</u> | <u>7,200</u> |

| 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, 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>1,726</u> | <u>3,992</u> | <u>1,138</u> | <u>5,130</u> | <u>6,856</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>1,726</u> | <u>4,609</u> | <u>2,711</u> | <u>7,320</u> | <u>9,046</u> |

| The Bank | | | | | |
|---|----------------------------------|--------------------------|--|------------------|----------------|
| | 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, 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>1,829</u> | <u>2,888</u> | <u>690</u> | <u>3,578</u> | <u>5,407</u> |
| The gross amounts of the above assets are stated: | | | | | |
| At cost | — | 2,358 | 1,858 | 4,216 | 4,216 |
| At Directors' valuation | — | 834 | — | 834 | 834 |
| At professional valuation | — | — | — | — | — |
| - 2007 | <u>1,829</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>1,829</u> |
| | <u>1,829</u> | <u>3,192</u> | <u>1,858</u> | <u>5,050</u> | <u>6,879</u> |

The net book value of bank premises and investment properties comprises:

| | The Group | | | |
|--|----------------------------------|--------------------------|----------------------------------|--------------------------|
| | 2008 | | 2007 | |
| | Investment Properties | Bank Premises | Investment Properties | Bank Premises |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn |
| 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 |
| Deferred tax arising from: | | | | | | | |
| 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 |
| Deferred tax arising from: | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| Deferred tax arising from: | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| Deferred tax arising from: | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
|--------------------------------------|------------|------------|
| | HK\$ Mn | HK\$ Mn |
| Expiring within 5 years | 57 | 95 |
| Expiring more than 5 years | 7 | 8 |
| No expiry date | 673 | 571 |
| | <u>737</u> | <u>674</u> |

33. OTHER LIABILITIES

| | The Group | | The Bank | |
|--|---------------|---------------|--------------|--------------|
| | 2008 | 2007 | 2008 | 2007 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | Mn |
| (a) Trading Liabilities | | | | |
| Exchange fund bills sold | 330 | 1,098 | 330 | 1,098 |
| Exchange fund notes sold | — | 33 | — | 33 |
| | 330 | 1,131 | 330 | 1,131 |
| Negative fair value of derivatives | 2,516 | 1,241 | 2,219 | 1,044 |
| | <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 | 7,197 | 7,985 | 2,172 | 2,967 |
| | <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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | 4,641 | 4,669 | 4,641 | 4,669 |
| | <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 | Number of options | Weighted average exercise price | Number of options |
| | HK\$ | Mn | HK\$ | 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 | <u>20</u> | 27.21 | <u>19</u> |
| 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 |
| | million | HK\$ Mn | million | HK\$ Mn |
| Authorised: Ordinary shares of HK\$2.50 each | 2,600 | 6,500 | 2,600 | 6,500 |
| 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 | 1,673 | 4,183 | 1,574 | 3,936 |

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

| Date of options granted | Option price | 2008 | 2007 |
|-------------------------|--------------|---------------|---------------|
| | | No. of shares | No. of shares |
| 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 | — |
| | | 19,820,000 | 19,300,000 |

37. RESERVES

| | 2008 | |
|---|-----------|----------|
| | The Group | The Bank |
| | HK\$ Mn | HK\$ Mn |
| (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 | 4,922 | 4,922 |

| | <u>The Group</u> | <u>The Bank</u> |
|---|------------------|-----------------|
| | HK\$ Mn | HK\$ Mn |
| (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> |
| (e) Capital reserve (undistributable) | | |
| At 1st January and 31st December | <u>86</u> | <u>—</u> |
| (f) Exchange revaluation reserve (undistributable) | | |
| At 1st January | 672 | 80 |
| Exchange adjustments | 334 | (32) |
| At 31st December | <u>1,006</u> | <u>48</u> |
| (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 | <u>125</u> | <u>125</u> |
| (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 | <u>(228)</u> | <u>(45)</u> |

| | | 2008 | |
|-----|--|------------------|-----------------|
| | | The Group | The Bank |
| | | HK\$ Mn | HK\$ Mn |
| (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 | <u>5,339</u> | <u>2,724</u> |
| (j) | Total Reserves | <u>27,963</u> | <u>23,042</u> |
| | | 2007 | |
| | | The Group | The Bank |
| | | HK\$ Mn | HK\$ Mn |
| (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> |

| | | 2007 | |
|-----|--|------------------|-----------------|
| | | <u>The Group</u> | <u>The Bank</u> |
| | | HK\$ Mn | HK\$ Mn |
| (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> |
| (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

| | <u>2008</u> | <u>2007</u> |
|---|-------------|-------------|
| | HK\$ Mn | HK\$ Mn |
| 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>339</u> | <u>347</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.

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 | <u>1,586</u> | <u>1,242</u> | <u>1,274</u> | <u>897</u> |
| | <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 | <u>1,929</u> | <u>2,009</u> | <u>1,464</u> | <u>1,364</u> |
| | <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 | <u>210</u> | <u>360</u> | <u>147</u> | <u>86</u> |
| | <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 |
| Assets | | | | | | | | |
| 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> |
| Liabilities | | | | | | | | |
| 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 | <u>(8,285)</u> | <u>—</u> | <u>(2,751)</u> | <u>(11,036)</u> | <u>(9,052)</u> | <u>—</u> | <u>(4,600)</u> | <u>(13,652)</u> |
| 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 |
| Assets | | | | | | | | |
| 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> |
| Liabilities | | | | | | | | |
| 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 | <u>(8,285)</u> | <u>—</u> | <u>(2,751)</u> | <u>(11,036)</u> | <u>(9,052)</u> | <u>—</u> | <u>(4,600)</u> | <u>(13,652)</u> |
| 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 December | Maximum | Minimum | Mean |
| | 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 December | Maximum | Minimum | Mean |
| | 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.

(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 | | | | | | |
|--|------------------------|---------------------|---|--|-----------------|-----------------------|----------------|
| | 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | |
| 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 | 23,548 | 134,393 | 63,985 | 97,024 | 57,035 | 39,269 | 415,254 |
| Liabilities | | | | | | | |
| 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 | 86,980 | 212,314 | 44,399 | 22,663 | 1,673 | 14,740 | 382,769 |
| Net gap | (63,432) | (77,921) | 19,586 | 74,361 | 55,362 | | |

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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | |
| 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 | 17,852 | 131,946 | 50,447 | 96,926 | 63,785 | 33,023 | 393,979 |
| Liabilities | | | | | | | |
| 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 | 84,950 | 197,134 | 44,684 | 18,337 | 5,317 | 13,111 | 363,533 |
| Net gap | (67,098) | (65,188) | 5,763 | 78,589 | 58,468 | | |

The Bank

| | 2008 | | | | | | |
|--|------------------------|---------------------|---|--|-----------------|-----------------------|----------------|
| | 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | |
| 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 |
| Total assets | 8,522 | 108,369 | 35,657 | 61,583 | 32,288 | 48,800 | 295,219 |
| Liabilities | | | | | | | |
| 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 |
| Total liabilities | 54,548 | 169,134 | 19,587 | 14,121 | 2,841 | 7,763 | 267,994 |
| Net gap | (46,026) | (60,765) | 16,070 | 47,462 | 29,447 | | |

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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | |
| 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 | 6,617 | 107,641 | 26,468 | 65,097 | 43,313 | 49,337 | 298,473 |
| Liabilities | | | | | | | |
| 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 | 56,727 | 167,617 | 19,475 | 13,108 | 7,470 | 7,895 | 272,292 |
| Net gap | (50,110) | (59,976) | 6,993 | 51,989 | 35,843 | | |

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 | | | | | | | | |
|---|---------------------------|----------------------------|-------------------------------|--|-----------------------------------|-----------------------------|----------------|---------------|
| 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\$ Mn | 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 | 384,561 | 389,518 | 87,160 | 214,034 | 46,219 | 25,334 | 2,031 | 14,740 |

| 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\$ Mn | 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 | 365,780 | 372,165 | 85,045 | 198,908 | 46,913 | 22,658 | 5,529 | 13,112 |

The Bank

2008

| | 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\$ 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 three months and one year | Between one and five years | More than five years | Undated |
|---|-----------------|--------------------|---------------------|------------------------|-----------------------------------|----------------------------|----------------------|--------------|
| | | | | | 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> |

(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 | | | | | |
|--|-----------------------------|--|---------------------------------------|-------------------------|---------------------------------|-----------------------|
| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 |
| Total Assets | <u>273,892</u> | <u>62,783</u> | <u>33,669</u> | <u>8,251</u> | <u>36,659</u> | <u>415,254</u> |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | <u>296,257</u> | <u>47,834</u> | <u>12,023</u> | <u>1,363</u> | <u>25,292</u> | <u>382,769</u> |
| Interest rate sensitivity gap | <u>(22,365)</u> | <u>14,949</u> | <u>21,646</u> | <u>6,888</u> | | |

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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 |
| Total Assets | 260,667 | 56,492 | 31,354 | 8,669 | 36,797 | 393,979 |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | 278,066 | 43,222 | 8,625 | 5,981 | 27,639 | 363,533 |
| Interest rate sensitivity gap | (17,399) | 13,270 | 22,729 | 2,688 | — | — |

The Bank

2008

| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|--|-----------------------|-------------------------------|------------------------------|---------------------|-------------------------|-----------------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 |
| Total Assets | <u>179,260</u> | <u>29,015</u> | <u>29,572</u> | <u>5,655</u> | <u>51,717</u> | <u>295,219</u> |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | <u>220,086</u> | <u>19,260</u> | <u>8,466</u> | <u>3,520</u> | <u>16,662</u> | <u>267,994</u> |
| Interest rate sensitivity gap | <u>(40,826)</u> | <u>9,755</u> | <u>21,106</u> | <u>2,135</u> | | |

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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 |
| Total Assets | 195,113 | 19,034 | 26,619 | 5,804 | 51,903 | 298,473 |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | 225,098 | 16,296 | 7,238 | 8,171 | 15,489 | 272,292 |
| 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 |
| | % | % | % | % |
| Assets | | | | |
| 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 |
| Liabilities | | | | |
| 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.

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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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:

| | The Group | | | | | |
|-----------------------------------|------------------|--------------------|----------------|----------------|--------------------|----------------|
| | 2008 | | | 2007 | | |
| | Trading | Non-trading | Total | Trading | Non-trading | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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> |

| | The Bank | | | | | |
|-----------------------------------|-----------------|--------------------|----------------|----------------|--------------------|----------------|
| | 2008 | | | 2007 | | |
| | Trading | Non-trading | Total | Trading | Non-trading | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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.

| The Group | | | | | | | | |
|--|---------------------------------------|-------------------------|----------------|----------------------------|---------------------------------------|-------------------------|----------------|--------|
| Notional amounts with remaining life of | | | | | | | | |
| 2008 | | | | 2007 | | | | |
| 1 year or less | Over 1 year to 5 years | Over 5 years | Total | 1 years or less | Over 1 year to 5 years | Over 5 years | Total | |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| 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 |
| | 64,300 | 19,708 | 4,554 | 88,562 | 62,087 | 20,477 | 5,227 | 87,791 |

| The Bank | | | | | | | | |
|--|---------------------------------------|-------------------------|----------------|----------------------------|---------------------------------------|-------------------------|----------------|--------|
| Notional amounts with remaining life of | | | | | | | | |
| 2008 | | | | 2007 | | | | |
| 1 year or less | Over 1 year to 5 years | Over 5 years | Total | 1 years or less | Over 1 year to 5 years | Over 5 years | Total | |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| 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 |
| | 50,771 | 17,899 | 4,648 | 73,318 | 62,444 | 19,146 | 4,681 | 86,271 |

(c) **Capital Commitments**

Capital commitments outstanding at 31st December and not provided for in the accounts were as follows:

| | The Group | | The Bank | |
|---|------------------|----------------|-----------------|----------------|
| | 2008 | 2007 | 2008 | 2007 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Expenditure authorised and contracted for | 1,611 | 1,880 | 608 | 647 |
| Expenditure authorised but not contracted for | 107 | 131 | 98 | 89 |
| | 1,718 | 2,011 | 706 | 736 |

(d) **Operating Lease Commitments**

At 31st December, 2008, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2008 | 2007 | 2008 | 2007 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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> |
| | | | | |
| | The Group | | The Bank | |
| | 2008 | 2007 | 2008 | 2007 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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) |
| | <u>6</u> | <u>4</u> |
| Goodwill arising on consolidation | <u>27</u> | <u>36</u> |
| Total purchase price | 33 | 40 |
| Less: cash and cash equivalents acquired | (12) | (2) |
| Cash flow on acquisition net of cash acquired | <u>21</u> | <u>38</u> |

(b) **Disposal of Subsidiary**

| | <u>2008</u> | <u>2007</u> |
|---|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Advances and other accounts less provisions | — | 53 |
| Taxation | — | (3) |
| Other accounts and provisions | — | (1) |
| | <u>—</u> | <u>49</u> |
| Add: gain on disposal | — | 406 |
| Cash flow on disposal of subsidiary | <u>—</u> | <u>455</u> |

(c) **Cash and Cash Equivalents**

(i) *Components of cash and cash equivalents in the consolidated cash flow statement*

| | <u>2008</u> | <u>2007</u> |
|---|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| 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 |
| | <u>94,106</u> | <u>103,718</u> |

(ii) *Reconciliation with the consolidated balance sheet*

| | <u>2008</u> | <u>2007</u> |
|---|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| 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 | (8,063) | (3,666) |
| 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 | 912 | 55 | 912 | 55 |
| | <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 |
|--|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Aggregate amount of relevant loans outstanding at 31st December | | |
| By the Bank | 4,169 | 1,432 |
| By subsidiaries | <u>1,073</u> | <u>625</u> |
| | <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 | <u>1,492</u> | <u>625</u> |
| | <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

Number of Share Options

| Date of Grant | Outstanding at 1/1/2007 | Granted | Exercised | Lapsed | Outstanding at 31/12/2007 |
|------------------------|------------------------------------|-------------------------|-------------------------|-----------------|--|
| 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 | — | <u>2,750,000</u> | — | — | <u>2,750,000</u> |
| Total | <u><u>24,060,000</u></u> | <u><u>2,750,000</u></u> | <u><u>7,510,000</u></u> | <u><u>—</u></u> | <u><u>19,300,000</u></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 |
| April | 03/5/2006 | 500,000 | — |
| | 18/4/2002 | — | 850,000 |
| | 02/5/2003 | 30,000 | 10,000 |
| | 22/4/2004 | 165,000 | 75,000 |
| May | 03/5/2005 | 110,000 | 290,000 |
| | 02/5/2003 | 90,000 | 210,000 |
| | 22/4/2004 | 20,000 | 155,000 |
| June | 03/5/2005 | 75,000 | 390,000 |
| | 02/5/2003 | — | 150,000 |
| | 22/4/2004 | 25,000 | 65,000 |
| July | 03/5/2005 | 25,000 | 655,000 |
| | 22/4/2004 | 5,000 | 75,000 |
| | 03/5/2005 | 55,000 | 145,000 |
| August | 02/5/2003 | — | 30,000 |
| | 22/4/2004 | 30,000 | 120,000 |
| | 03/5/2005 | 45,000 | 105,000 |
| September | 22/4/2004 | 20,000 | 30,000 |
| | 03/5/2005 | — | 115,000 |
| October | 22/4/2004 | — | 180,000 |
| | 03/5/2005 | — | 100,000 |
| November | 02/5/2003 | — | 15,000 |
| | 22/4/2004 | — | 310,000 |
| | 03/5/2005 | — | 160,000 |
| | 03/5/2006 | — | 50,000 |
| December | 02/5/2003 | — | 40,000 |
| | 22/4/2004 | — | 100,000 |
| | 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.

(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.

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:

**Effective for accounting
periods beginning on or after**

| | |
|--|------------------|
| 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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SUPPLEMENTAL OFFERING CIRCULAR DATED 16 July 2010



The Bank of East Asia, Limited

(incorporated with limited liability in Hong Kong)

U.S.\$150,000,000

6.125% Subordinated Notes due 2020

to be consolidated and form a single series with the U.S.\$450,000,000 6.125% per cent. Notes due 2020

Issue Price: 100.102% plus an amount corresponding to accrued interest from, and including, 16 July 2010 to, but excluding, the New Issue Date (as defined below)

This Supplemental Offering Circular is supplemental to the Offering Circular dated 9 July 2010 relating to the U.S.\$450,000,000 6.125% per cent. Notes due 2020 (the "Notes") issued by The Bank of East Asia, Limited ("BEA" or the "Issuer") which is attached hereto as Appendix 1 and forms part of and is to be read together with this Supplemental Offering Circular.

The Issuer proposes to issue U.S.\$150,000,000 6.125 per cent. Notes due 2020 (the "New Notes"). The New Notes have the same terms and conditions as the Notes, which were issued on 16 July 2010, in all respects (except for the issue date and issue price) and will be consolidated and form a single series with the Notes and, for the purposes of any meeting of Noteholders, shall be treated as one class with the Notes. The New Notes will constitute a "Further Issue" as described in and for the purposes of the "Terms and Conditions of the Notes" set forth in the Offering Circular. The issue price (the "Issue Price") of the New Notes will be 100.102 per cent. of the principal amount of the New Notes plus an amount corresponding to accrued interest in respect of the period from, and including, 16 July 2010 to, but excluding, the New Issue Date (as defined below).

The net proceeds of the issue of the New Notes will be approximately U.S.\$ 150,000,000, after deducting the commissions but before expenses incurred in connection with the issue of the New Notes. The Issuer intends to use the proceeds from the issue of the New Notes for its general working capital purposes.

As at 31 December 2009, the total long-term borrowings and the total capitalisation (comprising total medium-term borrowings, total long-term borrowings and total capital resources) of the Issuer and its subsidiaries and affiliates (the "Group"), after adjustments to give effect to the issue of the Notes and the offering of the New Notes, were approximately HK\$4,984 million (U.S.\$639 million) and HK\$69,112 million (U.S.\$8,861 million), respectively. Save as disclosed in this Supplemental Offering Circular and the Offering Circular, there has been no material change in the total capitalisation of the Group since 31 December 2009.

The Issuer has entered into a subscription agreement with Citigroup Global Markets Limited, J.P. Morgan Securities Ltd. (together, the "Joint Lead Managers"), BOCI Asia Limited, Crédit Agricole Corporate and Investment Bank and The Hongkong and Shanghai Banking Corporation Limited (together, the "Co-Managers", and together with the Joint Lead Managers, the "Managers"), dated 16 July 2010 (the "Subscription Agreement"), pursuant to which and subject to certain conditions contained therein, the Issuer agreed to sell to the Managers, and the Managers agreed severally but not jointly to subscribe and pay for the New Notes at 100.102 per cent. of their principal amount plus an amount corresponding to accrued interest in respect of the period from, and including 16 July 2010 to, but excluding, the New Issue Date. In addition, the Issuer has agreed to reimburse the Managers for certain of their expenses in connection with the issue of the New Notes and to indemnify the Managers against certain liabilities in connection with the offer and sale of the New Notes. The Subscription Agreement provides that the obligations of the Managers are subject to certain conditions precedent, and entitles the Joint Lead Managers (on behalf of the Managers) to terminate it in certain circumstances prior to payment being made to the Issuer.

Approval in-principle has been received for the listing of the New Notes 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 Supplemental Offering Circular. Admission of the New Notes to the Official List of the SGX-ST is not to be taken as an indication of the merits of the Issuer or the New Notes.

See "Investment Considerations" beginning on page 15 of the Offering Circular for a discussion of certain considerations to be taken into account in connection with an investment in the New Notes.

The New Notes have not been, and will not be, registered under the United States Securities Act of 1933 (the "Securities Act"). The New Notes are being offered outside the United States in accordance with Regulation S under the Securities Act ("Regulation S"), and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. The New Notes will be subject to the same selling and transfer restrictions as applicable to the Notes and set out in the Offering Circular.

The New Notes have been rated "A3" 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.

The New Notes and the Notes will be represented initially by a global certificate (the "**Global Certificate**") in registered form, which will be registered in the register of Noteholders in the name of a nominee of, and shall be deposited with a common depository for, Euroclear Bank S.A./N.V. ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream**") on or about 23 July 2010 (the "**New Issue Date**"). Beneficial interests in the Global Certificate will be shown on, and transfers thereof will be effected only through, the records maintained by Euroclear and Clearstream and their respective accountholders. Except in the limited circumstances set out herein, individual certificates for the New Notes will not be issued. See "*Summary of Provisions relating to the Notes while in Global Form*" in the Offering Circular.

This Supplemental Offering Circular amends and supplements, and to the extent inconsistent therewith, supersedes, the Offering Circular, and should be read together with the Offering Circular. References in the Offering Circular to "Notes" shall, where the context permits, include the New Notes.

Joint Bookrunners and Joint Lead Managers

Citi

J.P. Morgan

Co-Managers

BOC International

Crédit Agricole CIB

HSBC

Appendix 1

OFFERING CIRCULAR



The Bank of East Asia, Limited

(incorporated with limited liability in Hong Kong)

U.S.\$450,000,000

6.125% Subordinated Notes due 2020

Issue Price: 99.040%

The 6.125% Subordinated Notes due 2020 (the “**Notes**”) will be issued in an initial aggregate principal amount of U.S.\$450,000,000 by The Bank of East Asia, Limited (“**BEA**” or the “**Issuer**”). The Notes will bear interest from and including 16 July 2010 at a rate per annum equal to 6.125 per cent. Interest will be payable semi-annually in arrear on 16 January and 16 July of each year commencing on 16 January 2011. See “*Terms and Conditions of the Notes — Interest*”.

Unless previously redeemed or purchased and cancelled as provided in the Terms and Conditions of the Notes (the “**Conditions**”), the Issuer will redeem the Notes at their principal amount on 16 July 2020. See “*Terms and Conditions of the Notes — Redemption and Purchase*”. Subject to satisfaction of certain regulatory approval requirements, all but not some only of the Notes will be redeemable at the option of the Issuer, at a redemption price equal to 100% of their principal amount together with accrued and unpaid interest to the date fixed for redemption, upon the occurrence of certain changes in taxation in Hong Kong requiring the payment of additional amounts as provided in the Conditions. See “*Terms and Conditions of the Notes — Redemption and Purchase*”. In addition, subject to satisfaction of certain regulatory approval requirements, the Notes will be redeemable at the option of the Issuer in whole but not in part, at a redemption price equal to 100% of their principal amount together with accrued and unpaid interest to the date fixed for redemption, upon the occurrence of a Regulatory Redemption Event (as defined in the “*Terms and Conditions of the Notes — Redemption and Purchase*”). See “*Terms and Conditions of the Notes — Redemption and Purchase*”.

The Notes will constitute direct, unconditional and unsecured obligations of the Issuer and will be subordinated in right of payment to the claims of depositors and all other unsubordinated creditors of the Issuer. See “*Terms and Conditions of the Notes — Status*”.

The Notes have been rated “A3” 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.

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 15 for a discussion of certain considerations to be taken into account in connection with an investment in the Notes.

Approval in-principle has been received for the listing of the Notes 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 to the Official List of the SGX-ST is not to be taken as an indication of the merits of the Issuer or the Notes.

The Notes will be represented initially by a global certificate (the “**Global Certificate**”) in registered form, which will be registered in the register of Noteholders in the name of a nominee of, and shall be deposited with a common depository for, Euroclear Bank S.A./N.V. (“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream**”) on or about 16 July 2010 (the “**Closing Date**”). Beneficial interests in the Global Certificate will be shown on, and transfers thereof will be effected only through, the records maintained by Euroclear and Clearstream and their respective account holders. Except in the limited circumstances set out herein, individual certificates for the Notes will not be issued. See “*Summary of Provisions relating to the Notes while in Global Form*”.

Joint Bookrunners and Joint Lead Managers

Citi

J.P. Morgan

Co-Managers

BOC International

Crédit Agricole CIB

HSBC

The Issuer confirms that (i) this Offering Circular contains all information with respect to the Issuer and the Issuer's subsidiaries and affiliates (collectively, the "**Group**") and the Notes which is material in the context of the issue and offering of the Notes; (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 Notes, 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 the Issuer to ascertain such facts and to verify the accuracy of all such information and statements. In addition, the Issuer accepts full responsibility for the accuracy of the information contained in this Offering Circular.

In making an investment decision, you must rely on your own examination of the Issuer and the terms of the offering of the Notes, including the merits and risks involved. By receiving this Offering Circular, you acknowledge that (i) you have not relied on Citigroup Global Markets Limited or J.P. Morgan Securities Ltd. (the "**Joint Lead Managers**", BOCI Asia Limited, Crédit Agricole Corporate and Investment Bank, The Hongkong and Shanghai Banking Corporation Limited (together, the "**Co-Managers**", and together with the Joint Lead Managers, the "**Managers**"), or any person affiliated with the Managers or DB Trustees (Hong Kong) Limited (the "**Trustee**") or any person affiliated with the Trustee in connection with your investigation of the accuracy of any information in this Offering Circular or your investment decision; and (ii) no person has been authorised to give any information or to make any representation concerning the Issuer, the Group or the Notes 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 Issuer or the Managers.

No representation or warranty, express or implied, is made by the Managers or the Trustee or any of the Agents or their respective affiliates or advisors 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 Notes shall, under any circumstances, constitute a representation or create any implication that there has been no change in the affairs of the Issuer 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 Issuer, the Managers, the Trustee, the Agents or any of their respective affiliates or representatives is making any representation to any purchaser of the Notes 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. You should be aware that you may be required to bear the financial risks of an investment in the Notes for an indefinite period. You should consult with your own advisers as to the legal, tax, business, financial and related aspects of a purchase of the Notes.

This Offering Circular does not constitute an offer to sell, or an invitation by or on behalf of the Issuer, the Managers, the Trustee or any of their respective affiliates or representatives to purchase any of the Notes, 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, Singapore and Japan, 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.

The Notes 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 Notes are being offered and sold only outside the United States in accordance with Regulation S.

Each purchaser of Notes must comply with all applicable laws and regulations in force in each jurisdiction in which it purchases, offers or sells such Notes 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 Notes 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 Issuer nor the Managers shall have any responsibility therefor.

In connection with this issue, J.P. Morgan Securities Ltd. (or any person acting on its behalf) may over-allot or effect transactions with a view to supporting the market price of the notes at a level higher than that which might otherwise prevail. However, there is no assurance that J.P. Morgan Securities Ltd. (or any person acting on its behalf) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the Closing Date and 60 days after the date of the allotment of the Notes. Any stabilisation action or over-allotment must be conducted by J.P. Morgan Securities Ltd. (or person(s) acting on its behalf) in accordance with all applicable laws and rules.

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 “**US 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 “**EUR**”, “**euro**” and “**€**” are to the lawful currency of the member states of the European Union that adopt or have adopted the single currency in accordance with the Treaty establishing the European Community as amended by the Treaty of the European Union; all references to “**S\$**” are to the lawful currency of Singapore; all references to “**Renminbi**” and “**RMB**” 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 “**GBP**” and “**£**” 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 and “**HKMA**” is to Hong Kong Monetary Authority.

For convenience only, all Hong Kong dollar amounts in this Offering Circular have been translated into US 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 US 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.

This Offering Circular contains forward-looking statements regarding the intent, belief or current expectations of the Issuer 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”, “risk”, “seek”, “should”, “target” and similar expressions are used in relation to the Issuer 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 Issuer 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 Issuer’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 Issuer*”, 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 31 December 2009, BEA’s consolidated assets, advances to customers and customer deposits were HK\$434,082 million (U.S.\$55,652 million), HK\$247,654 million (U.S.\$31,751 million) and HK\$342,528 million (U.S.\$43,914 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, and (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.

The shares of BEA have been listed on the HKSE since the 1930s. As at 30 April 2010, the authorised share capital of BEA was 4,000 million ordinary shares of HK\$2.50 each and 500,000 substitute preference shares of U.S.\$1,000 each, of which approximately 2,031.2 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 April 2010, BEA’s market capitalisation was approximately HK\$57,178.51 million (U.S.\$7,330.58 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 April 2010, the Group offered a broad range of banking and related financial services in Hong Kong through a network of 88 branches, seven major subsidiaries and 52 wealth management centres called “SupremeGold Centres”.

In order to access the mainland China market and overseas Chinese markets, BEA expanded its operations to mainland China, Taiwan, Macau, the United States, the United Kingdom, the British Virgin Islands and South East Asia. As at 30 April 2010, BEA’s global operations (excluding Hong Kong) totalled 46 branches, 59 sub-branches, three representative offices, and several affiliates and joint ventures.

In 2007, BEA’s wholly-owned subsidiary, The Bank of East Asia (China) Limited (“**BEA (China)**”) was licensed and approved to conduct Renminbi business with local residents in mainland China. As at 30 April 2010, BEA (China) operated 20 branches and 56 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 operates two representative offices. For a discussion of the products and services provided by BEA (China), see “*Business of the Issuer — 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 and three sub-branches in Macau.

As at 31 December 2007, 2008 and 2009, approximately 24.9%, 29.8% and 31.3%, respectively, of the assets of the Group were accounted for in mainland China, Taiwan and Macau. For the years ended 31 December 2007, 2008 and 2009, approximately 23.7%, 18,550%⁽¹⁾ and 45.7%, 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 2007, 2008 and 2009, the Group’s capital adequacy ratio was approximately 12.6%, 13.8% and 13.3%⁽²⁾, respectively, compared with the statutory minimum requirement of 8.0%, and its loan to deposit ratio was approximately 73.6%, 69.9% and 71.7%, respectively. For the years ended 31 December 2007, 2008 and 2009, BEA’s average liquidity ratio was approximately 43.5%, 38.4% and 43.3%, 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 2007, 2008 and 2009, customer deposits accounted for approximately 81.4%, 88.1% and 91.6%, respectively, of borrowed funds. The remainder of the Group’s funding requirements as at 31 December 2007, 2008 and 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 year ended 31 December 2009, the Group’s profit after taxation was HK\$2,638 million (U.S.\$ 338 million), an increase of approximately 2,445.1% from the year ended 31 December 2008. The turnaround in operations and financial performance was the result of gradually improving conditions in the financial markets and global economy, as well as the absence of further substantial write-downs recorded by the Issuer. 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. The Group’s profits in 2008 were severely affected by 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 conducted in Hong Kong.

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.
- (2) Taking into account the issuance of 167.1 million new shares at a price of HK\$30.60 per share in January 2010, the pro forma capital adequacy ratio would be 15.1%.

For the year ended 31 December 2009, the Group achieved a return on average assets of approximately 0.6% and a return on average equity of approximately 7.7%, as compared with approximately 0.01% and 0.12%, respectively, for the year ended 31 December 2008 and approximately 1.2% and 14.6%, respectively, for the year ended 31 December 2007.

STRATEGY

BEA's core objectives are to strengthen its position as the largest independent local 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. 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; and
- Focus on enhancing operational efficiency.

THE OFFERING

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

| | |
|----------------------------|---|
| The Issuer | The Bank of East Asia, Limited, a company incorporated with limited liability in Hong Kong. |
| The Notes | U.S.\$450,000,000 6.125% Subordinated Notes due 2020. |
| Issue Price | 99.040 per cent. |
| Issue Date | 16 July 2010 |
| Interest | The Notes will bear interest at a rate of 6.125% per annum, payable semi-annually in arrear on 16 January and 16 July (subject to adjustment) of each year, commencing on 16 January 2011. |
| Final Redemption | Unless previously redeemed or purchased and cancelled, the Notes will mature and become payable at their principal amount on 16 July 2020. |
| Use of Proceeds | The net proceeds from the sale of the Notes will be used for the purpose of refinancing the Issuer’s existing debt obligations under its outstanding U.S.\$550,000,000 5.625 per cent. Subordinated Notes due 2015 and/or for the general working capital requirements of the Group. See “Use of Proceeds” for further details. |
| Status | The Notes constitute direct, unconditional, unsecured and subordinated obligations of the Issuer, ranking <i>pari passu</i> without any preference among themselves. |

The claims of the holders of the Notes will, in the event of the Winding-Up (as defined in the Conditions) of the Issuer, be subordinated in right of payment in the manner provided in the Conditions and the Trust Deed to the claims of depositors and all other unsubordinated creditors of the Issuer and will rank, in the event of the Winding-Up of the Issuer, at least *pari passu* in right of payment with all other Subordinated Indebtedness (as defined in the Conditions), present and future, of the Issuer. Claims in respect of the Notes will rank in priority to the rights and claims of holders of subordinated liabilities which by their terms rank or are expressed to rank in right of payment junior to the Notes and all classes of equity securities of the Issuer, including holders of preference shares, if any.

Events of Default

If default is made in the payment of principal or interest due in respect of the Notes or any of them and the default continues for a period of five Business Days in Hong Kong (in the case of principal) or 10 Business Days in Hong Kong (in the case of interest) (each such event, an “**Event of Default**”) then the Trustee at its discretion may, subject as provided in the Conditions, in order to enforce payment, without further notice, institute Winding-Up Proceedings (as defined in the Conditions) in Hong Kong against the Issuer, but may take no further action in respect of such default (but without prejudice to the provision below).

If an order is made or an effective resolution is passed for the Winding-Up of the Issuer in Hong Kong (except for the purposes of a reconstruction, amalgamation or reorganisation the terms of which have previously been approved by an Extraordinary Resolution (as defined in the Conditions) of Noteholders) (such event also, an “**Event of Default**”), then the Trustee, at its discretion may, subject as provided below, give written notice to the Issuer that the Notes are, and they shall forthwith thereupon become, immediately due and repayable at their principal amount together with accrued interest without further action or formality.

Enforcement.

The Trustee may, subject as provided below, at its discretion and without further notice, institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer under the Notes or the Trust Deed (other than any obligation for the payment of any principal or interest in respect of the Notes), provided that the Issuer shall not as a consequence of such proceedings be obliged to pay any sum or sums representing or measured by reference to principal or interest in respect of the Notes sooner than the same would otherwise have been payable by it.

The Trustee shall not be bound to take action upon any Event of Default or as referred to in the preceding paragraph or any other action under the Trust Deed unless (i) it shall have been so requested in writing by Noteholders holding at least one-quarter of the principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders and (ii) it shall have been indemnified and/or secured to its satisfaction.

No Noteholder shall be entitled to proceed directly against the Issuer unless the Trustee having become bound so to proceed, fails to do so within a reasonable period and such failure is continuing.

Redemption for Taxation
Reasons

Upon obtaining the approval of the HKMA and satisfying the Trustee immediately before the giving of the notice referred to below that (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction or any change in the official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 9 July 2010, on the occasion of the next payment due in respect of the Notes the Issuer would be required to pay additional amounts as provided or referred to in the provisions of the Notes relating to taxation, and (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it, the Issuer may at its option, having given not less than 30 nor more than 60 days' notice to the Noteholders, redeem all the Notes, but not some only, on the next Interest Payment Date at their principal amount together with interest accrued to but excluding the date of redemption, provided that no such notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer would be required to pay the additional amounts were a payment in respect of the Notes then due. See "*Terms and Conditions of the Notes — Redemption and Purchase — Redemption for Taxation Reasons*".

Redemption upon a Regulatory
Redemption Event

Upon obtaining the approval of the HKMA, the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable) at their principal amount together with interest accrued to but excluding the date fixed for redemption, following the occurrence of a Regulatory Redemption Event.

A "**Regulatory Redemption Event**" occurs if the Notes in whole, and not in part, no longer qualify as term subordinated debt for inclusion in Category II — Supplementary Capital (as defined in the Conditions) of the Issuer as a result of amendments to the relevant provisions of the Banking Ordinance of Hong Kong (Cap. 155 of the Laws of Hong Kong) (the "**Banking Ordinance**") or the statutory guidelines issued by HKMA in relation thereto after the Issue Date (excluding for the avoidance of doubt, non-qualification solely by virtue of the Issuer already having on issue securities with an aggregate principal amount up to or in excess of the limit of Supplementary Capital (as defined in the Conditions) permitted from time to time by the HKMA or solely as a result of any discounting requirements as to the eligibility of the Notes for such inclusion pursuant to the relevant legislation and statutory guidelines in force as at the Issue Date).

Trustee

DB Trustees (Hong Kong) Limited.

Trust Deed

The Notes will be constituted by a Trust Deed to be dated 16 July 2010 between the Issuer and the Trustee.

| | |
|---------------------------------|---|
| Form and Denomination | The Notes are issued in registered form in denominations of U.S.\$100,000 each and integral multiples of U.S.\$1,000 in excess thereof without coupons attached. The Notes will initially be represented by the Global Certificate deposited with a common depositary for, and representing Notes registered in the name of a common nominee of, Euroclear and Clearstream. Beneficial interests in the Global Certificate will be shown on, and transfer thereof will be effected only through, the records maintained by Euroclear and Clearstream. Except in the limited circumstances described in the Global Certificate, owners of interests in Notes represented by the Global Certificate will not be entitled to receive definitive Certificates in respect of their individual holdings of Notes. |
| Payments | All payments of principal, premium (if any) and interest by the Issuer will be made free and clear of, and without withholding or deduction for any taxes or duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of Hong Kong or any political subdivision or taxing authority thereof or therein, unless such withholding or deduction is required by law. In that event, the Issuer will pay such additional amounts as will result in receipt by the holder of a Note of such amount as would have been received by them had no such withholding or deduction been required, subject to certain exceptions (see “ <i>Terms and Conditions of the Notes — Taxation — Payment without Withholding or Deduction</i> ”). |
| 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 provisions of the Notes and the Trust Deed relating to subordination shall be governed by, and construed in accordance with, Hong Kong law. |
| Listing | Approval in-principle has been received for the listing of the Notes 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. |

SUMMARY FINANCIAL AND OTHER INFORMATION

SUMMARY CONSOLIDATED FINANCIAL AND OTHER INFORMATION RELATING TO THE GROUP

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 2007, 2008 and 2009 set forth below are derived from the Group's audited consolidated financial statements which have been audited by KPMG. The audited consolidated profit and loss accounts of the Group for the years ended 31 December 2007, 2008 and 2009 and the audited consolidated balance sheets of the Group as at 31 December 2007, 2008 and 2009 are included in this Offering Circular. The Group's consolidated financial statements are prepared and presented in accordance with HKFRS.

CONSOLIDATED PROFIT AND LOSS ACCOUNTS

| | <u>2007</u> | <u>2008</u> | <u>2009</u> |
|--|-----------------------|-----------------------|-----------------------|
| | (in HK\$ millions) | (in HK\$ millions) | (in HK\$ millions) |
| Interest income | 18,309 | 17,465 | 12,121 |
| Interest expense | <u>(12,332)</u> | <u>(10,672)</u> | <u>(5,374)</u> |
| Net interest income | <u>5,977</u> | <u>6,793</u> | <u>6,747</u> |
| Fee and commission income | 2,608 | 2,618 | 2,799 |
| Fee and commission expense | (471) | (473) | (537) |
| Net fee and commission | 2,137 | 2,145 | 2,262 |
| Net trading profits/(losses) | 1,417 | (1,292) | 941 |
| Net result from financial instruments designated at fair value through profit or loss | (1,154) | (1,612) | (267) |
| Other operating income | <u>437</u> | <u>423</u> | <u>505</u> |
| Non-interest income/(expense) | <u>2,837</u> | <u>(336)</u> | <u>3,441</u> |
| Operating income | 8,814 | 6,457 | 10,188 |
| Operating expenses | <u>(4,691)</u> | <u>(5,779)</u> | <u>(6,129)</u> |
| Operating profit before impairment losses | <u>4,123</u> | <u>678</u> | <u>4,059</u> |
| Impairment losses on loans and advances | (216) | (558) | (1,105) |
| Impairment losses on held-to-maturity investments | (42) | (44) | (9) |
| Impairment losses on available-for-sale financial assets | (228) | (352) | (14) |
| Impairment losses on associates | (41) | — | — |
| Write back of/(Charge for) impairment losses on bank premises Impairment losses | 132 | 6 | (13) |
| | (395) | (948) | (1,141) |
| Operating profit/(loss) after impairment losses | 3,728 | (270) | 2,918 |
| Net profit/(loss) on sale of held-to-maturity investments | — | 25 | (12) |
| Net profit on sale of available-for-sale financial assets | 667 | 197 | 102 |
| Net profit on disposal of loans and receivables | — | 1 | 2 |
| Net profit/(loss) on sale of subsidiaries/associates | 406 | (8) | — |
| Net profit/(loss) on sale of fixed assets | (1) | 178 | 16 |
| Valuation gains/(losses) on investment properties | 293 | (168) | 206 |
| Share of profits less losses on associates | <u>92</u> | <u>53</u> | <u>264</u> |
| Profit for the year before taxation | <u>5,185</u> | <u>8</u> | <u>3,496</u> |

| | <u>2007</u> | <u>2008</u> | <u>2009</u> |
|--|-----------------------|-----------------------|-----------------------|
| | (in HK\$ millions) | (in HK\$ millions) | (in HK\$ millions) |
| Income tax | | | |
| Current tax | | | |
| — Hong Kong | (258) | (64) | (73) |
| — Overseas | (331) | (566) | (454) |
| Deferred tax | (375) | 726 | (331) |
| Profit for the year after taxation | <u>4,221</u> | <u>104</u> | <u>2,638</u> |
| Attributable to: | | | |
| Owners of the parent | 4,144 | 39 | 2,565 |
| Minority interest | <u>77</u> | <u>65</u> | <u>73</u> |
| Profit after taxation | <u>4,221</u> | <u>104</u> | <u>2,638</u> |
| Proposed final dividend per share | <u>HK\$1.18</u> | <u>HK\$0.02</u> | <u>HK\$0.48</u> |
| Per share | | | |
| — Basic earnings | HK\$2.41* | HK\$0.02* | HK\$1.36 |
| — Diluted earnings | HK\$2.39* | HK\$0.02* | HK\$1.36 |
| — Dividends | HK\$1.51* | HK\$0.23* | HK\$0.76 |

Note:

(*) denotes that these figures have been adjusted for the bonus issue of shares to BEA's shareholders in April 2009.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| | 2007 | 2008 | 2009 |
|---|-----------------------|-----------------------|-----------------------|
| | (in HK\$ millions) | (in HK\$ millions) | (in HK\$ millions) |
| ASSETS | | | |
| Cash and balances with banks and other financial institutions . . . | 17,853 | 28,105 | 29,712 |
| Placements with banks and other financial institutions | 94,704 | 96,574 | 67,945 |
| Trade bills | 812 | 1,164 | 1,847 |
| Trading assets | 4,847 | 3,437 | 5,722 |
| Financial assets designated at fair value through profit or loss . | 8,658 | 4,130 | 10,392 |
| Advances to customers and other accounts | 231,740 | 243,725 | 261,803 |
| Available-for-sale financial assets | 12,217 | 18,560 | 30,883 |
| Held-to-maturity investments | 10,761 | 5,006 | 7,239 |
| Investments in associates | 2,793 | 2,486 | 2,615 |
| Fixed assets | 6,856 | 9,146 | 11,467 |
| — Investment properties | 1,726 | 1,839 | 2,095 |
| — Other property and equipment | 5,130 | 7,307 | 9,372 |
| Goodwill and intangible assets | 2,668 | 2,734 | 4,135 |
| Deferred tax assets | 70 | 187 | 322 |
| Total Assets | <u>393,979</u> | <u>415,254</u> | <u>434,082</u> |
| EQUITY AND LIABILITIES | | | |
| Deposits and balances of banks and other financial institutions . | 39,060 | 27,045 | 11,886 |
| Deposits from customers | 284,186 | 323,802 | 342,528 |
| Trading liabilities | 2,372 | 2,846 | 1,455 |
| Certificates of deposit issued | 12,165 | 5,491 | 2,812 |
| — At fair value through profit or loss | 7,660 | 3,777 | 2,442 |
| — At amortised cost | 4,505 | 1,714 | 370 |
| Current taxation | 229 | 333 | 147 |
| Debt securities issued | — | — | 4,346 |
| Deferred tax liabilities | 872 | 77 | 520 |
| Other accounts and provisions | 10,997 | 12,139 | 18,506 |
| Loan capital | 13,652 | 11,036 | 12,359 |
| — At fair value through profit or loss | 8,983 | 6,395 | 7,712 |
| — At amortised cost | 4,669 | 4,641 | 4,647 |
| Total Liabilities | 363,533 | 382,769 | 394,559 |
| Share capital | 3,936 | 4,183 | 4,623 |
| Reserves | <u>26,163</u> | <u>27,963</u> | <u>30,542</u> |
| Total equity attributable to equity owners of the parent | 30,099 | 32,146 | 35,165 |
| Minority interests | 347 | 339 | 4,358 |
| Total Equity | 30,446 | 32,485 | 39,523 |
| Total Equity and Liabilities | <u>393,979</u> | <u>415,254</u> | <u>434,082</u> |
| OTHER SELECTED FINANCIAL DATA | | | |
| | (%) | (%) | (%) |
| Loan to Deposit Ratio | 73.6 | 69.9 | 71.7 |
| Capital Adequacy Ratio | 12.6 | 13.8 | 13.3 ⁽¹⁾ |
| Average Liquidity Ratio | 43.5 | 38.4 | 43.3 |
| Return on Average Assets | 1.2 | 0.01 | 0.6 |
| Return on Average Shareholders' Funds | 14.6 | 0.1 | 7.7 |

Note

(1) Taking into account the issuance of 167.1 million new shares at a price of HK\$30.60 per share in January 2010, the pro forma capital adequacy ratio would be 15.1%.

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 Notes. The occurrence of one or more events described below could have an adverse effect on BEA's business, financial condition, or results of operations, and could affect its ability to make payments of principal and interest under the Notes. Additional considerations and uncertainties not currently known to BEA, or which BEA currently deems immaterial, may also have an adverse effect on an investment in the Notes.

CONSIDERATIONS RELATING TO BEA

Hong Kong Economy

BEA conducts most of its operations⁽¹⁾ 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 and the results of its 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 continue to affect markets, 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 global 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 reviving their economies. Since the second half of 2009, there has been evidence suggesting that the global economy is recovering, and some of the fiscal measures and other stimulus packages have been scaled back or withdrawn by various countries. However, in early 2010, fear of a sovereign debt crisis which has developed in some European countries including Greece, Spain and Portugal has again caused uncertainty to the global financial markets. The uncertain global economic outlook, together with the withdrawal of the fiscal aid measures put in place by various governments, may have an adverse impact on the Hong Kong economy which may affect 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, 2.5% in 2008 and 8.7% in 2009 (year-on-year), BEA believes that the recovery of, and

Note:

(1) Operations based on size of total assets

the continued growth in, the Hong Kong economy 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 economies of the United States, Europe, the PRC and Hong Kong.

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 which may have significantly greater financial and other resources. In particular, competition in the credit card 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.

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 2009 and 30 April 2010, BEA charged an average of 2.32% (P - 2.93%) and 2.23% (P - 3.02%), 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 14 May 2010, 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 China 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 retail or corporate lending portfolios in mainland China, 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 31 December 2009, total deposits increased from HK\$167,916 million to HK\$345,340 million, and retail deposits grew from HK\$163,738 million to HK\$342,528 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 questioning the liquidity and stability of BEA that BEA believes to be unfounded were disseminated in Hong Kong. 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. In April 2010, a bill seeking to amend the Deposit Protection Scheme Ordinance was gazetted. Among other things, the bill seeks to increase the Deposit Protection Scheme limit from HK\$100,000 to HK\$500,000 which is intended to come into effect upon the expiry of the guarantee at the end of 2010. However, there can be no assurance that the bill will be implemented and that the level of customer deposits of BEA will not be adversely affected by the withdrawal of the guarantee or any other 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. The Bank of East Asia (China) Limited ("**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 these markets. For a discussion of recent or proposed acquisitions and disposals of BEA's businesses, see "*Business of the Issuer — 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 the demand 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 that 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.

Changes in Regulations in the Mainland China Market

The body of law and other regulation which applies to BEA's business in the PRC is extensive, complex and subject to change. The nature and extent of such regulation have been changing over time and this is likely to continue in the future. BEA cannot guarantee that it will be in total compliance at all times with these regulatory requirements. Should BEA fail to meet any regulatory obligations or performance standards, this could result in enforcement action (which may include criminal prosecution) being taken against BEA and/or fines or other sanctions being imposed on BEA. It is also possible that new or stricter standards could be imposed on BEA that will raise BEA's operating costs which may affect BEA's financial performance.

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 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, through BEA (China), been expanding its range of products and services offered in mainland 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 expectation 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 April 2010, BEA's wholly-owned subsidiary, BEA (China), headquartered in Shanghai, operated 20 branches in Shanghai, Beijing, Tianjin, Dalian, Shenyang, Qingdao, Shijiazhuang, Urumqi, Hangzhou, Nanjing, Suzhou, Chengdu, Chongqing, Wuhan, Hefei, Xi'an, Shenzhen, Guangzhou, Zhuhai and Xiamen as well as 56 sub-branches (10 in Shanghai, eight in both Shenzhen and Guangzhou, four in each of Dalian, Xi'an and Xiamen, three in each of Beijing, Chongqing and Zhuhai, two in both Shenyang and Chengdu, one in each of Qingdao, Hangzhou, Foshan, Zhongshan and Huizhou). The three cross-location sub-branches in Foshan, Zhongshan and Huizhou were established under the liberalisation measures of Supplement VI to the CEPA. BEA (China) also operated ten 24-hour self-service banking centres and more than 370 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 two representative offices in Fuzhou and Dongguan. BEA (China) has also obtained preliminary approval to establish four new sub-branches in mainland China. In addition, BEA maintains two branches in Taiwan, which are located in Taipei and Kaohsiung, and one branch and three sub-branches in Macau.

As at 31 December 2007, 2008 and 2009, advances to customers made by BEA's mainland China, Taiwan and Macau branches amounted to HK\$78,566 million, HK\$96,885 million and HK\$101,313 million respectively representing approximately 36.0%, 42.1% and 40.9% 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 and the impact on the changes in regulations governing banking and other businesses). 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 April 2010, BEA's wholly-owned subsidiary, The Bank of East Asia (U.S.A.) N.A. ("BEAUSA") operated 13 branches in the United States. Pursuant to an agreement between BEAUSA and the Office of the Comptroller of the Currency ("OCC"), the primary U.S. federal regulator, BEAUSA adopted a capital programme ("Capital Programme") from 31 December 2008 under which it is required to maintain its regulatory capital at levels higher than those stipulated by published regulations in order to qualify as being "well capitalised". In particular, BEAUSA is required to maintain a minimum capital adequacy ratio ("CAR") of 12.5%. The Capital Programme will remain in place until the OCC is satisfied that BEAUSA's results of operations no longer warrant its capital ratios to remain higher than regulatory levels such that its "well-capitalised" status is preserved. In August 2009, BEA injected U.S.\$ 25 million into BEAUSA for the purposes of maintaining the required CAR and increasing the capital resources of BEAUSA in order to increase its loan portfolio and improve its interest earnings. As at 31 December 2009, the CAR of BEAUSA was 17.2%.

Given the current uncertain market and economic conditions in 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 Programme, 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 BEAUSA has entered into with third parties.

For the year ended 31 December 2009, BEAUSA made provisions of U.S.\$8.0 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

Exposure to the Property Market

BEA has significant direct and indirect exposure to the property market through its portfolio of property-related advances and property used as collateral.

As at 31 December 2007, 2008 and 2009, property related loans amounted to HK\$37,639 million, HK\$43,181 million and HK\$42,754 million which accounted for approximately 47.9%, 44.6% and 42.2%, respectively, of BEA's total outstanding customer advances in mainland China, Taiwan and Macau.

As at 31 December 2007, 2008 and 2009, home mortgage advances (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, which amounted to HK\$37,286 million, HK\$25,615 million, and HK\$26,749 million, respectively, which accounted for approximately 17.1%, 11.1% and 10.8% respectively of the Group's total advances to customers. In particular, advances under GHOS, PSPS and TPS accounted for HK\$1,041 million, HK\$1,318 million and HK\$1,529 million, respectively, or approximately 0.5%, 0.6% and 0.6%, respectively, of the Group's total advances to customers. Advances for property development and investment in Hong Kong amounted to HK\$35,103 million, HK\$36,286 million and HK\$39,177 million, which accounted for approximately 16.1%, 15.8% and 15.8%, respectively, of BEA's total advances to customers.

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 signs of recovery since 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 2007, 2008 and 2009, BEA's net interest income represented approximately 67.8%, 105.2% and 66.2%, 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 2007, 2008 and 2009 were 1.91%, 1.85% and 1.80% 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, or any increase at all, in loan demand. 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, high 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 depends on various quantitative and qualitative factors, including the number of months by which payments have fallen into 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 2007, 2008 and 2009, approximately 91.3%, 85.9% and 83.9% 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 if they do, BEA's liquidity and funding will not be adversely affected by such incidents.

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. In April 2010, a bill seeking to amend the Deposit Protection Scheme Ordinance was gazetted. Among other things, the bill seeks to increase the Deposit Protection Scheme limit from HK\$100,000 to HK\$500,000 which is intended to come into effect upon the expiry of the guarantee at the end of 2010. However, there can be no assurance that the bill will be implemented and that the level of customer deposits, and therefore of BEA's liquidity, will not be adversely affected by the withdrawal of the guarantee or any other changes to the Deposit Protection Scheme.

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, 25% 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 2007, 2008 and 2009, BEA held a substantial part of its spot assets in U.S. dollars amounting to HK\$94,859 million, HK\$83,532 million and HK\$82,024 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 of 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. As at 31 December 2007, 2008 and 2009, at least 70% of the Group's advances were secured by collateral. 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 2009, BEA had a total investment in debt securities of HK\$40,537 million, of which approximately 12% were rated Aaa, 29% were rated between Aa1 to Aa3, 19% were rated between A1 to A3, 5% were rated lower than A3, 25% were rated P-1 and 10% were unrated.

In respect of BEA's exposure to sovereign debt in Europe, as at 30 April 2010, BEA holds government agency bonds guaranteed by the governments of the U.K. and the Netherlands amounting to approximately U.S.\$33 million. Accordingly, BEA does not consider its exposure to European sovereign debt to be significant.

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 2009, 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 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 ("Mini-Bonds"), subscribed or purchased through BEA. As at 30 April 2010, approximately 98.4% of the eligible persons have accepted the offer (see "*Business of the Issuer — Litigation*") and the remaining 1.6% (i.e. 14 Mini-Bonds holders) have rejected the offer. In February 2010, one Mini-Bonds holder who did not accept the offer made 4 claims against BEA in the Small Claims Tribunal of Hong Kong for around HK\$200,000. The relevant proceedings are still ongoing. In addition, BEA has recently reached settlement with one of the 14 Mini-Bonds holders. It is still uncertain at this stage whether the remaining 12 Mini-Bonds holders 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 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. 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 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. In December 2009, the Basel Committee on Banking Supervision issued a consultative document with proposals to reform the capital adequacy standards of the banking sector. There is no certainty as to the final framework for capital and adequacy standards which will be developed and implemented, which may require increased capital requirements and impact existing business models, or the timing of the implementation. If such final recommended measures are adopted by the HKMA, BEA may incur substantial costs in monitoring and complying with the new requirements.

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 Issuer'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. In 2009, there has also been a significant number of confirmed cases of Human Swine Influenza A (H1N1) globally which resulted in 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, 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 Notes 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 NOTES

No limitation on issuing senior or pari passu securities in respect of the Notes

There is no restriction on the amount of securities which the Issuer may issue and which rank senior to, or pari passu with, the Notes. The issue of any such securities may reduce the amount recoverable by the Noteholders in case of a Winding-Up of the Issuer. The Notes are subordinated obligations of the Issuer. Accordingly, in the Winding-Up of the Issuer, there may not be sufficient amount to satisfy the amounts owing to the holders of the Notes.

Subordination of the Notes

BEA's obligations under the Notes will be direct, unconditional and unsecured, and will be subordinated in right of payment to the claims of depositors and all other unsubordinated creditors of the Issuer in the event of a Winding-Up of the Issuer. Although the Notes may pay a higher rate of interest than comparable notes which are unsubordinated, an investor in the Notes may lose all or some of his investment should BEA become insolvent.

Restricted Remedy for Non-Payment

The sole remedy against BEA available to the Trustee to receive any amounts owing in respect of the principal of, or interest on, the Notes will be to institute proceedings for the Winding-Up of BEA and/or prove in such Winding-Up.

Modification, Waivers and Substitution

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.

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 14.

Change of Law

The Conditions, and any non-contractual obligations arising out of or in connection with them, are governed by English law (except for the provisions relating to subordination which are governed by Hong Kong law). No assurance can be given as to the impact of any possible judicial decision or change to English or Hong Kong law or administrative practice after the date of issue of the Notes.

Secondary Market

The Notes may have no established trading market when issued and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a material adverse effect on the market value of Notes.

Credit Ratings

The Notes have been rated A3 by Moody's and BBB+ by S&P. The ratings may not reflect the potential impact of all risks related to the structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. Rating agencies may also revise or replace entirely the methodology applied to derive credit ratings.

USE OF PROCEEDS

The net proceeds of the issue of the Notes will be approximately U.S.\$445,005,000, after deducting the commissions but before expenses incurred in connection with the issue of the Notes. The Issuer intends to use the proceeds from the issue of the notes for the purpose of refinancing its existing debt obligations under its outstanding US\$550,000,000 5.625 per cent. Subordinated Notes due 2015 and/or for its general working capital purposes.

CAPITALISATION AND INDEBTEDNESS

CAPITALISATION AND INDEBTEDNESS OF THE GROUP

As at 31 December 2009, the Issuer had an authorised share capital of HK\$6,500 million consisting of 2,600 million ordinary shares of HK\$2.50 each, and an authorised share capital of U.S.\$500 million consisting of 0.5 million substitute preference shares of U.S.\$1,000 each, each issued and fully paid up share capital of approximately HK\$4,623 million consisting of approximately 1,849 million ordinary shares of HK\$2.50 each.

The following table sets out the Group's consolidated capitalisation and indebtedness as at 31 December 2009 and as adjusted for the issue of the Notes.

| | As at 31 December 2009 | | | |
|--|------------------------|-------------------------|-----------------------|-------------------------|
| | Actual | Actual | As adjusted | As adjusted |
| | HK\$ (in millions) | U.S.\$ (in millions) | HK\$ (in millions) | U.S.\$ (in millions) |
| Short-term borrowings ⁽¹⁾ | | | | |
| Customer deposit accounts | 331,461 | 42,495 | 331,461 | 42,495 |
| Certificates of deposits in issue | 1,414 | 181 | 1,414 | 181 |
| Deposits from banks | 11,833 | 1,517 | 11,833 | 1,517 |
| Loan capital | 4,281 | 549 | 4,281 | 549 |
| Total short-term borrowings | <u>348,989</u> | <u>44,742</u> | <u>348,989</u> | <u>44,742</u> |
| Medium-term borrowings ⁽²⁾ | | | | |
| Customer deposit accounts | 11,067 | 1,419 | 11,067 | 1,419 |
| Certificates of deposits in issue | 1,094 | 140 | 1,094 | 140 |
| Debt securities issue | 4,346 | 557 | 4,346 | 557 |
| Deposits from banks | 20 | 3 | 20 | 3 |
| Loan capital | 8,078 | 1,036 | 8,078 | 1,036 |
| Total medium-term borrowings | <u>24,605</u> | <u>3,154</u> | <u>24,605</u> | <u>3,154</u> |
| Long-term borrowings ⁽³⁾ | | | | |
| Certificates of deposits in issue | 304 | 39 | 304 | 39 |
| Total Notes to be issued | — | — | 3,510 | 450 |
| Total long-term borrowings | <u>304</u> | <u>39</u> | <u>3,814</u> | <u>489</u> |
| Capital resources ⁽⁴⁾ | | | | |
| Share capital | 4,623 | 593 | 4,623 | 593 |
| Reserves | 30,542 | 3,916 | 30,542 | 3,916 |
| Shareholders' funds | 35,165 | 4,508 | 35,165 | 4,508 |
| Minority interests | 4,358 | 559 | 4,358 | 559 |
| Total minority interests | 4,358 | 559 | 4,358 | 559 |
| Total capital resources | <u>39,523</u> | <u>5,067</u> | <u>39,523</u> | <u>5,067</u> |
| Total capitalisation ⁽⁵⁾ | <u>64,432</u> | <u>8,261</u> | <u>67,942</u> | <u>8,711</u> |
| Short-term borrowings and total capitalisation | <u>413,421</u> | <u>53,003</u> | <u>416,931</u> | <u>53,453</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) In January 2010, the Issuer issued 167.1 million new shares at a price of HK\$30.60 per share.
- (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 31 December 2009.

BUSINESS OF THE ISSUER

INTRODUCTION

Overview

Incorporated in 1918, BEA is the largest independent local bank in Hong Kong in terms of assets. As at 31 December 2009, BEA's consolidated assets, advances to customers and customer deposits were HK\$434,082 million (U.S.\$55,652 million), HK\$247,654 million (U.S.\$31,751 million) and HK\$342,528 million (U.S.\$43,914 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, and 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.

The shares of BEA have been listed on the HKSE since the 1930s. As at 30 April 2010, the authorised share capital of BEA was 4,000 million ordinary shares of HK\$2.50 each and 500,000 substitute preference shares of U.S.\$1,000 each, of which approximately 2,031.2 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 April 2010, BEA's market capitalisation was approximately HK\$57,178.51 million (U.S.\$7,330.58 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. BEA Life and Blue Cross 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 April 2010, the Group offered a broad range of banking and related financial services in Hong Kong through a network of 88 branches, seven major subsidiaries and 52 wealth management centres called "SupremeGold Centres".

As at 30 April 2010, BEA's overseas operations had in total 45 branches, 59 sub-branches and three representative offices as well as several affiliates and joint ventures in mainland China, Taiwan, Macau, the United States, the United Kingdom, the British Virgin Islands and South East Asia.

BEA is one of the first foreign banks to have received approval to establish a locally-incorporated bank in mainland China. The locally-incorporated bank and BEA's wholly-owned subsidiary, 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, loans, deposits, trade finance, guarantees, remittance, Renminbi forward, SupremeGold accounts, Renminbi debit and credit cards, private banking, Cyberbanking, Qualified Domestic Institutional Investors ("QDII") services, derivative and investment products, agency services for general and life insurance products, and cross-border Renminbi trade settlement services.

As at 30 April 2010, BEA (China), with its headquarters in Shanghai, operated 20 branches and 56 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 two representative offices.

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

As at 31 December 2007, 2008 and 2009, approximately 24.9%, 29.8% and 31.3%, respectively, of the assets of the Group were accounted for in mainland China, Taiwan and Macau. The corresponding figures for Hong Kong as at 31 December 2007, 2008 and 2009 were 64.1%, 60.3% and 57.8%. For the years ended 31 December 2007, 2008 and 2009, approximately 23.7%, 18,550%⁽¹⁾ and 45.7%, respectively, of BEA's consolidated profit before taxation were accounted for in mainland China, Taiwan and Macau. The corresponding figures for Hong Kong as at 31 December 2007, 2008 and 2009 were 68.8%, -23,450% and 55.2%.

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 2007, 2008 and 2009, the Group's capital adequacy ratio was approximately 12.6%, 13.8% and 13.3%⁽²⁾, respectively, compared with the statutory minimum requirement of 8.0%, and its loan to deposit ratio was approximately 73.6%, 69.9% and 71.7%, respectively. For the years ended 31 December 2007, 2008 and 2009, BEA's average liquidity ratio was approximately 43.5%, 38.4% and 43.3%, 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 2007, 2008 and 2009, customer deposits accounted for approximately 81.4%, 88.1% and 91.6%, respectively, of borrowed funds. The remainder of the Group's funding requirements as at 31 December 2007, 2008 and 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 year ended 31 December 2009, the Group's profit after taxation was HK\$2,638 million (U.S.\$ 338 million), an increase of approximately 2,445.1% from the year ended 31 December 2008. The turnaround in operations and financial performance was the result of gradually improving conditions in the financial markets and global economy, as well as the absence of further substantial write-downs recorded by the Issuer. For the year ended 31 December 2008, the Group's profit after taxation was

Notes:

- (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.
- (2) Taking into account the issuance of 167.1 million new shares at a price of HK\$30.60 per share in January 2010, the pro forma capital adequacy ratio would be 15.1%.

HK\$104 million (U.S.\$13 million), a decrease of approximately 97.5% from the year ended 31 December 2007 (HK\$4,221 million (U.S.\$541 million)). The Group's profits in 2008 were severely affected by 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 conducted in Hong Kong.

For the year ended 31 December 2009, the Group achieved a return on average assets of approximately 0.6% and a return on average equity of approximately 7.7%, as compared with approximately 0.01% and 0.12%, respectively, for the year ended 31 December 2008 and approximately 1.2% and 14.6%, respectively, for the year ended 31 December 2007.

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 the deterioration in the global economy. A severe decrease in 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.

History

Incorporated in 1918, BEA is 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 of the restrictions on Hong Kong banks in 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 Renminbi-denominated bonds in an aggregate principal amount of RMB 4 billion 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. BEA (China) will continue to offer Renminbi trade settlement services in the pilot cities including Shanghai, Guangzhou, Shenzhen and Zhuhai.

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.

Over the years, BEA has continuously expanded its network in mainland China and has a total of 80 outlets in mainland China, including the headquarters of BEA (China), 20 branches, 56 sub-branches, two representative offices and one booking branch as at 30 April 2010. 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. 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.

BEA (China)’s achievements were further recognised through a number of awards received in 2009, including the “Best Development Team for Information Technology”, the “Best Information Technology Strategy Award” and the “Best Technical Strategy Award” in 2008 from the National Information Evaluation Centre, the “Best Financial Services in 2008” at the Golden-Shell Award of Finance hosted by the 21st Century Business Herald, the “30 Years of Reform and Opening-up - Leadership Award for Best Industry Contribution” from China Internet Week, the “2009 Best Foreign Bank Website” from Hexun.com, the “2009 Best SME Services in Asia” in the 4th Asian Banks Competitive Rankings held during the 21st Century Annual Finance Summit of Asia, the “2009 Best Localised Foreign Bank” and the “2009 Best Secured Credit Card” from Moneyweek, and the “2009 Best Wealth Management Bank” in the 2009 Bank Rating hosted by money.sohu.com.

STRATEGY

BEA’s core objectives are to strengthen its position as the largest independent local 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. The key components of BEA’s strategy are set out below.

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 through capitalising on opportunities arising from the full liberalisation of the banking sector and the 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 its network of ATMs and 24-hour self service centres. Such automated systems will provide accessibility and 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 and intends to strengthen its treasury operations across its network of branches in mainland China.

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 April 2010, BEA operated 52 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 “*Business of the Issuer — 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 further enhance efficiency and market competitiveness. 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 2007, 2008 and 2009, approximately 17.1%, 11.1% and 10.8%, 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 16.1%, 15.8% and 15.8%, respectively, comprised advances for property development and property investment. As at 30 April 2010, BEA had over 1.4 million retail customers in Hong Kong, which include 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 April 2010, BEA had 88 branches and 52 SupremeGold Centres in Hong Kong. BEA is a founding member of JETCO, which currently provides over 2,410 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 acceptance locations in Hong Kong, Macau and Shenzhen.

As at 30 April 2010, BEA had in total 46 branches, 59 sub-branches and three representative offices, as well as several affiliates and joint ventures outside of Hong Kong. In mainland China, Taiwan and Macau, BEA has 24 branches (including the BEA booking branch), 59 sub-branches and two representative offices. Headquartered in Shanghai, BEA (China) operates 20 branches and 56 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 but are not limited to loans, deposits, trade finance, guarantees, remittance, Renminbi forward, SupremeGold accounts, Renminbi debit and credit cards, private banking, Cyberbanking, QDII services, derivative and investment products, agency services for general and life insurance products, and cross-border Renminbi trade settlement services. As at 31 December 2007, 2008 and 2009, approximately 24.9%, 29.8% and 31.3%, respectively, of the Group's assets and approximately 23.7%, 18,550%⁽¹⁾ and 45.7%, respectively, of BEA's consolidated profit before taxation for the years ended 31 December 2007, 2008 and 2009 were accounted for in mainland China, Taiwan and Macau.

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.

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. On 1 January 2010, the Consultant was renamed Senior Advisor.

On 1 April 2010, an additional General Manager was appointed to oversee the business of Blue Cross, BEA Life, Bank of East Asia (Trustees) Limited, Insurance Services Department of BEA, and Blue Care Medical Centre under the newly established Insurance and Retirement Benefits Division.

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

| | <u>Operating income</u> | <u>Profit before taxation</u> |
|--|------------------------------------|------------------------------------|
| | <u>Year ended 31 December 2007</u> | <u>Year ended 31 December 2007</u> |
| | (in HK\$ millions) | (in HK\$ millions) |
| Personal Financial Services ⁽¹⁾ | 3,052 | 988 |
| Corporate Banking ⁽²⁾ | 3,416 | 1,934 |
| Investment Banking ⁽³⁾ | 1,288 | 1,525 |
| Corporate Services ⁽⁴⁾ | 760 | 314 |
| Others ⁽⁵⁾ | 270 | 346 |
| Unallocated ⁽⁶⁾ | 186 | 78 |
| Inter-segment elimination | <u>(158)</u> | <u>—</u> |
| Total | <u>8,814</u> | <u>5,185</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.

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 accounts has accordingly been 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 years ended 31 December 2008 and 2009, the Group's operating income and profit before taxation by business segment were as follows:

| | Operating income/(loss) | | | Profit/(loss) before taxation | | |
|--|--|--------------|-------------------------|--|----------|-------------------------|
| | Year ended 31 December | | | Year ended 31 December | | |
| | 2009 | 2008 | Increase/ (decrease) | 2009 | 2008 | Increase/ (decrease) |
| | (in HK\$ millions, except percentages) | | | (in HK\$ millions, except percentages) | | |
| Hong Kong Region | | | | | | |
| Personal Banking ⁽¹⁾ | 2,435 | 1,943 | 25.3% | 1,021 | 563 | 81.3% |
| Corporate Banking ⁽²⁾ | 1,410 | 84 | 1,578.6% | 1,250 | (140) | 992.9% |
| Treasury Markets ⁽³⁾ | 130 | (1,006) | 112.9% | 5 | (1,138) | 100.4% |
| Wealth Management ⁽⁴⁾ | 342 | 252 | 35.7% | 223 | 112 | 99.1% |
| Others | | | | | | |
| China Operations ⁽⁵⁾ | 3,472 | 3,377 | 2.8% | 1,525 | 1,453 | 5.0% |
| Overseas Operations ⁽⁶⁾ | 1,077 | 673 | 60.0% | (416) | 95 | (537.9)% |
| Corporate Services ⁽⁷⁾ | 817 | 816 | 0.1% | 299 | 301 | (0.7)% |
| Others ⁽⁸⁾ | 1,236 | 977 | 26.5% | (108) | (1,042) | 89.6% |
| Inter-segment elimination . . | (731) | (659) | 10.9% | (303) | (196) | (54.6)% |
| Total | 10,188 | 6,457 | 57.8% | 3,496 | 8 | 43,600% |

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 and related assets in Hong Kong.
- (5) China operations include all branches and subsidiaries in China, except those subsidiaries carrying out corporate services and associates operating in China.
- (6) Overseas operations include overseas branches and subsidiaries, except those subsidiaries carrying out corporate services and associates operating in overseas.
- (7) Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.
- (8) Other businesses include insurance business, property-related business, supporting units of Hong Kong operations, investment properties, bank premises, the net results of associates and other subsidiaries in Hong Kong.

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 as compared with the year ended 31 December 2007. For the Treasury Markets 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. Comparisons of financial performance for the years ended 31 December 2007 and 2008 are made using the previous method of presenting segment information prior to 1 January 2009 when BEA adopted the revised HKFRS 8, where all segments were presented on a Group basis and included all overseas operations.

The results for the year ended 31 December 2009 have improved significantly compared with the year ended 31 December 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 with the year ended 31 December 2008, it did not record any substantial write-down or impairment on its portfolio. Similarly, the 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 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 2007, 2008 and 2009, 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 | | |
| | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 |
| | (in HK\$ millions) | | | (in HK\$ millions) | | |
| Hong Kong | 5,938 | 2,962 | 6,461 | 3,568 | (1,876) | 1,931 |
| People's Republic of China ⁽¹⁾ . . | 2,391 | 3,447 | 3,527 | 1,227 | 1,484 | 1,598 |
| Other Asian Countries | 446 | 525 | 585 | 229 | 381 | 163 |
| Others | 578 | 492 | 883 | 161 | 19 | (196) |
| Inter-Segment Elimination | <u>(539)</u> | <u>(969)</u> | <u>(1,268)</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| Total | <u>8,814</u> | <u>6,457</u> | <u>10,188</u> | <u>5,185</u> | <u>8</u> | <u>3,496</u> |

Note:

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

HONG KONG

Home Mortgages

As at 31 December 2007, 2008 and 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\$37,286 million, HK\$25,615 million and HK\$26,749 million, respectively, or approximately 17.1%, 11.1% and 10.8%, respectively, of the Group's total advances to customers. As at 31 December 2007, 2008 and 2009, advances under GHOS, PSPS and TPS accounted for HK\$1,041 million, HK\$1,318 million and HK\$1,529 million, respectively, or approximately 0.5%, 0.6% and 0.6%, 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.

BEA intends to increase its market share in the mortgage business in 2010 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. BEA provides various different mortgage plans, including fixed Prime-based rate and floating HIBOR-based rate mortgage plans which are repayable by instalments. As at 31 March 2010, 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, which 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, issuance of 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 on either 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 31 December 2009, trade finance and commercial mortgages amounted to HK\$17,011 million, representing a decline of approximately 4% as compared with the corresponding period ended 31 December 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 with the corresponding period ended 31 December 2007, and accounted for approximately 7.1% of the Group's total advances to customers.

Consumer Finance

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.

BEA runs an annual tax loan promotion campaign, the "Tax Loan Programme", during the tax season in Hong Kong. As with previous years, the Tax Loan Programme was offered to customers in 2009 with a loan book of HK\$1,474 million and recorded a growth of 596% in programme drawdowns as compared with 2008.

In April 2010, BEA launched the new "Instalment Loan Programme", which offers tiered pricing based on a drawdown amount with a 12-month annualised percentage rate ranging from 3.5% to 7.85%. To further enhance BEA's services to its customers, a 30-minute express approval process was introduced to auto-payroll customers while a streamlined loan drawdown procedure was put in place for all BEA customers. Attractive product terms such as a repayment holiday were provided to suit customers' financial needs.

As at 31 December 2009, total outstanding consumer advances amounted to HK\$1,920 million, representing a significant increase of 90.1% as compared with 31 December 2008, which accounted for approximately 0.8% of the Group's total advances to customers as at 31 December 2009. The increase is mainly attributed to the increases in advances under the Tax Loan Programme for the relevant period.

As at 31 December 2008, the corresponding figure was HK\$1,010 million, representing a decline of approximately 5.0% as compared with 31 December 2007, which accounted for approximately 0.4% of the Group's total advances to customers as at 31 December 2008.

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 April 2010, CGFC operated through 14 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 31 December 2009 was HK\$144 million and HK\$208 million, respectively, which represented 0.06% and 0.08%, respectively, of the total advances to customers of the Group.

Credit Cards

As at 31 December 2009, credit card advances amounted to HK\$2,675 million, which accounted for approximately 1.1% of the Group's total advances to customers and represented a decline of 10.7% as compared with 31 December 2008. BEA believes that the decline was due mainly to the increased acceptance of the personal tax loans offered by BEA to its credit card customers which resulted in fewer customers making tax payments by credit cards for the relevant period.

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 with the corresponding period in 2007. The growth in credit card advances was attributable to various dining and entertainment offers and attractive spending rewards introduced in the latter part of 2008 which stimulated credit card usage.

In January 2010, BEA launched the “BEA CUP Dual Currency PLATINUM” Credit Card (the “**Dual Currency Platinum Card**”), which facilitates dual-currency settlement in both HKD and RMB. Transactions carried out in the mainland are settled in RMB while those carried out in Hong Kong and overseas are settled in HKD. Holders of the Dual Currency Platinum Card can therefore dispense with the need to incur currency conversion charges and handling fees when transacting in different countries.

BEA launched various promotional activities throughout 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. Priority bookings in respect of a series of concerts proved to be very popular with our customers.

BEA has also been focusing on building up a younger client base, in particular the university student sector, as it believes that customers in this sector have the potential to become lifelong high-value customers of the Issuer. 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 increase their spending using 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 it has received major awards such as “Capital Weekly PRO Choice Award — Medical & General Insurance”, “Quality Life Award — Quality Insurance Service Award”, “The Best Editor's Pick 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”, 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 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”, “Cancer Care Series — Premier Choice (for Telemarketing)” 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 repeat purchases.

The total premium income of the insurance business for the year ended 31 December 2009 was HK\$1,697 million, which increased by 5% as compared with the year ended 31 December 2008. The non-life insurance premium income for the year ended 31 December 2009 was HK\$689 million, a 3% increase as compared with the year ended 31 December 2008.

The life insurance premium income for the year ended 31 December 2009 was HK\$1,008 million, a 7% increase as compared with the year ended 31 December 2008. The corresponding figure as calculated by the 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\$335 million, a 10% increase as compared with the year ended 31 December 2008. These positive results recorded by BEA Life are attributable to the aforementioned new insurance plans, which were well received by customers.

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 Mandatory Provident Fund (“**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 12 constituent funds for investment including 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) Global Equity Fund, BEA (MPF) European Equity Fund, BEA (MPF) Long Term Guaranteed Fund and BEA (MPF) Conservative Fund. BEA (MPF) Industry Scheme consists of six constituent funds including BEA (Industry Scheme) Growth Fund, BEA (Industry Scheme) Balanced Fund, BEA (Industry Scheme) Stable Fund, BEA (Industry Scheme) Greater China Growth Fund, BEA (Industry Scheme) Hong Kong Growth Fund and BEA (Industry Scheme) MPF Conservative Fund. All constituent funds (except BEA (MPF) Long Term Guaranteed Fund, BEA (MPF) Conservative Fund and BEA (Industry Scheme) 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 strongest 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. Moreover, BEA Union Investment Management Limited, investment manager of the BEA MPF schemes, 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.

According to the latest Mercer MPF Index, BEA was ranked as the top MPF service provider for the year ending 31 December 2009. In addition, BEA won Asia Asset Management magazine's "Best MPF Trustee in Hong Kong" Award as part of its "Best of the Best Awards 2009". BEA received these industry awards in recognition of the performance of its MPF services.

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, as the administrator of estates, as attorney administrator for overseas estates having assets in Hong Kong and as escrow agent for commercial transactions. BEAT also acts as trustee for family or other trusts and settlement, investment funds, unit trusts, charities, public funds and capital market issues. BEAT recorded growth in revenue of approximately 20% for the year ended 31 December 2009 (HK\$3.71 million), as compared with the revenue levels for the year ended 31 December 2008 (HK\$3.10 million), from its private trust business.

Internet Banking Services

Internet banking services provided by BEA include its Cyberbanking and Cybertrading services.

Cyberbanking

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, over fixed-line telephones, 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 transactions and redemption of bonus points for gifts, an 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 deposit. 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, deposit and withdrawal history and current investments and obtain fund information.

As at 30 April 2010, the number of registered Cyberbanking users and Corporate Cyberbanking users were up 9% and 7%, respectively, as compared with the respective number of users as at 30 April 2009.

Cybertrading

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. In June 2009, East Asia Securities launched a new promotional campaign for its securities trading services, intended to gain new securities clients and increase its volume of transactions in anticipation of a potential recovery of the financial markets in 2009 and 2010. East Asia Securities saw the number of Cybertrading accounts rise by 4% during 2009 and, as at 31 December 2009, more than 60% of East Asia Securities clients had subscribed to Cybertrading. With a view to further enhancing the Cybertrading service, an e-Statement Service was launched in January 2010. With the implementation of the eStatement service, Cybertrading clients can view their daily

consolidated statements and monthly account statements over the internet up to the last 90 days and 12 months respectively.

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.

East Asia Futures recorded a 4.3% increase in net fees and commission income for the year ended 31 December 2009 as compared with the year ended 31 December 2008. As at 31 December 2009, approximately 74% of East Asia Futures' clients had subscribed to the Futures Cybertrading Services, and for the year ended 31 December 2009, 79% of East Asia Futures' total number of transactions were traded via the Cybertrading platform; whereas for East Asia Securities, the volume of transactions executed via the Cybertrading platform, expressed as a percentage of total turnover, reached 62% of the number of trades and 46% of the gross transaction value for the year ended 31 December 2009. BEA believes that the high volume of online trading recorded by East Asia Securities and East Asia Futures suggests that online trading is becoming increasingly popular with retail investors.

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 private or state-owned enterprises in mainland China.

The Hong Kong corporate loan market exhibited weakness in 2008 and in the first quarter of 2009, as the impact of the financial crisis was felt throughout the Hong Kong economy. Loan demand was mainly driven by refinancing needs. The weak first quarter of 2009 was followed by a rebound from the second quarter of 2009. Corporate and individual investors took advantage of the improving local credit environment from the second quarter to pursue investment opportunities, leading to a gradual revival in corporate lending business for the year ended 31 December 2009.

In light of the tenuous nature of the global economic recovery, BEA is taking a proactive approach to expanding its client base by focussing on high quality local and mainland China enterprises. With its strong Mainland network, BEA is particularly well positioned to serve local and mainland Chinese customers, and meet both their onshore and offshore financing needs.

The majority of the project financing in which BEA participates is extended on a recourse basis and is secured by the underlying project. Typically, the average maturity of BEA's corporate advances is 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 on advances to these borrowers are generally more attractive than margins on unsecured syndicated advances to large property developers.

As at 31 December 2009, bilateral advances and syndicated advances outstanding totalled HK\$43,178 million, representing a growth of approximately 15.3% from 31 December 2008, and accounted for approximately 17.4% of the Group's total advances to customers as at 31 December 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.

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 to clients who are searching for asset protection, 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 services, structured and treasury products, mutual funds, insurance and premium financing, succession and estate planning services, services relating to the Capital Investment Entrance Scheme, asset custodian services, trusts, discretionary asset management services and certain banking services such as time deposits and loans. The division provides private banking services to the very high net worth segment, and is also responsible for providing investment products support to general banking customers. As from 1 April 2010, the division is also responsible for the Issuer's private trust business.

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 four years and has achieved a critical mass in terms of clients and business acquisition. The number of clients in BEA Private Banking increased by over 15% in 2009 from 2008, a year which was greatly affected by the global financial crisis. BEA continues to look for growth in its private banking business with particular emphasis on mainland China, Hong Kong, Taiwan and Macau.

BEA Private Banking has clients from many different countries and its clientele from mainland China is growing significantly. In mid 2009, BEA acquired the AIG Group's Taiwan wealth management business, which was renamed BEA Wealth Management Services (Taiwan) Limited. BEA expects that there will be enhanced opportunities to promote wealth management services in Taiwan across the Group and between the two countries.

As at 31 December 2009, the assets under management of BEA Private Banking increased by 25% from the corresponding period in the previous year. The net profit of the department increased substantially from HK\$43 million in 2008 to HK\$175 million in 2009.

BEA continues to stress the importance of diversification of investments. Prior to the financial crisis, customers had a tendency towards highly leveraged investment in stocks for a quick return. This proved to be risky and BEA has since placed a strong emphasis on educating customers the need for diversification to weather market downturns. This has proven to be successful as many customers were able to recuperate their losses whilst maintaining a healthy portfolio of investments. Customers' interest in investment products has also shifted increasingly towards more transparent and simpler products such as vanilla bonds and simple structured products rather than complicated structures incorporating various derivatives. After the outbreak of the global financial crisis which resulted from the collapse of Lehman Brothers, in 2008, the investment climate in Hong Kong started to recuperate in the second quarter of 2009. Structured investment business volume in 2009 achieved 78% of the 2007 levels in Hong Kong, and in China, 6.7 times its lower-based figure in 2007. Since the beginning of 2010, the structured products and mutual funds business has also improved; first quarter profits were approximately 65% up from the corresponding period in 2008.

Regulatory changes as a result of the collapse of Lehman Brothers which were introduced in early 2009 meant that businesses involving equity-linked products and various other structured products in the market were suspended for a few months. In June 2009, BEA was the first bank in Hong Kong to obtain re-authorisation to offer equity-linked deposits followed by other structured products.

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.

The last 12 months also saw the Issuer's increased capability to provide a wider range of information to clients on their fund investments and returns through an upgrade of the Issuer's financial planning system.

For the year ended 31 December 2009, the Wealth Management Division's profit before taxation was HK\$223 million, a 99% increase from the previous year.

Since the financial crisis and in response to the increase in claims against the banking sector for the mis-selling of financial products in 2008 and 2009, the regulatory authorities in Hong Kong have, for the protection of customers, introduced new guidelines and rules to ensure proper selling. BEA has since reviewed its internal procedures and controls on risk exposures, and implemented new measures governing the sale process of financial products. These measures include, for example, strict guidelines on the categorisation of financial products based on objective criteria and standards, and the matching of customers' risk profiles and their product suitability, which might include the customers' previous investment experience, their liquidity situation and technical knowledge about a particular investment product. Considerable resources were also deployed by BEA Private Banking to improve systems and controls to ensure adherence to regulations and protection to customers, leading to an increase in the cost of compliance as a result.

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, 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 2007, 2008 and 2009, fees and commission income attributable to Tricor was approximately 28.9%, 31.2% and 28.8%, 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 Services (Malaysia) Sdn. Bhd. acquired a majority interest in Roots Consulting Sdn. Bhd., which provides training and consulting services in the field of corporate governance, performance management and risk management for companies. Tricor currently employs approximately 1,400 professional and support staff and provides services in 21 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 a 75% interest in ICEA Finance Holdings Limited (“**ICEA Finance**”) from ICBC. The transaction completed on 28 January 2010 and ICEA Finance became a wholly-owned subsidiary of BEA, which has reinforced the Issuer's position in the securities broking business in Hong Kong.

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 of 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 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 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 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 2009, including the “Best Development Team for Information Technology”, the “Best Information Technology Strategy Award” and the “Best Technical Strategy Award” in 2008 from the National Information Evaluation Centre, the “Best Financial Services in 2008” at the Golden-Shell Award of Finance hosted by the 21st Century Business Herald, the “30 Years of Reform and Opening-up — Leadership Award for Best Industry Contribution” from China Internet Week, the “2009 Best Foreign Bank Website” from Hexun.com, the “2009 Best SME Services in Asia” in the 4th Asian Banks Competitive Rankings held during the 21st Century Annual Finance Summit of Asia, the “2009 Best Localised Foreign Bank” and the “2009 Best Secured Credit Card” from Moneyweek, and the “2009 Best Wealth Management Bank” in the 2009 Bank Rating hosted by money.sohu.com.

In July 2009, BEA (China) issued Renminbi-denominated bonds in an aggregate principal amount of RMB 4 billion 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 April 2010, BEA's wholly-owned subsidiary, BEA (China), operated 20 branches in Shanghai, Beijing, Tianjin, Dalian, Shenyang, Qingdao, Shijiazhuang, Urumqi, Hangzhou, Nanjing, Suzhou, Chengdu, Chongqing, Wuhan, Hefei, Xi'an, Shenzhen, Guangzhou, Zhuhai and Xiamen, as well as 56 sub-branches (10 in Shanghai, eight in both Shenzhen and Guangzhou, four in each of Dalian, Xi'an

and Xiamen, three in each of Beijing, Chongqing and Zhuhai, two in both Shenyang and Chengdu, one in each of Qingdao, Hangzhou, Foshan, Zhongshan and Huizhou). The three cross-location sub-branches in Foshan, Zhongshan and Huizhou were established under the liberalisation measures of Supplement VI to the CEPA. To take advantage of these new measures, BEA will continue to submit applications for the establishment of sub-branches in Guangdong. BEA (China) also operates ten 24-hour self-service banking centres and more than 370 automatic teller machines in major urban areas nationwide. In addition to the BEA (China) network, BEA also operates a branch in Shanghai which provides foreign exchange wholesale services to corporate customers and has two representative offices in Fuzhou and Dongguan. BEA has also obtained preliminary approval to establish four new sub-branches in mainland China.

BEA provides a full range of Renminbi and foreign currency banking services in mainland China, including but not limited to loans, deposits, trade finance, guarantees, remittance, Renminbi forward, SupremeGold accounts, Renminbi debit and credit cards, private banking, Cyberbanking, QDII services, derivative and investment products, agency services for general and life insurance products, 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 liberalisation of the banking sector and from the CEPA between Hong Kong and mainland China.

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

BEA maintains two branches in Taiwan, which are located in Taipei and Kaohsiung. The acquisition of BEAWMS was completed in June 2009. BEAWMS provides a wide range of wealth management services, including securities brokerage, wealth management, insurance brokerage, and securities investment consultancy services for high net worth clients. Such acquisition complements BEA's existing commercial banking business and marks BEA's first step in wealth management in Taiwan.

BEA commenced its property-related lending business in Taiwan in 2009 and is planning to launch its trust business in 2010, including trust of real estate accounts for its property-related loan business and custodian services for wealth management accounts of BEAWMS.

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 distributed insurance products in Macau in the third quarter of 2009. In light of Macau's recovering economy since the second half of 2009, BEA in Macau will continue to extend credit facilities to both quality corporate and retail customers, and focus on personal banking business by expanding its sub-branch network prudently and launching a wider range of retail products and services in the market.

For the years ended 31 December 2007, 2008 and 2009, BEA's operations in mainland China, Taiwan and Macau accounted for approximately 23.7%, 18,550%⁽¹⁾ and 45.7% respectively of the Group's total profit before taxation and approximately 24.9%, 29.8%, 31.3% respectively of the Group's total assets as at 31 December 2007, 2008 and 2009.

The main source of income for BEA's operations in mainland China, Taiwan and Macau is interest income on loans and the performance in this business area is largely driven by market conditions. As part of BEA's expansion plan, BEA aims to diversify into other business areas (including trade finance, personal banking, wealth management and treasury businesses) to increase its fee income.

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

| | As at 31 December | | |
|--------------------------------------|--------------------|---------------|----------------|
| | 2007 | 2008 | 2009 |
| | (in HK\$ millions) | | |
| Trade Finance | 150 | 105 | 146 |
| Property Related Loans | 37,639 | 43,181 | 42,754 |
| Non-Property Related Loans | 40,420 | 53,144 | 58,018 |
| Others | 357 | 456 | 396 |
| Total | <u>78,566</u> | <u>96,886</u> | <u>101,314</u> |

The primary strategic focus of BEA (China) is currently Renminbi-denominated lending, which as at 31 December 2007, 2008 and 2009 amounted to HK\$57,058 million, HK\$70,337 million and HK\$74,733 million respectively or approximately 76%, 77% and 78% respectively of the total customer advances of BEA (China). Borrowers comprise 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 in the mainland China banking market because of its long history, sound track record, good relationships with regulators and local enterprises, extensive local knowledge and experienced local talent.

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.

INTERNATIONAL

BEA's international operations were commenced to meet the requirements of its core customers as their interests expanded 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 April 2010.

| 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 |

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**”). Currently BEAUSA operates a total of 13 branches in the United States (10 branches in California and three branches in New York). In 2009, BEAUSA undertook measures to control its operating expenses and improve its net interest margin, principally through lowering its cost of funds by reducing its reliance on high-priced time deposits. Despite incurring a net loss for the full year ended 31 December 2009, as a result of such measures BEAUSA recorded a net profit (for reporting purposes in the United States) in the third and fourth quarters of 2009. BEAUSA also recorded a net profit in the first quarter of 2010 (for reporting purposes in the United States).

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*”.

The Singapore branch of BEA was relocated to its new building at 60 Robinson Road in October 2009. The Branch serves as the Bank's hub for the Group's activities in 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 was holding a 21.725% interest as at 30 April 2010.

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. 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. As a result of these transactions, ICEA Finance became a wholly-owned subsidiary of BEA, and BEA (Canada) ceased to be a subsidiary of BEA and is held as to 30% by BEA and 70% by ICBC. BEA and ICBC have continued to cooperate in the operations

and management of BEA (Canada). BEA believes that the transactions have further strengthened the Group's overall financial services capability and in particular the securities broking business in Hong Kong. At the same time, BEA also aims to leverage on the global strength of ICBC to reinforce the development of BEA (Canada).

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 year ended and as at 31 December 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 31 December 2009, the Group's principal subsidiaries were as follows:

| Name of subsidiary of the Issuer | Place of incorporation and operation the Group | Issued and paid-up capital | % held by | | Nature of business |
|---|--|----------------------------|------------|-----------|---------------------------------------|
| | | | The Issuer | The Group | |
| Ample Delight Limited | Hong Kong | HK\$450,000,000 | | 100% | Investment holding |
| 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 | U.S.\$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\$374,580,000 | 51% | | Asset management |
| BEA Wealth Management Services (Taiwan) Limited | Taiwan, Republic of China | NTD218,000,000 | | 100% | Wealth management services |
| CCSL St. Lucia Limited | St. Lucia | U.S.\$1,200 | | 60.49% | Holding company |
| Central Town Limited | Hong Kong | HK\$2 | 100% | | Property investment |
| Century Able Limited | Hong Kong | HK\$866,951,045 | | 100% | Investment holding |
| Corona Light Limited | BVI | HK\$866,951,045 | | 100% | Investment holding |
| Credit Gain Finance Company Limited . . | Hong Kong | HK\$1 | 100% | | Money lenders |
| Crystal Gleaming Limited | BVI | HK\$866,951,045 | 100% | | Investment holding |
| East Asia Corporate Services (BVI) Limited | BVI | U.S.\$250,000 | | 75.61% | Registered agent and trustee services |

| Name of subsidiary of the Issuer | Place of incorporation and operation the Group | Issued and paid-up capital | % held by | | Nature of business |
|--|--|----------------------------|------------|-----------|---|
| | | | The Issuer | The Group | |
| East Asia Facility Management Limited . | Hong Kong | HK\$10,000 | | 100% | Facility management |
| East Asia Financial Services (BVI) Ltd. . | BVI | U.S.\$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. | U.S.\$5 | 100% | | Bank holding company |
| East Asia Indonesian Holdings Limited . | Seychelles | U.S.\$100,000 | | 100% | Investment holding |
| East Asia Investment Holdings Limited. . | Hong Kong | HK\$100,000,000 | 100% | | Investment holding |
| East Asia Investments Holdings (BVI) Ltd. | BVI | HK\$186,038,725 | 100% | | Investment holding |
| East Asia Marketing Limited | BVI | U.S.\$1 | | 75.61% | Marketing services to related companies |
| East Asia Property Agency Company Limited | Hong Kong | HK\$1,000,000 | 100% | | Property agency |
| East Asia Properties Holding Company Limited | Hong Kong | HK\$10,000 | 100% | | Investment holding |
| East Asia Properties (US), Inc.* | U.S.A. | U.S.\$5 | | 100% | Property holding |
| 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 | U.S.\$50,000,000 | 100% | | Investment holding |
| Flowery World Corporation | BVI | U.S.\$1 | | 75.61% | Holding company |
| Innovate Holdings Limited | BVI | U.S.\$1 | 100% | | Special purpose vehicle 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 | 30% | | Banking services |
| The Bank of East Asia (China) Limited ¹ | PRC | RMB8,000,000,000 | 100% | | Banking and related financial services |
| The Bank of East Asia (U.S.A.) N.A.* . | U.S.A. | U.S.\$4,500 | | 100% | Banking |
| Tricor Consultancy (Beijing) Limited ¹ . | PRC | U.S.\$1,850,000 | | 75.61% | Business consultancy in China |
| Tricor Holdings Limited | BVI | U.S.\$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 |

| Name of subsidiary of the Issuer | Place of incorporation and operation the Group | Issued and paid-up capital | % held by | | Nature of business |
|--|--|----------------------------|------------|-----------|---|
| | | | The Issuer | The Group | |
| Tricor Services Limited | Hong Kong | HK\$2 | | 75.61% | Business, corporate and investor services |
| Tricor Services (BVI) Limited | BVI | U.S.\$250,000 | | 75.61% | Registered agent and trustee services |
| Tricor Services (Malaysia) Sdn. Bhd. | Malaysia | RM5,672,484 | | 60.49% | Investment holding |
| Vitaway (Mauritius) Limited | Mauritius | U.S.\$1 | | 75.61% | Regional treasurer |

Notes

1. Represents a wholly foreign-owned enterprise.
2. BVI denotes the British Virgin Islands.

* *Companies not audited by KPMG. The accounts of the subsidiaries not audited by KPMG reflect total net assets and total income constituting approximately 6.3% and 2.1% 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, adequacy of resources, qualifications and experience of the accounting and financial reporting function, 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 the Chief Executive, Senior Management 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, Senior Management and Division Heads of BEA, and for the review of management succession plans for Executive Directors, Senior Management 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; the 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 in respect of fixed income, equity and equity related investments for BEA, East Asia Investment Holdings Limited, The Bank of East Asia, Limited Employees Provident Funds and The Bank of East Asia, Limited Employees Provident Fund (UCB); 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 12 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 Insurance & Retirement Benefits 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, the Risk Management Division and the 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 55,587 square feet, 133,815 square feet and 63,418 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 31 December 2009, the net book value for BEA's investment properties and bank premises amounted to HK\$2,095 million and HK\$8,572 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 cover 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 acts; 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 cover. BEA also requires borrowers to obtain appropriate insurance cover 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 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 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.

Claims by private banking clients

In two connected court proceedings initiated in September 2009 in the High Court of Hong Kong, two private banking clients claimed 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 clients' 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. These proceedings are in the preliminary stages and no provisions have been made by BEA as at 31 December 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 the 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 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 accounts for the expected cost in respect of the repurchase of the aforementioned structured investment products.

As at 30 April 2010, approximately 98.4% of the eligible persons have accepted the offer and the remaining 1.6% (i.e. 14 Mini-Bonds holders) have rejected the offer. In February 2010, one Mini-Bonds holder who did not accept the offer made four claims against BEA in the Small Claims Tribunal of Hong Kong for around HK\$200,000. The relevant proceedings are still ongoing. In addition, BEA has recently reached settlement with one of the 14 Mini-Bonds holders. It is still uncertain at this stage whether the remaining 12 Mini-Bonds holders will make monetary or compensatory claims against BEA.

EMPLOYEES

As at 30 April 2010, the Group had a total of 10,720 employees as set forth in the following table:

| | <u>No. of employees</u> |
|---|-----------------------------|
| Commercial and retail banking | 2,170 |
| Head office and operational support | 2,062 |
| Overseas (mainland China only) | 4,202 |
| (excluding mainland China) | 1,193 |
| Subsidiaries | <u>1,093</u> |
| Total | <u><u>10,720</u></u> |

As at 30 April 2010, approximately 25% 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 ordinary shares in BEA have been granted to eligible employees and executive director(s). As at 30 April 2010, approximately 17,384,500 shares, representing approximately 0.85% 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, 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. In April 2010, a bill seeking to amend the Deposit Protection Scheme Ordinance was gazetted. Among other things, the bill seeks to increase the Deposit Protection Scheme limit from HK\$100,000 to HK\$500,000 which is intended to come into effect upon the expiry of the guarantee at the end of 2010. However, there can be no assurance that the bill will be implemented and that the level of customer deposits of BEA will not be adversely affected by the withdrawal of the guarantee or any other changes to the Deposit Protection Scheme.

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 2007, 2008 and 2009, and should be read in conjunction with the information contained elsewhere in this Offering Circular, including “*Business of the Issuer*”.

ADVANCE PORTFOLIO

Overview

As at 31 December 2007, 2008 and 2009, the Group’s total outstanding advances to customers were HK\$218,184 million, HK\$230,339 million and HK\$247,654 million, respectively, which represented approximately 55.4%, 55.5% and 57.1%, 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 2007, 2008 and 2009, represented approximately 32.7%, 26.3% and 26.0%, 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 | | | | | |
|---|-------------------|------------------------|----------------|------------------------|----------------|------------------------|
| | 2007 | Percentage of total | 2008 | Percentage of total | 2009 | Percentage of total |
| (in HK\$ millions, except percentages) | | | | | | |
| Loans for use in Hong Kong | | | | | | |
| Industrial, commercial and financial | | | | | | |
| - Property development | 9,080 | 4.2% | 8,855 | 3.9% | 9,411 | 3.8% |
| - Property investment | 26,023 | 11.9% | 27,431 | 11.9% | 29,766 | 12.0% |
| - Financial concerns | 1,932 | 0.9% | 2,542 | 1.1% | 2,699 | 1.1% |
| - Stockbrokers | 659 | 0.3% | 550 | 0.2% | 1,190 | 0.5% |
| - Wholesale and retail trade | 1,469 | 0.7% | 2,405 | 1.0% | 3,265 | 1.3% |
| - Manufacturing | 1,934 | 0.9% | 2,055 | 0.9% | 2,177 | 0.9% |
| - Transport and transport equipment | 4,345 | 2.0% | 3,642 | 1.6% | 3,794 | 1.5% |
| - Recreational activities | 285 | 0.1% | 285 | 0.1% | 45 | — |
| - Information technology | 5 | — | 4 | — | 8 | — |
| - Others ⁽¹⁾ | 9,673 | 4.4% | 9,954 | 4.3% | 13,006 | 5.3% |
| - Sub-total | <u>55,405</u> | <u>25.4%</u> | <u>57,723</u> | <u>25.0%</u> | <u>65,361</u> | <u>26.4%</u> |
| Individuals | | | | | | |
| - Loans for the purchase of flats in the GHOS, PSPS and TPS | 1,041 | 0.5% | 1,318 | 0.6% | 1,529 | 0.6% |
| - Loans for the purchase of other residential properties | 36,245 | 16.6% | 24,297 | 10.5% | 25,220 | 10.2% |
| - Credit card advances | 2,619 | 1.2% | 2,997 | 1.4% | 2,675 | 1.1% |
| - Others ⁽²⁾ | 5,450 | 2.5% | 6,553 | 2.8% | 8,839 | 3.5% |
| - Sub-total | <u>45,355</u> | <u>20.8%</u> | <u>35,165</u> | <u>15.3%</u> | <u>38,263</u> | <u>15.4%</u> |
| Total loans for use in Hong Kong | 100,760 | 46.2% | 92,888 | 40.3% | 103,624 | 41.8% |
| Trade finance | 3,714 | 1.7% | 2,905 | 1.3% | 2,652 | 1.1% |
| Loans for use outside Hong Kong ⁽³⁾ | 113,710 | 52.1% | 134,546 | 58.4% | 141,378 | 57.1% |
| Total advances to customers | <u>218,184</u> | <u>100.0%</u> | <u>230,339</u> | <u>100.0%</u> | <u>247,654</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.

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.⁽¹⁾

| | As at 31 December | | | | | |
|---|-------------------|------------------------|----------------|------------------------|----------------|------------------------|
| | 2007 | Percentage of total | 2008 | Percentage of total | 2009 | Percentage of total |
| (in HK\$ millions, except percentages) | | | | | | |
| Hong Kong | 123,539 | 56.6% | 112,038 | 48.7% | 121,538 | 49.1% |
| People's Republic of China ⁽²⁾ | 62,518 | 28.7% | 85,741 | 37.2% | 93,084 | 37.6% |
| Other Asian Countries ⁽³⁾ | 10,340 | 4.7% | 10,798 | 4.7% | 10,103 | 4.1% |
| Others ⁽⁴⁾ | 21,787 | 10.0% | 21,762 | 9.4% | 22,929 | 9.2% |
| Total | <u>218,184</u> | <u>100.0%</u> | <u>230,339</u> | <u>100.0%</u> | <u>247,654</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 Concentration

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 31 December 2009, the Group's exposure to its 20 largest borrowers (including groups of individuals and companies) amounted to approximately HK\$32,796 million, or approximately 13.2% of the Group's gross advances, with the largest accounting for HK\$4,152 million, or approximately 1.7% 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.

Advance Analysis

As a significant proportion of the Group's gross advances are made for the purchase of residential property, as at 31 December 2007, 2008 and 2009, approximately 28.4%, 24.1% and 24.8% of advances had a remaining maturity of more than five years, respectively.

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 | | | | | | |
|--|----------------|------------------------|----------------|------------------------|----------------|------------------------|
| | 2007 | Percentage of total | 2008 | Percentage of total | 2009 | Percentage of total |
| (in HK\$ millions, except percentages) | | | | | | |
| Repayable on demand ⁽¹⁾ | 4,200 | 1.9% | 4,437 | 1.9% | 4,354 | 1.8% |
| 3 months or less | 35,394 | 16.2% | 42,013 | 18.2% | 35,254 | 14.2% |
| 1 year or less but over 3 months | 33,382 | 15.3% | 40,712 | 17.7% | 45,088 | 18.2% |
| 5 years or less but over 1 year | 82,678 | 37.9% | 85,835 | 37.3% | 100,683 | 40.7% |
| After 5 years | 61,831 | 28.4% | 55,411 | 24.1% | 61,516 | 24.8% |
| Undated | 699 | 0.3% | 1,931 | 0.8% | 759 | 0.3% |
| Gross advances to customers | <u>218,184</u> | <u>100.0%</u> | <u>230,339</u> | <u>100.0%</u> | <u>247,654</u> | <u>100.0%</u> |

Note:

(1) Includes overdrafts.

As at 31 December 2007, 2008 and 2009, approximately 87.2%, 93.4% and 86.6% 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 3% below the prime rate (which is currently 5.25%). The interest rate for Hong Kong dollar consumer finance advances is typically calculated on the initial principal amounts of such advances and typically ranges from 0.2% to 1.2% per month flat for fixed rate products and from 3.5% (P-1.75%) to 7.25% (P+2%) per annum for prime based products. 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 2007, 2008 and 2009, approximately 50.5%, 44.8% and 46.9%, respectively, of advances made by the Group were denominated in Hong Kong dollars, approximately 15.2%, 17.6% and 15.6%, respectively, were denominated in U.S. dollars and approximately 26.2%, 30.5% and 30.2%, 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 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 |
| (in HK\$ millions, except percentages) | | | | | | |
| 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 |
| (in HK\$ millions, except percentages) | | | | | | |
| 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 31 December 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 31 December 2009 | | | | | | |
|--|---------------------------|----------------------------|----------------------------------|----------------------------|----------------|----------------------------|
| | HK dollar advances | | Foreign currency advances | | Total | |
| | Amount | Percentage of total | Amount | Percentage of total | Amount | Percentage of total |
| (in HK\$ millions, except percentages) | | | | | | |
| Fixed rate | 21,054 | 18.4% | 12,153 | 9.1% | 33,207 | 13.4% |
| Floating rate | 93,498 | 81.6% | 120,949 | 90.9% | 214,447 | 86.6% |
| Total | <u>114,552</u> | <u>100.0%</u> | <u>133,102</u> | <u>100.0%</u> | <u>247,654</u> | <u>100.0%</u> |

As at 31 December 2007, 2008 and 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 Issuer'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 43.5%, 38.4% and 43.3% for the years ended 31 December 2007, 2008 and 2009, respectively, which is above the statutory minimum ratio of 25%.

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 |
| (in HK\$ millions) | | | |
| Credit Committee | Any amount | Any amount | Any amount |
| Division Head | 80 (20) ⁽¹⁾ | 80 | 20 |
| Department Head | 30 (5) ⁽¹⁾ | 30 | 2 |
| Manager (Levels M4 to SM2) | 1.5 (0.5) to 7.5 (3.5) ⁽¹⁾ | 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 in Hong Kong (excluding advances under GHOS, PSPS and TPS) are limited to 60% (for property value at or above HK\$20 million) and 70% (for property value below HK\$20 million, and maximum loan amount being capped at HK\$12 million). 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 2007, 2008 and 2009, property lending (excluding advances under GHOS, PSTS and TPS) accounted for approximately 32.7%, 26.3% and 26.0%, 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 2007, 2008 and 2009, home mortgage advances (including advances under GHOS, PSPS and TPS) in Hong Kong amounted to HK\$37,286 million, HK\$25,615 million and HK\$26,749 million, respectively, or approximately 17.1%, 11.1% and 10.8%, 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 2007, 2008 and 2009, BEA's PRC exposure is approximately 36.0%, 42.1% and 40.9%, respectively, of the Group's total advances and its PRC classified advances account for approximately 0.3%, 0.3% and 0.2%, 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 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.

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.

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

| | Years ended 31 December | | |
|--|-------------------------|--------------|--------------|
| | 2007 | 2008 | 2009 |
| (in HK\$ millions, except percentages) | | | |
| Provisions for impairment allowance: | | | |
| Beginning balance | 732 | 728 | 1,076 |
| Provision during the period/year | 414 | 779 | 1,246 |
| Bad debts charges recovered | (198) | (221) | (141) |
| Loans written-off | (341) | (351) | (885) |
| Other movements | 121 | 141 | 89 |
| Closing balance | <u>728</u> | <u>1,076</u> | <u>1,385</u> |
| Provisions for impairment allowance as a percentage of: | | | |
| Total loans at period/year end | 0.3% | 0.5% | 0.6% |
| Total impaired loans at period/year end | 58.6% | 67.8% | 56.6% |
| Write-offs as a percentage of: | | | |
| Average total loans during the period/year | 0.2% | 0.2% | 0.4% |
| Total loans at period/year end | 0.2% | 0.2% | 0.4% |
| Total impaired loans at period/year end | 27.5% | 22.1% | 36.2% |

As at 31 December 2009, the provision for impairment allowance was HK\$1,385 million which had increased by HK\$309 million as compared with the provision as at 31 December 2008 (HK\$1,076 million). A larger provision was recorded as at 31 December 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 year ended 31 December 2009, HK\$141 million of bad debts had been recovered, which represents a decrease of HK\$80 million as compared against the bad debts recovered for the year ended 31 December 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 2007, 2008 and 2009, the Group's ten largest impaired loans accounted for approximately 0.3%, 0.3% and 0.4%, respectively, of its total advances and approximately 52.7%, 43.4% and 41.9%, 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 71.1%, 45.8% and 66.0% of the aggregate exposure relating to such ten largest impaired loans as at 31 December 2007, 2008 and 2009, respectively. As at 31 December 2009, the Group's exposure under its ten largest impaired loans ranged from HK\$59 million to HK\$225

million per impaired loan, and amounted to approximately HK\$1,026 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.

As at 31 December 2007, 2008 and 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 | | |
|--|--|--------------|--------------|
| | 2007 | 2008 | 2009 |
| | (in HK\$ millions, except percentages) | | |
| Gross impaired loans | 1,242 | 1,586 | 2,448 |
| Aggregate individual impairment loss allowance | <u>264</u> | <u>523</u> | <u>534</u> |
| Net impaired loans | <u>978</u> | <u>1,063</u> | <u>1,914</u> |
| Gross impaired loans as a percentage of total loan portfolio | 0.6% | 0.7% | 1.0% |
| Net impaired loans as a percentage of total loan portfolio | 0.4% | 0.5% | 0.8% |

Held-to-maturity Debt Securities

The Group's held-to-maturity debt securities included listed and unlisted debt securities. As at 31 December 2007, 2008 and 2009, the book value of these securities were HK\$10,761 million, HK\$5,006 million and HK\$7,239 million, respectively, which represented approximately 30.5%, 16.9% and 13.6% 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 Issuer (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 30 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 the 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 31 December 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 31 December 2009, amounted to HK\$429,000 (U.S.\$55,000).

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.

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 | | | | | |
|--|-------------------|---------------|--------------|---------------|--------------|---------------|
| | 2007 | | 2008 | | 2009 | |
| | Amount | Percentage | Amount | Percentage | Amount | Percentage |
| (in HK\$ millions, except percentages) | | | | | | |
| Held-to-maturity securities issued by: | | | | | | |
| Central governments and central banks | 5,411 | 50.3% | 243 | 4.8% | 1,510 | 20.9% |
| Public sector entities | 664 | 6.2% | 318 | 6.4% | 621 | 8.6% |
| Banks and other financial institutions | 3,507 | 32.6% | 3,344 | 66.8% | 4,328 | 59.8% |
| Corporate entities | <u>1,179</u> | <u>10.9%</u> | <u>1,101</u> | <u>22.0%</u> | <u>780</u> | <u>10.7%</u> |
| Total | <u>10,761</u> | <u>100.0%</u> | <u>5,006</u> | <u>100.0%</u> | <u>7,239</u> | <u>100.0%</u> |

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 three Senior Advisors; four Deputy Chief Executives; Head of Risk Management Division; Head of Strategic Planning & Control Division and 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.

As at 31 December 2008, the combined currency asset-liability gap position for BEA's local Hong Kong banking operations were as follows:

| | <u>Total</u> | <u>Up to 1 month</u> | <u>1 month to 3 months</u> | <u>3 months to 6 months</u> | <u>6 months to 12 months</u> | <u>Greater than 1 year</u> |
|---|----------------|--------------------------|--------------------------------|---------------------------------|----------------------------------|--------------------------------|
| (in HK\$ millions) | | | | | | |
| ASSETS | | | | | | |
| 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 | <u>17,246</u> | <u>7,202</u> | <u>4,993</u> | <u>4,791</u> | <u>253</u> | <u>7</u> |
| 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> |
| LIABILITIES | | | | | | |
| 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 | <u>968</u> | <u>738</u> | <u>30</u> | <u>100</u> | <u>100</u> | <u>—</u> |
| 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 | <u>—</u> | <u>32</u> | <u>(4,823)</u> | <u>(3,651)</u> | <u>(206)</u> | <u>8,648</u> |
| 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 31 December 2009, the combined currency asset-liability gap position for BEA's local Hong Kong banking operations were as follows:

| | <u>Total</u> | <u>Up to 1 month</u> | <u>1 month to 3 months</u> | <u>3 months to 6 months</u> | <u>6 months to 12 months</u> | <u>Greater than 1 year</u> |
|---|----------------|--------------------------|--------------------------------|---------------------------------|----------------------------------|--------------------------------|
| (in HK\$ millions) | | | | | | |
| ASSETS | | | | | | |
| Total loans | 113,053 | 97,978 | 9,493 | 2,268 | 2,138 | 1,176 |
| Total investments | 28,860 | 3,246 | 9,378 | 1,144 | 770 | 14,322 |
| Placements | 78,378 | 42,449 | 18,674 | 10,716 | 6,134 | 405 |
| Others | <u>15,248</u> | <u>11,973</u> | <u>1,838</u> | <u>448</u> | <u>934</u> | <u>55</u> |
| Total assets | <u>235,539</u> | <u>155,646</u> | <u>39,383</u> | <u>14,576</u> | <u>9,976</u> | <u>15,958</u> |
| LIABILITIES | | | | | | |
| Total deposits | 209,868 | 161,078 | 34,361 | 12,084 | 2,322 | 23 |
| Acceptances | 3,407 | 1,489 | 1,383 | 487 | 48 | 0 |
| Certificates of deposit and Subordinated notes | 19,576 | 305 | 5,144 | 994 | 4,265 | 8,868 |
| Others | <u>1,093</u> | <u>1,093</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> |
| Total liabilities | <u>233,944</u> | <u>163,965</u> | <u>40,888</u> | <u>13,565</u> | <u>6,635</u> | <u>8,891</u> |
| Off-balance-sheet items | <u>(615)</u> | <u>839</u> | <u>(4,299)</u> | <u>(3,309)</u> | <u>4,246</u> | <u>1,908</u> |
| Asset-Liability Gap | <u>980</u> | <u>(7,480)</u> | <u>(5,804)</u> | <u>(2,298)</u> | <u>7,587</u> | <u>8,975</u> |

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

| | As at 31 December 2009 | | | As at 31 December 2008 | | |
|---|------------------------|------------------|------------------|------------------------|------------------|------------------|
| | HK\$ | U.S.\$ | RMB | HK\$ | U.S.\$ | RMB |
| | HK\$ millions | HK\$ millions | HK\$ millions | HK\$ millions | HK\$ millions | HK\$ millions |
| Impact on earnings over the next 12 months if interest rates rise by 200 basis points | (112) | (72) | (25) | 64 | (26) | 185 |
| Impact on economic value if interest rates rise by 200 basis points | (231) | (312) | (152) | (98) | (203) | 113 |

Given the re-pricing position of the assets and liabilities for BEA as at 31 December 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 to decrease by HK\$112 million, HK\$72 million and HK\$25 million, respectively, and the economic value for BEA to decrease by HK\$231 million, HK\$312 million and HK\$152 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 43.5%, 38.4% and 43.3% for the years ended 31 December 2007, 2008 and 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 Issuer 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 "*— Asset Quality — Held-to-maturity Debt Securities*".

As at 31 December 2007, 2008 and 2009, approximately 87.2%, 93.4% and 86.6%, 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.

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 2007, 2008 and 2009. Average balances of interest-earning assets and interest-bearing liabilities for the years ended 31 December 2007, 2008 and 2009 are based on the arithmetic mean of the respective balances at the beginning and the end of such period.

| | Years ended 31 December | | | | | | | | |
|---|-------------------------|---------------|------------------------|--------------------|---------------|------------------------|--------------------|---------------|------------------------|
| | 2007 | | | 2008 | | | 2009 | | |
| | Average balance | Interest | Average rate (%) | Average balance | Interest | Average rate (%) | Average balance | Interest | Average rate (%) |
| (in HK\$ millions, except percentages) | | | | | | | | | |
| ASSETS | | | | | | | | | |
| Interest-earning assets | | | | | | | | | |
| Customer loans and credit advances to customers . . . | 198,373 | | | 237,112 | | | 231,914 | | |
| Trade bills less provision . . . | 703 | | | 1,121 | | | 1,156 | | |
| Total | 199,076 | 11,960 | 6.0% | 238,233 | 12,099 | 5.1% | 233,070 | 8,781 | 3.8% |
| Interbank placements and loans | | | | | | | | | |
| Cash and balances with banks | 8,397 | | | 20,451 | | | 20,915 | | |
| Money at call and short notice | 55,299 | | | 45,309 | | | 38,707 | | |
| Placements | 21,627 | | | 33,174 | | | 44,785 | | |
| Advances to banks | 2,852 | | | 1,071 | | | 1,351 | | |
| Total | 88,175 | 4,167 | 4.7% | 100,005 | 3,033 | 3.0% | 105,758 | 1,417 | 1.3% |
| Securities | | | | | | | | | |
| Treasury bills | 5,206 | | | 4,781 | | | 11,597 | | |
| Certificates of deposit | 2,692 | | | 2,347 | | | 3,109 | | |
| Debt securities | 22,825 | | | 22,514 | | | 23,263 | | |
| Total | 30,723 | 1,375 | 4.5% | 29,642 | 1,242 | 4.2% | 37,969 | 1,015 | 2.7% |
| Total interest-earning assets . | 317,974 | 17,502 | 5.5% | 367,880 | 16,374 | 4.5% | 376,797 | 11,213 | 3.0% |
| Allowance for possible loan losses | (740) | | | (735) | | | (1,247) | | |
| Non-interest earning assets . . | 25,710 | | | 29,755 | | | 34,474 | | |
| Total assets | 342,944 | | | 396,900 | | | 410,024 | | |

Years ended 31 December

| | 2007 | | | 2008 | | | 2009 | | |
|---|-----------------------|---------------------|------------------------|-----------------------|---------------------|------------------------|-----------------------|---------------------|------------------------|
| | Average balance | Interest | Average rate (%) | Average balance | Interest | Average rate (%) | Average balance | Interest | Average rate (%) |
| (in HK\$ millions, except percentages) | | | | | | | | | |
| LIABILITIES | | | | | | | | | |
| Interest-bearing liabilities | | | | | | | | | |
| Deposits | | | | | | | | | |
| Deposits from customers | 239,206 | 9,128 | 3.8% | 291,922 | 7,678 | 2.6% | 319,289 | 3,395 | 1.1% |
| Deposits and balances of banks | <u>39,656</u> | <u>1,144</u> | 2.9% | <u>34,346</u> | <u>901</u> | 2.6% | <u>19,959</u> | <u>247</u> | 1.2% |
| Total deposits | <u>278,862</u> | <u>10,272</u> | 3.7% | <u>326,268</u> | <u>8,579</u> | 2.6% | <u>339,248</u> | <u>3,642</u> | 1.1% |
| Other liabilities | | | | | | | | | |
| Certificates of deposits | 9,002 | | | 9,138 | | | 3,313 | | |
| Debt securities issued | — | | | — | | | 4,323 | | |
| Loan capital | <u>12,201</u> | | | <u>12,932</u> | | | <u>11,825</u> | | |
| Total | <u>21,203</u> | <u>425</u> | 2.0% | <u>22,070</u> | <u>301</u> | 1.4% | <u>19,461</u> | <u>137</u> | 0.7% |
| Total interest-bearing liabilities | 300,065 | 10,697 | 3.6% | 348,338 | 8,880 | 2.5% | 358,709 | 3,779 | 1.1% |
| Non interest-bearing liabilities | <u>14,391</u> | | | <u>15,272</u> | | | <u>19,222</u> | | 0.7% |
| Total liabilities | <u>314,456</u> | | | <u>363,610</u> | | | <u>377,931</u> | | 1.1% |
| NET INTEREST INCOME | | <u>6,805</u> | | | <u>7,494</u> | | | <u>7,434</u> | |
| NET INTEREST SPREAD | | | 1.9% | | | 2.0% | | | 1.9% |

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 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 regulatory changes relevant to the operations of the Group.

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 April 2010, the Board of Directors of BEA comprised the following individuals:

| Name | Age | Title | Address |
|---------------------------------------|-----|--|---|
| Dr. The Hon. Sir David Li Kwok-po . | 71 | 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 | 59 | 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 | 81 | Independent Non-executive Director | 76th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong |
| Mr. Aubrey Li Kwok-sing | 60 | Non-executive Director | 19th Floor, St. George's Building, 2 Ice House Street, Central, Hong Kong |
| Dr. William Mong Man-wai | 82 | 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 | 71 | Non-executive Director | 5th Floor, Menara PMI, No. 2 Jalan Changkat Ceylon, 50200 Kuala Lumpur, Malaysia |
| Mr. Thomas Kwok Ping-kwong | 58 | Independent Non-executive Director | 46/F., Sun Hung Kai Centre, 30 Harbour Road, Hong Kong |
| Mr. Richard Li Tzar-kai | 43 | Non-executive Director | 42/F., PCCW Tower, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong |
| Mr. Kenneth Lo Chin-ming | 68 | 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 |

| <u>Name</u> | <u>Age</u> | <u>Title</u> | <u>Address</u> |
|---------------------------------------|------------|--|--|
| Mr. Stephen Charles Li Kwok-sze . . . | 50 | Non-executive Director | Unit 26-F, Star Crest — 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 | 64 | 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 |

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 71, joined the Issuer in 1969. He was appointed 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 members of the Group, and he is also the chairman or a member of various committees appointed by the Board.

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 S.H. Ho College of the Chinese University of Hong Kong.

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 and Chairman of the Saint Joseph's College Foundation Limited. He is also an Emeritus Trustee of the Cambridge Foundation, a Trustee of the Cambridge Overseas Trust and a Trustee Emeritus of the Institute for Advanced Study in Princeton. 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 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 AFFIN Holdings Berhad (listed in Malaysia), Criteria CaixaCorp, S.A. (listed in Spain), China Overseas Land & Investment Limited, COSCO Pacific Limited, Guangdong Investment Limited, The Hong Kong and China Gas Company Limited, The Hongkong and Shanghai Hotels, Limited, PCCW Limited, San Miguel Brewery Hong Kong Limited, SCMP Group Limited and

Vitasoy International Holdings Limited. He is also a director of Hong Kong Interbank Clearing Limited, The Hong Kong Mortgage Corporation Limited and IMG Worldwide Holdings, Inc. He was a director of China Merchants China Direct Investments Limited and Dow Jones & Company, Inc (listed in the United States).

Sir David is a member of the Board of Trustees of the Asia Society International Council and Asia Business Council, a member of the Crédit Agricole S.A. International Advisory Board, a member of the Deutsche Bank Asia Pacific Advisory Board, a member of the Munich Re Greater China Advisory Board, and Chairman of the Asian Youth Orchestra Board. He serves on the advisory boards of Carlos P. Romulo Foundation for Peace and Development, Federal Reserve Bank of New York's International Advisory Committee, Hospital for Special Surgery and Scripps International Network. 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, Non-executive Director

Professor Li, aged 64, was a Director of the Issuer (1995-2002) and was re-appointed a Director in January 2008. He is a director of AFFIN Holdings Berhad (listed in Malaysia). 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 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 59, was appointed 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 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 81, was appointed 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 60, was appointed 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, Kunlun Energy Company Limited, Kowloon Development Co. Ltd, Pokfulam Development Company Limited and AFFIN Bank Berhad. He was the chairman of Atlantis Asian Recovery Fund plc (listed in the Republic of Ireland), and 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 82, was appointed 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.

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 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 71, was appointed 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 (both listed in Malaysia). Dr. Khoo is also the Chairman of Laura Ashley Holdings plc (listed in London) and Corus Hotels Limited the United Kingdom, Pan Malaysian Industries Berhad (listed in Malaysia) and Morning Star Resources Limited. He is also a director of SCMP Group Limited.

Dr. Khoo is a trustee of Regent University, Virginia, USA, 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, Member of the Remuneration Committee

Mr. Kwok, aged 58, was appointed 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 serves on the Commission on Strategic Development, is a non-official member of the Provisional Minimum Wage Commission, and until 30 April 2010, he served as a government appointed Member of the Exchange Fund Advisory Committee. 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, the Business Facilitation Advisory Committee, the Council for Sustainable Development and the Construction Industry Council. 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 43, was appointed a Director in 2001. Mr. Li is an executive director and the Chairman of PCCW Limited, one of Asia's leading companies in Information and Communications Technologies. He is also the Chairman and Chief Executive of the Pacific Century Group, an executive director and the Chairman of Pacific Century Premium Developments Limited and Singapore-based

Pacific Century Regional Developments Limited (listed in Singapore). 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 68, was appointed a Director in 2005. Mr. Lo is the Chairman and Chief Executive Officer of the Industrial Bank of Taiwan, the Chairman of EverTrust Bank (USA) 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 been 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 Chairman of IBT Venture Co., 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 recognised professional accomplishments, Mr. Lo is also active in public service. He is the Vice Chairman of the Chinese National Association of Industry and Commerce, a 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 a Director in 2006. Mr. Li is a non-executive director of BEA Life and Blue Cross. 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, U.S.A., 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 50, was appointed 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 hedge funds in the United Kingdom and the United States. 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.

Mr. William DOO Wai-hoi, *BSc, MSc, G.G., Chevalier de la Légion d'Honneur, JP*
Independent Non-executive Director and Member of the Audit Committee

Mr. Doo, aged 65, was appointed a Director in 2008. He is currently the vice-chairman of New World China Land Limited and the deputy chairman of NWS Holdings 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 a deputy chairman of Taifook Securities Group Limited.

Mr. Doo is Member of 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 54, was appointed a Director in 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 of which are listed in Thailand.

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

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

Independent Non-executive Director and Member of the Audit Committee

Mr. Cheung, aged 64, was appointed a Director in 2008. He was a partner at KPMG, a leading international accounting firm in Hong Kong, until his retirement in 2001. He has extensive experience in assurance and corporate finance work, particularly in trading and manufacturing corporations in Hong Kong and the PRC. Mr. Cheung 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 Winteam Pharmaceutical Group Limited (formerly known as Wing Shan International Limited).

Mr. Cheung is currently an independent non-executive director, the chairman of the audit committee and the connected transactions control committee of BEA(China).

Dr. Isidro FAINÉ CASAS

Non-executive Director and Member of the Nomination Committee

Dr. Fainé, aged 67, was appointed a Director in June 2009. Dr. Fainé is the Chairman of the following companies: (i) Criteria CaixaCorp, S.A., the holding company of the largest industrial and financial investment group in Spain (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 controlling shareholder of Criteria CaixaCorp, S.A. and (iii) "la Caixa" Foundation.

Dr. Fainé currently holds chairmanships and directorships in other listed companies as follows: (i) First Deputy Chairman of Abertis Infraestructuras, S.A. (infrastructure manager, listed in Spain), (ii) Deputy Chairman of Telefónica, S.A. (integrated operator in the telecommunication sector, listed in Spain), (iii) Second Deputy Chairman of Repsol YPF, S.A. (oil company, listed in Spain), (iv) Director of Banco BPI, S.A. (financial and multi-specialist group focusing on the banking business, listed in Portugal) and (v) Director of Grupo Financiero Inbursa, S.A.B. de C.V. (financial and banking group, listed in Mexico).

Dr. Fainé was 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, Chairman of the Association of Spanish Savings Banks and Chairman of the Association of Catalan Savings Banks. He is also Chairman of the Spanish Confederation of Directors and Executives and the Spanish Chapter of the Club of Rome. He has been a member of the Executive Committee of the Deposit Guarantee Fund for Savings Bank since 2007.

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 “la Caixa” and was appointed Deputy Executive General Manager in 1982. He was appointed General Manager in 1999 and was further appointed Chairman of “la Caixa” in 2007.

Among other academic and professional qualifications, Dr. Fainé holds a PhD in Economic and Business Sciences, an International Senior Managers Program 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. Li, aged 36, joined the Issuer 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. Li is primarily responsible for the overall management and control of the Issuer’s business in Hong Kong, including corporate banking, personal banking, wealth management, insurance and retirement benefits. He is also a director of various members of the Group and a member of various committees appointed by the Board.

Mr. 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. Li is a member of the Ninth and Tenth Guangdong Provincial Committees of the Chinese People’s Political Consultative Conference (“CPPCC”) and was formerly a member of the Ninth and Tenth Guangzhou Committees of the CPPCC. He is also a member of the Ninth and Tenth Committees of the All-China Youth Federation, the Deputy Chairman of the Ninth Committee of the Beijing Youth Federation and a Counsellor of the Hong Kong United Youth Association. 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 the 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. Li holds a Master Degree in Management from Kellogg Graduate School of Management, Northwestern University, Evanston, Illinois, United States, and a Bachelor of Arts Degree and a Master of Arts Degree in Law from the University of Cambridge, United Kingdom. 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. Li, aged 35, 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 Issuer'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.

Mr. Li is currently an Independent Non-executive Director of Towngas China Company Limited, an Independent Director of Goldwind Science & Technology Company Limited and an Alternate Director of AFFIN Bank Berhad.

Mr. 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 the Hong Kong-Taiwan Business Cooperation Committee, 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. Li is a Member of the Hong Kong Institute of Certified Public Accountants and a Member of Treasury Markets Association. Mr. Li is an Associate of The Institute of Chartered Accountants in England and Wales and holds an MBA from Stanford University as well as an MA and a 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 Issuer 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 Issuer from 1997 to March 2009. He was promoted to Deputy Chief Executive & Chief Investment Officer in April 2009. Mr. Li is primarily responsible for the Issuer's investment activities and treasury & broking operations including treasury markets, as well as the management of East Asia Securities and East Asia Futures. He is also a director of various members of the Group and a member of various committees appointed by the Board.

Mr. Li is currently an Independent Non-executive Director and the Chairman of Audit Committee of China Merchants China Direct Investments Limited.

Mr. 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 51, joined the Issuer in 1975. He was promoted to Assistant General Manager in 1995 and 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 Issuer. He is also a director of various members of the 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. 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 2007, 2008 and 2009, the outstanding balances of amounts due from and due to them as at 31 December 2007, 2008 and 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 | | |
| | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 |
| | (in HK\$ millions) | | | (in HK\$ millions) | | | (in HK\$ millions) | | |
| Interest income | 155 | 264 | 125 | 833 | 1,079 | 588 | 9 | 8 | 3 |
| Interest expense | 134 | 88 | 25 | 204 | 148 | 560 | — | — | — |
| Amounts due from . . . | 10,448 | 8,209 | 6,971 | 17,964 | 16,398 | 12,719 | 213 | 124 | 626 |
| Amounts due to | 3,961 | 3,696 | 5,147 | 1,634 | 1,994 | 1,642 | 10 | 7 | 4 |
| Maximum amounts due from | 11,361 | 12,429 | 10,443 | 23,699 | 22,072 | 15,953 | 422 | 446 | 924 |
| Maximum amounts due to | 8,593 | 8,527 | 9,826 | 1,894 | 2,850 | 2,295 | 62 | 34 | 14 |

PRINCIPAL SHAREHOLDERS' AND DIRECTORS' INTERESTS

REGISTERED SHAREHOLDERS

As at 30 April 2010, the following corporations were holding 5% or more of the issued ordinary shares of BEA according to its Register of Members:

| Name of Shareholder | Number of shares held | Percentage of shares |
|--|-----------------------|----------------------|
| HKSCC Nominees Limited | 1,545,595,099 | 76.09 |
| The Bank of East Asia (Nominees) Limited | 170,791,164 | 8.41 |

INTERESTS OF SUBSTANTIAL SHAREHOLDERS AND OTHER PERSONS

As at 30 April 2010, 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 ordinary shares of the Issuer:

| 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 | 302,258,869 ¹ | 14.99 | 14.1.2010 |
| Criteria CaixaCorp, S.A. | Interest of corporation | 302,258,869 ¹ | 14.99 | 14.1.2010 |
| Caja de Ahorros y Pensiones de Barcelona . | Interest of corporation | 302,258,869 ¹ | 14.99 | 14.1.2010 |
| Guoco Management Company Limited | Beneficial owner | 162,003,726 ^{2,3} | 8.03 ⁴ | — |
| Guoco Group Limited | Interest of corporation | 162,003,726 ² | 8.03 | 9.2.2010 |
| GuoLine Overseas Limited. | Interest of corporation | 162,003,726 ^{2,3} | 8.03 ⁴ | — |
| GuoLine Capital Assets Limited. | Interest of corporation | 162,003,726 ² | 8.03 ⁴ | — |
| Hong Leong Company (Malaysia) Berhad . . | Interest of corporation | 162,003,726 ^{2,3} | 8.03 | 9.2.2010 |
| HL Holdings Sdn Bhd | Interest of corporation | 162,003,726 ² | 8.03 | 9.2.2010 |
| Quek Leng Chan | Interest of corporation | 162,003,726 ² | 8.03 | 9.2.2010 |
| Hong Leong Investment Holdings Pte. Ltd. . | Interest of corporation | 162,003,726 ³ | 8.03 | 9.2.2010 |
| Davos Investment Holdings Private Limited | Interest of corporation | 162,003,726 ³ | 8.03 | 9.2.2010 |
| Kwek Leng Kee | Interest of corporation | 162,003,726 ³ | 8.03 | 9.2.2010 |

Notes:

- 1 As at 31 December 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 302,258,869 shares held by Negocio de Finanzas e Inversiones I, S.L.U. These 302,258,869 shares represented approximately 14.88% of the issued share capital of the Issuer as at 30 April 2010.

- 2 The references to 162,003,726 shares of the Issuer in Notes 2 and 3 relate to the same block of shares. Guoco Management Company Limited was the beneficial owner of 162,003,726 shares (equivalent to approximately 7.98% of the issued share capital of the Issuer as at 30 April 2010). Hong Leong Company (Malaysia) Berhad was deemed to be interested in the 162,003,726 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 owned a 100% interest in Guoco Management Company Limited. GuoLine Capital Assets Limited, GuoLine Overseas Limited and Guoco Group Limited were all deemed to be interested in the 162,003,726 shares held by Guoco Management Company Limited.

Quek Leng Chan was deemed to be interested in the 162,003,726 shares held by Guoco Management Company Limited by virtue of his 100% interest in HL Holdings Sdn Bhd (“**HLH**”). Hong Leong Company (Malaysia) Berhad was held as to 46.68% and 2.43% by HLH and Quek Leng Chan respectively.

- 3 The references to 162,003,726 shares of the Issuer 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 in turn 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 162,003,726 shares (equivalent to approximately 7.98% of the issued share capital of the Issuer as at 30 April 2010) held by Guoco Management Company Limited by virtue of their interests in Hong Leong Company (Malaysia) Berhad.

Kwek Leng Kee was deemed to be interested in the 162,003,726 shares held by Guoco Management Company Limited by virtue of his 41.92% interest in Davos Investment Holdings Private Limited.

- 4 GuoLine Overseas Limited and GuoLine Capital Assets Limited are wholly-owned subsidiaries of Hong Leong Company (Malaysia) Berhad and Guoco Management Company Limited is a wholly-owned subsidiary of Guoco Group Limited. With the filing of the substantial shareholder notices by Hong Leong Company (Malaysia) Berhad and Guoco Group Limited, GuoLine Overseas Limited, GuoLine Capital Assets Limited and Guoco Management Company Limited 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 or underlying shares of BEA were recorded in the Register.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS

As at 30 April 2010, the interests and short positions of the Directors and Chief Executive of the Issuer in the shares, underlying shares and debentures of the Issuer 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 ordinary shares of the Issuer:

| Name | Capacity and nature | No. of shares | Total | % of issued share capital |
|----------------------------------|------------------------------------|---------------|-------------------------|---------------------------|
| David LI Kwok-po | Beneficial owner | 46,492,863 | | |
| | Interest of spouse | 1,514,314 | 48,007,177 ¹ | 2.36 |
| Arthur LI Kwok-cheung | Beneficial owner | 9,613,420 | | |
| | Founder of discretionary trust | 13,345,556 | 22,958,976 ² | 1.13 |
| Allan WONG Chi-yun | Beneficial owner | 339,217 | | |
| | Interest of spouse | 136 | | |
| | Founder of discretionary trust | 12,720,718 | 13,060,071 ³ | 0.64 |
| WONG Chung-hin | Beneficial owner | 51,491 | | |
| | Interest of spouse | 378,544 | 430,035 ⁴ | 0.02 |
| LEE Shau-kee | Beneficial owner | 2,092,183 | | |
| | Interest of corporation | 1,100,000 | 3,192,183 ⁵ | 0.16 |
| Aubrey LI Kwok-sing | Beneficial owner | 25,730 | | |
| | Interest of spouse | 18,626 | | |
| | Beneficiary of discretionary trust | 33,976,516 | 34,020,872 ⁶ | 1.68 |
| William MONG Man-wai | Beneficial owner | 2,042,950 | | |
| | Interest of spouse | 33,000 | | |
| | Interest of corporation | 6,041,926 | 8,117,876 ⁷ | 0.40 |
| Winston LO Yau-lai | — | — | Nil | Nil |
| KHOO Kay-peng | Interest of corporation | 5,287,213 | 5,287,213 ⁸ | 0.26 |
| Thomas KWOK Ping-kwong | — | — | Nil | Nil |
| Richard LI Tzar-kai | Interest of corporation | 5,568,860 | 5,568,860 ⁹ | 0.27 |
| Kenneth LO Chin-ming | — | — | Nil | Nil |

| <u>Name</u> | <u>Capacity and nature</u> | <u>No. of shares</u> | <u>Total</u> | <u>% of issued share capital</u> |
|------------------------------------|--|----------------------|--------------------------|----------------------------------|
| Eric LI Fook-chuen | Beneficial owner | 4,291,634 | | |
| | Founder and beneficiary of discretionary trust | 21,451,555 | | |
| | Interest of corporation | 8,819,799 | 34,562,988 ¹⁰ | 1.70 |
| Stephen Charles LI Kwok-size . . . | Beneficial owner | 11,602,560 | | |
| | Interest of children | 530,724 | | |
| | Beneficiary of discretionary trusts | 2,218,368 | 14,351,652 ¹¹ | 0.71 |
| William DOO Wai-hoi | — | — | Nil | Nil |
| KUOK Khoon-ean | — | — | Nil | Nil |
| Valiant CHEUNG Kin-piu | — | — | Nil | Nil |
| Isidro FAINÉ CASAS | — | — | Nil | Nil |

Notes:

- 1 David LI Kwok-po was the beneficial owner of 46,492,863 shares and he was deemed to be interested in 1,514,314 shares through the interests of his spouse, Penny POON Kam-chui.
- 2 Arthur LI Kwok-cheung was the beneficial owner of 9,613,420 shares. Arthur LI Kwok-cheung made a voluntary disclosure of 13,345,556 shares held by a discretionary trust of which he is the founder but has no influence on how the trustee exercises his discretion.
- 3 Allan WONG Chi-yun was the beneficial owner of 339,217 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 12,720,718 shares held by a discretionary trust, The Wong Chung Man 1984 Trust, of which Allan WONG Chi-yun was a founder.
- 4 WONG Chung-hin 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.
- 5 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 39.88% 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.
- 6 Aubrey LI Kwok-sing was the beneficial owner of 25,730 shares and he was deemed to be interested in 18,626 shares through the interests of his spouse, Elizabeth WOO. The remaining 33,976,516 shares were held by The Fook Wo Trust, a discretionary trust in which Aubrey LI Kwok-sing was one of the discretionary beneficiaries.

- 7 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.
- 8 KHOO Kay-peng was deemed to be interested in 5,287,213 shares out of which (i) 1,178,916 shares were held through Bonham Industries Limited, a company in which he held 99.9% of the issued capital, and (ii) 4,108,297 shares were held through the Malayan United Industries Berhad Group of which he is the Chairman and Chief Executive and a deemed substantial shareholder.
- 9 Richard LI Tzar-kai was deemed to be interested in 5,568,860 shares held by certain corporations in their capacity as investment managers, out of which (i) 5,390,120 shares were held by PineBridge Investments Asia Limited (“PBI A”), and (ii) 178,740 shares were held by PineBridge Investments LLC (“PBI LLC”). PBI A and PBI LLC were indirect wholly-owned subsidiaries of Chitonlink Limited which was 100% owned by Richard LI Tzar-kai.
- 10 Eric LI Fook-chuen was the beneficial owner of 4,291,634 shares, and 21,451,555 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 8,819,799 shares held by The Kowloon Dairy Limited of which he is the Chairman and Chief Executive Officer.
- 11 Stephen Charles LI Kwok-sze was the beneficial owner of 11,602,560 shares, and he was deemed to be interested in 530,724 shares through the interests of his children under the age of 18. Of the remaining 2,218,368 shares, (i) 2,034,600 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) 183,768 shares were held by a discretionary trust, Longevity Trust, of which his children under the age of 18 were beneficiaries.

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

Shares options, being unlisted physically settled equity derivatives, to subscribe for the ordinary shares of the Issuer were granted to David LI Kwok-po pursuant to the approved Staff Share Option Schemes. As at 30 April 2010, the outstanding share options were as follows:

| Name | Date of Grant | Exercise Period | Exercise | Number of shares in the options |
|----------------------------|---------------|----------------------------|---------------------------|---------------------------------|
| | | | Price per share (in HK\$) | |
| David LI Kwok-po | 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 Issuer:

| Name | Capacity and nature | Amount of debentures |
|--------------------------------|--------------------------------------|----------------------|
| David LI Kwok-po | Beneficial owner ¹ | GBP1,000,000 |
| William MONG Man-wai | Interest of corporation ² | U.S.\$2,000,000 |

Notes:

- 1 David LI Kwok-po was the beneficial owner of the above interests in the 6.125% step-up perpetual subordinated notes issued by the Bank. The perpetual subordinated notes, with a face value of GBP300 million, were issued by the Bank in 2007 and are listed on Singapore Exchange Securities Trading Limited.
- 2 The above interests in the 5.625% subordinated notes of the Issuer 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. The subordinated notes, with a principal amount of U.S.\$550,000,000 were issued by the Issuer in 2005 and are listed on The Stock Exchange of Hong Kong Limited.

IV. Interests in debentures of associated corporation of the Issuer:

| Name | Capacity and nature | Amount of debentures |
|------------------------------|---------------------------------|----------------------|
| Allan WONG Chi-yun | Interest of spouse ¹ | RMB20,000,000 |
| Eric LI Fook-chuen | Beneficial owner ² | RMB10,000,000 |

Notes:

- 1 Allan WONG Chi-yun was deemed to be interested in the Renminbi bonds issued by BEA(China), through the interests of his spouse, Margaret Kwok Chi-wai. The bonds, with an aggregate principal amount of RMB4 billion, were issued in 2009 at an annual interest rate of 2.8%.
- 2 Eric LI Fook-chuen was the beneficial owner of the above interests in the Renminbi bonds issued by The BEA (China), a wholly-owned subsidiary of the Issuer. The bonds, with an aggregate principal amount of RMB4 billion, were issued in 2009 at an annual interest rate of 2.8%.

V. Interests in Hybrid Tier I Capital Instruments:

Allan WONG Chi-yun was the beneficial owner of the following capital instruments (*Note*):

| Issuer | Type/Class of securities | Amount of debentures | No. of shares |
|--|---|----------------------|---------------|
| The Bank of East Asia, Limited | Subordinated Notes | U.S.\$4,500,000 | — |
| Innovate Holdings Limited | Preference Shares | — | 4,500 |
| The Bank of East Asia, Limited | Substitute Preference Shares (unissued) | — | 4,500 |

Note: In November 2009, the Issuer issued capital instruments qualifying as hybrid tier 1 capital with a face value of U.S.\$500 million. The capital instruments comprise 8.5% step-up subordinated notes due 2059 issued by the Issuer (the “Innovate Notes”) stapled with perpetual non-cumulative step-up preference shares issued by Innovate Holdings Limited, a wholly-owned subsidiary of the Issuer (the “Innovate Preference Shares”). The Innovate Notes and the Innovate Preference Shares are listed on the SGX-ST. The substitute preference shares (being perpetual non-cumulative step-up preference shares having a par value of U.S.\$1,000 each) are to be created, and issued upon the occurrence of a Substitution Event (as defined in the circular to shareholders of the Issuer dated 11 November 2009) by the Issuer as a term of the issue of the Innovate Notes and the Innovate Preference Shares.

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.

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 July 2010 and the HKMA Annual Report 2009, 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 14 May 2010 comprised 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 14 May 2010, there were 146 licensed banks, 24 restricted licence banks and 27 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 70 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 31 December 2009 the Group's capital adequacy ratio was approximately 13.3%⁽¹⁾. 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 decreased approximately 0.86% from HK\$10,754 billion as at 31 December 2008 to HK\$10,661 billion as at 31 December 2009.

Note

- (1) Taking into account the issuance of 167.1 million new shares at a price of HK\$ 30.60 per share in January 2010, the pro forma capital adequacy ratio would be 15.1%.

Loans and Advances

As at 31 December 2009, loans and advances to customers represented approximately 30.9% 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 0.09% from HK\$3,286 billion as at 31 December 2008 to HK\$3,289 billion as at 31 December 2009. Approximately 73.0% of loans and advances to customers extended by all authorised institutions in Hong Kong were denominated in Hong Kong dollars as at 31 December 2009, with the rest in foreign currencies. As at that date, of the total loans and advances to customers of HK\$3,289 billion extended by all authorised institutions, approximately 81.3% was classified as “Loans and Advances for use in Hong Kong plus trade finance” and approximately 18.7% 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 2009.

| Sector | Percentage of Total |
|--|------------------------|
| Building, Construction, Property Development and Investment | 26 |
| Financial Concerns (other than authorised institution) | 7 |
| Hong Kong’s visible trade | 7 |
| Manufacturing | 5 |
| Wholesale and Retail Trade | 6 |
| Transport and Transport Equipment | 6 |
| Individuals: | |
| - to purchase flats in GHOS, PSPS and TPS | 2 |
| - to purchase other residential properties | 24 |
| - other purposes | 8 |
| Others | 10 |
| Total | <u>100</u> |

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 2009, interbank lending represented approximately 35.2% of the total assets of all authorised institutions in Hong Kong, with approximately 85.5% of such lending being to banks outside Hong Kong.

FUNDING

Deposits from Customers

As at 31 December 2009, deposits from customers represented approximately 59.9% of the total liabilities of all authorised institutions in Hong Kong. Total deposits from customers of all authorised institutions increased approximately 5.3% from HK\$6,060 billion as at 31 December 2008 to HK\$6,381 billion as at 31 December 2009, of which approximately 53.0% of total customer deposits with authorised institutions were denominated in Hong Kong dollars. Hong Kong dollar deposits increased approximately 11.2% while deposits denominated in foreign currencies decreased approximately 0.6%, in each case from 31 December 2008 to 31 December 2009. As at 31 December 2009, deposits from customers with licensed banks represented approximately 99.6% of deposits from customers with all authorised institutions in Hong Kong. As at 31 December 2009, time deposit accounts, demand accounts and savings accounts accounted for approximately 46.6%, 11.1%, and 42.3%, respectively, of total deposits by customers with all authorised institutions in Hong Kong.

Interbank Funds

Interbank transactions are significant in funding the Hong Kong banking system. As at 31 December 2009, interbank liabilities represented approximately 27.0% 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 2009, approximately 81.0% 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 March 2010, the total outstanding value of negotiable certificates of deposit issued by authorised institutions in Hong Kong amounted to HK\$108,902 million, of which approximately 73.0% 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. In April 2010, a bill seeking to amend the Deposit Protection Ordinance was gazetted. Among other things, the bill seeks to increase the Deposit Protection Scheme limit from HK\$100,000 to HK\$500,000 which is intended to come into effect upon the expiry of the guarantee at the end of 2010.

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 has undergone 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 |
|---|--------------------------------|----------|----------|----------|----------|---|
| | 2004 | 2005 | 2006 | 2007 | 2008 | Annual Growth Rate (2004-2008) |
| | (in RMB, except percentages) | | | | | |
| GDP per capita | 12,336.0 | 14,053.0 | 16,165.0 | 19,524.0 | 22,698.0 | 21.08% |
| Annual disposable income of urban households per capita | 9,421.6 | 10,493.0 | 11,760.0 | 13,786.0 | 15,781.0 | 13.76% |
| Annual net income of rural households per capita | 2,936.4 | 3,254.9 | 3,587.0 | 4,140.4 | 4,760.6 | 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 Chinese citizens within the territory of the mainland China with a local currency business licence, while previously, Renminbi business could only be provided to foreign individuals, foreign-invested enterprises and local enterprises 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 April 2010, BEA (China) has 20 branches and 56 sub-branches in mainland China.

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 certain 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 alternative standardised 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 accepted 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 or incur any other liability 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 or of another company of which it is a subsidiary.

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;
- (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.

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:

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

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

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%.

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the Conditions of the Notes which (subject to modification and except for the paragraphs in italics) will be endorsed on the Certificates issued in respect of the Notes:

The U.S.\$450,000,000 6.125 per cent. Subordinated Notes due 2020 (the “**Notes**”, which expression shall in these Conditions, unless the context otherwise requires, include any further Notes issued pursuant to Condition 16) of The Bank of East Asia, Limited (the “**Issuer**”) are constituted by a trust deed (the “**Trust Deed**”) dated 16 July 2010 (the “**Issue Date**”) made between the Issuer and DB Trustees (Hong Kong) Limited (the “**Trustee**”, which expression shall include its successors(s)) as trustee for the holders (as defined below) of the Notes. The issue of the Notes was authorised by resolutions of the Committee of the Board of Directors of the Issuer on 23 June 2010. These terms and conditions (the “**Conditions**”) include summaries of, and are subject to, the detailed provisions of and definitions in the Trust Deed. Copies of the Trust Deed and the agency agreement dated 16 July 2010 (the “**Agency Agreement**”) made between the Issuer, Deutsche Bank AG, Hong Kong Branch as initial principal paying agent (the “**Principal Paying Agent**”), the other paying agents named therein (together with the Principal Paying Agent, the “**Paying Agents**”, which expression includes any successor or additional paying agents appointed from time to time in connection with the Notes), Deutsche Bank AG, Hong Kong Branch as registrar (the **Registrar**), Deutsche Bank AG, Hong Kong Branch as transfer agent (the “**Transfer Agent**”) and the Trustee are available for inspection during normal business hours by the Noteholders at the principal office for the time being of the Trustee, being at the date of issue of the Notes at 48th Floor, Cheung Kong Center, 2 Queen’s Road Central, Hong Kong, and at the specified office of each of the Agents. The Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and are deemed to have notice of those provisions of the Agency Agreement applicable to them. The Paying Agents, Registrar and Transfer Agent are together referred to as the “**Agents**” and each as “**Agent**”. References in these Conditions to an Agent shall include any successor appointed under the Agency Agreement.

1 FORM, DENOMINATION AND TITLE

1.1 Form and Denomination

The Notes are issued in registered form in denominations of U.S.\$100,000 and integral multiples of U.S.\$1,000 in excess thereof without coupons attached. A note certificate (each a “**Certificate**”) will be issued to each Noteholder in respect of its registered holding of Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the Register (as defined in Condition 2) which the Issuer will procure to be kept by the Registrar.

*Upon issue, the Notes will be represented by a Global Certificate deposited with a common depositary for, and representing Notes registered in the name of a common nominee of, Euroclear Bank S.A./N.V. (“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream**”). The Conditions are modified by certain provisions contained in the Global Certificate. Except in the limited circumstances described in the Global Certificate, owners of interests in Notes represented by the Global Certificate will not be entitled to receive definitive Certificates in respect of their individual holdings of Notes. The Notes are not issuable in bearer form.*

1.2 Title

Title to the Notes passes only by transfer and registration in the Register as described in Condition 2. 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 or any writing on (other than a duly completed and signed form of transfer), 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 Conditions “**Noteholder**” and (in relation to a Note) “**holder**” means the person in whose name a Note is registered in the Register.

2 TRANSFERS OF NOTES AND ISSUE OF CERTIFICATES

2.1 Register

The Issuer will cause to be kept at the specified office of the Registrar and in accordance with the terms of the Agency Agreement a register 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 (the “**Register**”).

Each Noteholder shall be entitled to receive only one Certificate in respect of its entire holding.

2.2 Transfers

Subject to Conditions 2.5 and 2.6, a Note may be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer on the back duly completed and signed by the holder or his attorney duly authorised in writing, at the specified office of the Registrar or any of the Agents. No transfer of title to a Note will be valid unless and until entered on the Register.

Transfers of interests in the Notes evidenced by the Global Certificate will be effected in accordance with the rules of the relevant clearing systems.

2.3 Delivery of new Certificates

Each new Certificate to be issued upon transfer or exchange of Notes will, within five business days of receipt by the Registrar or the relevant Agent of the original Certificate and the duly completed and signed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address specified in the form of transfer. For the purposes of this Condition, “**business day**” shall mean a day on which banks are open for business in the city in which the specified office of the Agent with whom a Certificate is deposited in connection with a transfer or exchange is located.

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 some but not all of the Notes in respect of which a Certificate is issued are to be transferred, exchanged or redeemed, a new Certificate in respect of the Notes not so transferred exchanged or redeemed will, within five business days of receipt by the Registrar or the relevant Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred, exchanged or redeemed to the address of such holder appearing on the register of Noteholders or as specified in the form of transfer.

2.4 Formalities free of charge

Registration of transfer of Notes and issuances of new Certificates will be effected without charge by or on behalf of the Issuer or any Agent but upon (i) payment (or the giving of such indemnity as the Issuer or any Agent may reasonably require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer and (ii) the Issuer or the relevant Agent being satisfied that the regulations concerning transfer of Notes have been complied with.

2.5 Closed periods

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal, premium (if any) or interest on that Note.

2.6 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 Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Registrar and the Trustee. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3 STATUS

3.1 Subordination

- (a) The Notes constitute direct, unconditional, unsecured and, in accordance with sub-paragraph (b) below, subordinated obligations of the Issuer, ranking *pari passu* without any preference among themselves.
- (b) The claims of the holders of the Notes will, in the event of the Winding-Up (as defined in Condition 9) of the Issuer, be subordinated in right of payment in the manner provided in this Condition 3.1 and the Trust Deed (to the claims of depositors and all other unsubordinated creditors of the Issuer) and will rank, in the event of the Winding-Up of the Issuer, at least *pari passu* in right of payment with all other Subordinated Indebtedness (as defined in Condition 3.4), present and future, of the Issuer. Claims in respect of the Notes will rank in priority to the rights and claims of holders of subordinated liabilities which by their terms rank or are expressed to rank in right of payment junior to the Notes and of all classes of equity securities of the Issuer, including holders of preference shares, if any.

3.2 Waiver of Set-Off

Claims in respect of any Notes may not be set-off, or be the subject of a counterclaim, by the holder against or in respect of any obligations of the holder to the Issuer or to any other persons and the holder of any Note shall, by virtue of being the holder of any Note, be deemed to have waived all such rights of set-off and counterclaim to the fullest extent permitted by applicable law.

3.3 Noteholders to Account

In the event that any Noteholder nevertheless receives (whether by set-off or otherwise) directly in a Winding-Up Proceeding (as defined in Condition 9) in respect of the Issuer any payment by, or distribution of assets of, the Issuer of any kind or character, whether in cash, property or securities, in respect of any amount owing to it by the Issuer arising under or in connection with the Notes, other than in accordance with this Condition 3 and Clause 5 of the Trust Deed, such Noteholder shall, subject to applicable law, immediately pay an amount equal to the amount of such payment or discharge to the liquidator for the time being in the Winding-Up of the Issuer for distribution in accordance with Clause 5 of the Trust Deed and each Noteholder, by virtue of becoming a Noteholder, shall be deemed to have so agreed and undertaken with and to the Issuer and all depositors and other unsubordinated creditors of the Issuer for good consideration.

3.4 Definition

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

4 INTEREST

The Notes bear interest from and including 16 July 2010 at the rate of 6.125 per cent. per annum, payable semi-annually in arrear in equal instalments of U.S.\$30.625 per Calculation Amount (as defined below) on 16 January and 16 July in each year (each an “**Interest Payment Date**”). Each Note will cease to bear interest from the due date for redemption unless, upon due presentation, payment of principal is improperly withheld or refused. In such event it shall continue to bear interest at such rate (both before and after judgment) until whichever is the earlier of (a) 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 holder, and (b) the day seven days after the Trustee or the Principal Paying Agent has notified Noteholders of receipt of all sums due in respect of all the Notes up to that seventh day (except to the extent that there is failure in the subsequent payment to the relevant holders under these Conditions). If interest is required to be calculated for a period of less than a complete Interest Period (as defined below), the relevant day-count fraction will be determined on the basis of a 360-day year consisting of 12 months of 30 days each.

In these Conditions, the period beginning on and including 16 July 2010 and ending on but excluding the first Interest Payment Date and each successive period beginning on and including an Interest Payment Date and ending on but excluding the next succeeding Interest Payment Date is called an “**Interest Period**”.

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 period shall, save as provided above in relation to equal instalments, be equal to the product of 6.125 per cent., the Calculation Amount and the day-count fraction for the relevant period, rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

5 PAYMENTS

5.1 Payments in respect of Notes

Payments of principal and interest will be made by transfer to the registered account of the Noteholder or by U.S. dollar cheque drawn on a bank that processes payments in U.S. dollars mailed to the registered address of the Noteholder if it does not have a registered account. Payments of principal and payments of interest due otherwise than on an Interest Payment Date will only be made against surrender of the relevant Certificate at the specified office of any of the Agents. Interest on Notes due on an Interest Payment Date will be paid to the holder shown on the Register at the close of business on the date (the “**record date**”) being the fifteenth day before the relevant Interest Payment Date.

For the purposes of this Condition, a Noteholder’s “**registered account**” means the U.S. dollar account maintained by or on behalf of it with a bank that processes payments in U.S. dollars, details of which appear on the Register at the close of business, in the case of principal and interest due otherwise than on an Interest Payment Date, on the second Business Day (as defined below) before the due date for payment and, in the case of interest due on an Interest Payment Date, on the relevant record date, and a Noteholder’s “**registered address**” means its address appearing on the Register at that time.

5.2 Payments subject to Applicable Laws

Payments in respect of principal and interest on Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 7.

5.3 No commissions

No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition.

5.4 Payment on Business Days

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day (as defined below), for value 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, on the Business Day preceding the due date for payment or, in the case of a payment of principal or a payment of interest due otherwise than on an Interest Payment Date, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of an Agent.

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 or is lost in the mail.

In this Condition “**Business Day**” means a day (other than a Saturday or Sunday) on which commercial banks are open for business in Hong Kong, New York City and, in the case of presentation of a Certificate, in the place in which the Certificate is presented.

5.5 Partial Payments

If the amount of principal or interest which is due on the Notes is not paid in full, the Registrar will annotate the Register with a record of the amount of principal or interest in fact paid.

5.6 Agents

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents provided that it will at all times maintain:

- (a) a Principal Paying Agent;
- (b) a Registrar in Hong Kong;
- (c) a Paying Agent having a specified office in Singapore where the Notes may be presented or surrendered for payment or redemption, so long as the Notes are listed on the Singapore Exchange Securities Trading Limited (the “**SGX-ST**”) and the rules of that exchange so require; and
- (d) a Paying Agent with 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 termination or appointment and of any changes in specified offices will be given to the Noteholders promptly by the Issuer in accordance with Condition 12.

So long as the Notes are listed on the SGX-ST and the rules of that exchange so require, in the event that the Global Certificate is exchanged for definitive Certificates, the Issuer 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 Certificate is exchanged for definitive Certificates, announcement of such exchange shall be made 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.

6 REDEMPTION AND PURCHASE

6.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled, the Issuer will redeem the Notes at their principal amount on 16 July 2020 (the “**Maturity Date**”).

6.2 Redemption for Taxation Reasons

Subject to Condition 6.7, if the Issuer satisfies the Trustee immediately before the giving of the notice referred to below that (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction (as defined in Condition 7.2(b) below) or any change in the official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 9 July 2010, on the occasion of the next payment due in respect of the Notes the Issuer would be required to pay additional amounts as provided or referred to in Condition 7, and (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it, the Issuer may at its option, having given not less than 30 nor more than 60 days’ notice to the Noteholders in accordance with Condition 12 (which notice shall be irrevocable and shall specify the date fixed for redemption), redeem all the Notes, but not some only, at their principal amount together with interest accrued to but excluding the date of redemption, provided that no such notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer would be required to pay the additional amounts were a payment in respect of the Notes then due. Prior to the publication of any notice of redemption pursuant to this Condition 6.2, the Issuer shall deliver to the Trustee a certificate signed by two Authorised Signatories (as defined in the Trust Deed) of the Issuer stating that the requirement referred to in (a) above will apply on the occasion of the next payment due in respect of the Notes and cannot be avoided by the Issuer taking reasonable measures available to it and the Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders.

6.3 Redemption upon a Regulatory Redemption Event

Subject to Condition 6.7, the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days’ notice to the Noteholders (which notice shall be irrevocable) at their principal amount together with interest accrued to but excluding the date fixed for redemption, following the occurrence of a Regulatory Redemption Event.

A “**Regulatory Redemption Event**” occurs if the Notes in whole, and not in part, no longer qualify as term subordinated debt for inclusion in Category II - Supplementary Capital of the Issuer as a result of amendments to the relevant provisions of the Banking Ordinance or the statutory guidelines issued by the Hong Kong Monetary Authority (or any successor thereto) (the “**HKMA**”) in relation thereto after the Issue Date (excluding for the avoidance of doubt, non-qualification solely by virtue of the Issuer already having outstanding securities with an aggregate principal amount up to or in excess of the limit of Supplementary Capital permitted from time to time by the HKMA or solely as a result of any discounting requirements as to the eligibility of the Notes for such inclusion pursuant to the relevant legislation and statutory guidelines in force as at 16 July 2010).

“**Category II - Supplementary Capital**” has the meaning given to it from time to time in the HKMA Supervisory Policy Manual CA-S-7, as amended, supplemented or replaced from time to time.

“**Supplementary Capital**” has the meaning given to it from time to time in the Part 3 of the Banking (Capital) Rules (Cap. 155L) of Hong Kong, as amended, supplemented or replaced from time to time.

6.4 Purchases

Subject to Condition 6.7 below, the Issuer or any of its Subsidiaries (may at any time purchase Notes in any manner and at any price.

In these Conditions, “**Subsidiary**” means each subsidiary as defined in section 2 of the Companies Ordinance for the time being of the Issuer.

6.5 Cancellations

All Notes which are (a) redeemed or (b) purchased by or on behalf of the Issuer or any of its Subsidiaries will forthwith be cancelled and accordingly may not be held, reissued or resold. For the avoidance of doubt, this provision shall not apply to the Issuer or any of its Subsidiaries holding the Notes in a purely nominee capacity.

6.6 Notices Final

Upon the expiry of any notice as is referred to in Condition 6.2 or Condition 6.3 above, the Issuer shall be bound to redeem the Notes to which the notice refers in accordance with the terms of such Condition.

6.7 Conditions for Redemption and Purchase

Notwithstanding any other provision in these Conditions, the Notes (other than pursuant to Condition 6.1 or 9 and subject as provided below) may not be redeemed or purchased and cancelled without the prior consent of the HKMA. Accordingly (i) the Issuer shall not redeem any of the Notes (other than pursuant to Condition 6.1 or 9) and (ii) neither the Issuer nor its Subsidiaries shall purchase the Notes (as principal not as agent) unless the prior written consent of the HKMA thereto shall have been obtained provided, however, that if from time to time the consent of the HKMA is not a requirement of any such Notes to constitute Category II - Supplementary Capital (or equivalent) of the Issuer for the purposes of, and as defined in, the Banking Ordinance (Cap. 155) of Hong Kong, or any successor legislation, then the condition to the redemption or purchase and cancellation of the relevant Notes set out in this Condition 6.7 shall not apply. For the avoidance of doubt, this provision shall not apply to the Issuer or any of its Subsidiaries holding the Notes in a purely nominee capacity.

Noteholders should note that it is intended that the Notes should constitute Category II Supplementary Capital of the Issuer and, accordingly, under statutory requirements prevailing at the date hereof relating to Category II Supplementary Capital, and by virtue of the above provisions, any redemption of the Notes, other than at maturity or following an event of default, and any purchase of the Notes by the Issuer or any of its Subsidiaries, is subject to the prior written consent of the HKMA at the relevant time.

7 TAXATION

7.1 Payment without Withholding or Deduction

All payments of principal, premium (if any) and interest by or on behalf of the Issuer in respect of the Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or within the Relevant Jurisdiction, unless such withholding or deduction is required by

law. In that event the Issuer shall pay such additional amounts as will result in receipt by the Noteholders of such amounts as would have been received by them had no such withholding or deduction been required, except that no such additional amounts shall be payable in respect of any Note:

- (a) to a holder (or to a third party on behalf of a holder) who is subject to such taxes, duties, assessments or governmental charges in respect of such Note by reason of his having some connection with the Relevant Jurisdiction otherwise than merely by holding the Note or by the receipt of amounts in respect of the Note; or
- (b) (in the case of a payment of principal or premium) if the Certificate in respect of such Note is surrendered more than 30 days after the Relevant Date except to the extent that the holder would have been entitled to such additional amount on surrendering the relevant Certificate for payment on the last day of such period of 30 days; or
- (c) 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
- (d) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a Member State of the European Union.

7.2 Interpretation

In these Conditions:

- (a) “**Relevant Date**” means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received in New York City by the Principal Paying 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 shall have been given to the Noteholders; and
- (b) “**Relevant Jurisdiction**” means the Hong Kong Special Administrative Region of the People’s Republic of China (“**Hong Kong**”) or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal or interest on the Notes.

7.3 Additional Amounts

Any reference in these Conditions to principal, premium (if any) and/or interest in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable under this Condition or under any undertaking given in addition to or substitution for it under the Trust Deed.

8 PRESCRIPTION

Claims in respect of principal and interest will become prescribed unless made within 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date.

9 EVENTS OF DEFAULT

- 9.1** If default is made in the payment of principal or interest due in respect of the Notes or any of them and the default continues for a period of five Business Days in Hong Kong (in the case of principal) or 10 Business Days in Hong Kong (in the case of interest) (each such event, an “**Event of Default**”), then the Trustee at its discretion may, subject as provided in Condition 10.2, in order to enforce payment, without further notice, institute Winding-Up Proceedings in Hong Kong against the Issuer, but may take no further action in respect of such default (but without prejudice to Condition 9.2 below).
- 9.2** If an order is made or an effective resolution is passed for the Winding-Up of the Issuer in Hong Kong (except for the purposes of a reconstruction, amalgamation or reorganisation the terms of which have previously been approved by an Extraordinary Resolution of the Noteholders) (such event also, an “**Event of Default**”), then the Trustee at its discretion may, subject as provided in Condition 10.2, give written notice to the Issuer that the Notes are, and they shall forthwith thereupon become, immediately due and repayable at their principal amount together with accrued interest without further action or formality.

In these Conditions:

“**Winding-Up**” shall mean, with respect to the Issuer, a final and effective order or resolution for the bankruptcy, winding-up, liquidation, administrative receivership or similar proceeding in respect of the Issuer (as applicable); and

“**Winding-Up Proceeding**” shall mean, with respect to the Issuer, proceedings in Hong Kong for the bankruptcy, liquidation, winding-up, administrative receivership, or other similar proceeding of the Issuer (as applicable).

10 ENFORCEMENT

- 10.1** Without prejudice to Condition 9, the Trustee may, subject as provided below, at its discretion and without further notice, institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer under the Notes or the Trust Deed (other than any obligation for the payment of any principal or interest in respect of the Notes), provided that the Issuer shall not as a consequence of such proceedings be obliged to pay any sum or sums representing or measured by reference to principal or interest in respect of the Notes sooner than the same would otherwise have been payable by it.
- 10.2** The Trustee shall not be bound to take action as referred to in Condition 9 or Condition 10.1 above or any other action under the Trust Deed unless (i) it shall have been so requested in writing by Noteholders holding at least one-quarter of the principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders and (ii) it shall have been indemnified and/or secured to its satisfaction.
- 10.3** No Noteholder shall be entitled to proceed directly against the Issuer unless the Trustee having become bound so to proceed, fails to do so within a reasonable period and such failure is continuing. Subject to applicable laws, no remedy (including the exercise of any right of set-off or analogous event) other than those provided for in Condition 9 and Conditions 10.1 and 10.2 or submitting a claim in the Winding-Up of the Issuer will be available to the Trustee or the Noteholders. No Noteholder shall be entitled to institute Winding-Up Proceedings in Hong Kong (or elsewhere) against the Issuer or to submit a claim in such Winding-Up except that, if the Trustee, having become bound to institute such proceedings as aforesaid, fails to do so, or, being able and bound to submit a claim in such Winding-Up, fails to do so, in each case within a reasonable period and such failure is continuing, then any such holder may, himself institute Winding-Up Proceedings against the Issuer in Hong Kong (but not elsewhere) and/or submit a claim in such Winding-Up to the same extent (but not further or otherwise) that the Trustee would have been entitled to do.

11 REPLACEMENT OF CERTIFICATES

Should any Certificate be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

12 NOTICES

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the Register maintained by the Registrar. The Issuer shall also ensure that notices are duly given in a manner which complies with the rules and regulations of any stock exchange on which the Notes are for the time being listed. Any such notice will be deemed to have been given on the second day after being so mailed. If notification as provided above is not practicable, notice shall be given in such other manner, and shall be deemed to have been given on such date, as the Trustee may approve.

So long as the Notes are represented by a Global Certificate 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 the entitled accountholders in substitution for notification, as required by these Conditions.

13 MEETING OF NOTEHOLDERS, MODIFICATION ETC.

13.1 Provisions for Meetings

The Trust Deed contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification by Extraordinary Resolution of any of these Conditions or any of the provisions of the Trust Deed. Such a meeting may be convened by the Issuer or by the Trustee and shall be convened by the Trustee upon the request in writing of Noteholders holding not less than one-tenth of the aggregate principal amount of the outstanding Notes. The quorum at any meeting for passing an Extraordinary Resolution will be two or more persons present holding or representing more than 50 per cent. in principal amount of the Notes for the time being outstanding, or at any adjourned meeting two or more persons present whatever the principal amount of the Notes held or represented by him or them, except that at any meeting the business of which includes the modification of certain of the provisions of these Conditions and certain of the provisions of the Trust Deed (including any proposal to change the maturity of the Notes, 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 12 shall not be a reserved matter)) the necessary quorum for passing an Extraordinary Resolution will be two or more persons present holding or representing not less than two-thirds, or at any adjourned meeting not less than one-third, of the principal amount of the Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders will be binding on all Noteholders, whether or not they are present at the meeting.

In addition, a resolution in writing signed by or on behalf of Noteholders of at least 90 per cent. in aggregate principal amount of Notes for the time being outstanding who for the time being are entitled to receive notice of a meeting of Noteholders will take effect as if 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.

13.2 Modification and Waiver

The Trustee may, without the consent of the Noteholders agree 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 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. No modification to these Conditions or any other provisions of the Trust Deed shall become effective unless the Issuer shall have received prior written approval 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 as soon as practicable thereafter in accordance with Condition 12.

13.3 Exercise of Powers by Trustee

In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution), the Trustee shall have regard to the general interests of the Noteholders as a class but 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 any such exercise for individual Noteholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub division thereof and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer 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 7 and/or any undertaking given in addition to, or in substitution for, Condition 7 pursuant to the Trust Deed.

14 SUBSTITUTION

The Trustee may, without the consent of the Noteholders, agree with the Issuer to the substitution in place of the Issuer (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 3) of a Subsidiary of the Issuer, or a holding company of the Issuer or any other subsidiary of any such holding company (in each case, the “**Substitute Issuer**”), subject to (a) the prior written approval of the HKMA (if and to the extent then required), (b) the Trustee being satisfied that the interests of the Noteholders will not be materially prejudiced by the substitution, (c) (unless the Issuer’s successor in business is the Substituted Issuer) the obligations of the Substitute Issuer in these Conditions shall be guaranteed by the Issuer on equivalent terms to Condition 3 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 Agency Agreement provided that such change would not in the opinion of the Trustee be materially prejudicial to the interests of the Noteholders.

15 INDEMNIFICATION OF THE TRUSTEE

The Trust Deed contains provisions for the indemnification of, and/or the provision of security for, the Trustee and for its relief from responsibility. The Trustee is entitled to enter into business transactions with the Issuer and any entity related to the Issuer without accounting for any profit.

The Trustee may rely without liability to Noteholders on a report, confirmation or certificate or any advice of any accountants, financial advisers, financial institution or any other expert, whether or not addressed to it and whether their liability in relation thereto is limited (by its terms or by any engagement letter relating thereto entered into by the Trustee or in any other manner) by reference to a monetary cap, methodology or otherwise. The Trustee may accept and shall be entitled to rely on any such report, confirmation or certificate or advice and such report, confirmation or certificate or advice shall be binding on the Issuer, the Trustee and the Noteholders.

16 FURTHER ISSUES

The Issuer is at liberty from time to time, without the consent of the Noteholders, to create and issue further notes or bonds (whether in bearer or registered form) either (a) ranking *pari passu* in all respects (or in all respects save for the first payment of interest thereon) and so that the same shall be consolidated and form a single series with the outstanding notes or bonds of any series (including the Notes) or (b) upon such terms as to ranking, interest, conversion, redemption and otherwise as the Issuer may determine at the time of the issue. Any further notes or bonds forming a single series with the outstanding notes or bonds of any series (including the Notes) constituted by the Trust Deed or any supplemental deed shall, and any other further notes or bonds may (with the consent of the Trustee), be constituted by a deed supplemental to the Trust Deed. The Trust Deed contains provisions for convening a single meeting of the Noteholders and the holders of notes or bonds of other series in certain circumstances where the Trustee so decides.

17 CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

18 GOVERNING LAW AND SUBMISSION TO JURISDICTION

18.1 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 Clause 5 of the Trust Deed and Condition 3 shall be governed by, and construed in accordance with, Hong Kong law.

18.2 Jurisdiction of English Courts

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 and accordingly any suit, action or proceedings arising out of or in connection therewith (together referred to as “**Proceedings**”) may be brought in the courts of England. Pursuant to the Trust Deed, the Issuer has irrevocably and unconditionally submitted to the jurisdiction of such courts.

18.3 Appointment of Process Agent

Pursuant to the Trust Deed, the Issuer has irrevocably and unconditionally appointed its London branch at its registered office for the time being (now at 75 Shaftesbury Avenue, London W1D 5BB, United Kingdom (Attention: General Manager)) as its agent for service of process in England in respect of any Proceedings.

SUMMARY OF PROVISIONS RELATING TO THE NOTES WHILE IN GLOBAL FORM

The Global Certificate contains provisions, which apply to the Notes in respect of which the Global 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 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 Certificate is issued. The Trustee may allow a person with an interest in Notes in respect of which the Global 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 Certificate and in the Register of Noteholders.

TRUSTEE'S POWERS

In considering the interests of Noteholders while the Global 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 their Notes and (b) consider such interests on the basis that such accountholders were the holders of the Notes in respect of which the Global Certificate is issued.

PAYMENT

Payments of principal and interest in respect of Notes represented by the Global 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 Certificate to or to the order of the Principal Paying Agent or such other Agent as shall have been notified to the Noteholders for such purpose. Each payment will be made to, or to the order of, the person whose name is entered on the Register at the close of business on the Clearing System Business Day immediately prior to the date for payment, where Clearing System Business Day means Monday to Friday inclusive except 25 December and 1 January.

NOTICES

So long as Notes are represented by the Global Certificate and such Global Certificate is held on behalf of Euroclear or Clearstream or any alternative clearing system on behalf of which the Notes evidenced by the Global 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 Notes 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 in exchange for interests in Notes in respect of which the Global 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

Transfers of interests in the Notes 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 principal amount of Notes in respect of which the Global Certificate is issued (in which regard any certificate or other document issued by Euroclear or Clearstream (or any Alternative Clearing System) as to the principal amount of Notes represented by such Global 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.

TAXATION

The statements herein regarding taxation are based on the laws and practice in force as at the date of this Offering Circular and are subject to any changes in law or practice 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 Notes.

HONG KONG

Withholding Tax

No withholding tax is payable in Hong Kong in respect of payments of principal or interest on the Notes or in respect of any capital gains arising from the sale of the Notes.

Profits Tax

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 company, 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 person, other than a company, carrying on a trade, profession or business in Hong Kong and is in respect of the funds of that trade, profession or business and such interest is of a Hong Kong source; or
- (iii) 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, notwithstanding that the moneys in respect of which the interest is received or accrues are made available outside Hong Kong.

Pursuant to the Exemption from Profits Tax (Interest Income) Order, interest income 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*, a financial 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 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 has a Hong Kong source. However, where the sum is considered to be a capital gain in the hands of the investor who is not a financial institution, such capital gain will not be subject to Hong Kong profits tax.

Stamp Duty

No Hong Kong stamp duty is payable on the issue of a note not in bearer form. If the transfer of a non-bearer note is required to be registered in Hong Kong, stamp duty will be payable unless:

- (i) the note is denominated in a currency other than the currency of Hong Kong and is not repayable in any circumstance in the currency of Hong Kong; or
- (ii) the note constitutes loan capital (as defined in the Stamp Duty Ordinance (Cap. 117) of Hong Kong).

No Hong Kong stamp duty will be chargeable upon the issue or subsequent transfer of the Notes.

Estate Duty

No estate duty will be payable in respect of the Notes.

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 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.

SUBSCRIPTION AND SALE

SUBSCRIPTION AGREEMENT

The Issuer has entered into a subscription agreement with Citigroup Global Markets Limited, J.P. Morgan Securities Ltd. (together, the “Joint Lead Managers”), BOCI Asia Limited, Crédit Agricole Corporate and Investment Bank, The Hongkong and Shanghai Banking Corporation Limited (together, the “Co-Managers”, and together with the Joint Lead Managers, the “Managers”), dated 9 July 2010 (the “Subscription Agreement”), pursuant to which and subject to certain conditions contained therein, the Issuer agreed to sell to the Managers, and the Managers agreed to severally but not jointly subscribe and pay for the aggregate principal amount of the Notes indicated opposite its name in the following table. In addition, the Issuer has agreed to reimburse the Managers for certain of its expenses in connection with the issue of the Notes.

| | <u>Aggregate principal amount of Notes</u> |
|---|--|
| Citigroup Global Markets Limited | U.S.\$217,500,000 |
| J.P. Morgan Securities Ltd. | U.S.\$217,500,000 |
| BOCI Asia Limited | U.S.\$ 5,000,000 |
| Crédit Agricole Corporate and Investment Bank | U.S.\$ 5,000,000 |
| The Hongkong and Shanghai Banking Corporation Limited | U.S.\$ 5,000,000 |
| Total | <u>U.S.\$450,000,000</u> |

The Subscription Agreement provides that the Issuer will indemnify the Managers against certain liabilities in connection with the offer and sale of the Notes. The Subscription Agreement provides that the obligations of the Managers are subject to certain conditions precedent, and entitles the Joint Lead Managers (on behalf of the Managers) to terminate it in certain circumstances prior to payment being made to the Issuer.

The Managers and certain of their affiliates may have performed certain investment banking and advisory services for the Issuer and/or its affiliates from time to time for which they have received customary fees and expenses and may, from time to time, engage in transactions with and perform services for the Issuer and/or its affiliates in the ordinary course of their business. The Managers or certain of their affiliates may purchase the Notes and be allocated the Notes for asset management and/or proprietary purposes but not with a view to distribution.

The Managers or their respective affiliates may purchase the Notes for its or their own account and enter into transactions, including credit derivatives, such as asset swaps, repackaging and credit default swaps relating to the Notes and/or other securities of the Issuer or its subsidiaries or associates at the same time as the offer and sale of the Notes or in secondary market transactions. Such transactions would be carried out as bilateral trades with selected counterparties and separately from any existing sale or resale of the Notes to which this Offering Circular relates (notwithstanding that such selected counterparties may also be purchasers of the Notes).

SELLING RESTRICTIONS

General

The distribution of this Offering Circular or any offering material and the offering, sale or delivery of the Notes is restricted by law in certain jurisdictions. Therefore, persons who may come into possession of this Offering Circular or any offering material are advised to consult with their own legal advisers as to what restrictions may be applicable to them and to observe such restrictions. This Offering Circular may not be used for the purpose of an offer or invitation in any circumstances in which such offer or invitation is not authorised.

United States

The Notes have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in accordance with Regulation S or pursuant to any other exemption from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.

The Managers have agreed that it will offer, and sell the Notes (i) as part of their distribution at any time and (ii) otherwise until 40 days after the later of the commencement of the offering and the Closing Date, only in accordance with Rule 903 of Regulation S under the Securities Act, and it will have sent to each dealer to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S.

The Notes are being offered and sold outside of the United States to non-U.S. persons in reliance on Regulation S. In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”), each of the Managers has represented 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 Notes which are the subject of the offering contemplated by this Offering Circular as completed by the final terms in relation thereto to the public in that Relevant Member State except that it may, with effect from and including the Relevant Implementation Date, make an offer of such Notes to the public in that Relevant Member State:

- (i) if the final terms in relation to the Notes specify that an offer of those Notes may be made other than pursuant to Article 3(2) of the Prospectus Directive in that Relevant Member State (a “**Non-exempt Offer**”), following the date of publication of a prospectus in relation to such Notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, provided that any such prospectus has subsequently been completed by the final terms contemplating such Non-exempt Offer, in accordance with the Prospectus Directive, in the period beginning and ending on the dates specified in such prospectus or final terms, as applicable;
- (ii) at any time 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;
- (iii) at any time to any legal entity which has two or more of (a) an average of at least 250 employees during the last financial year; (b) a total balance sheet of more than €43,000,000 and (c) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts;
- (iv) at any time 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 nominated by the Issuer for any such offer; or

- (v) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive, provided that no such offer of Notes referred to in (ii) to (v) above shall require the Issuer or any Manager to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of Notes to the public” in relation to any Notes 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 Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, 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 in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; 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 Notes in, from or otherwise involving the United Kingdom.

Hong Kong

Each of the Managers has represented 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 Notes other than (a) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance; 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 or which do not constitute an offer to the public within the meaning of that Ordinance; and
- (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, in each case whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Notes, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance.

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 Notes or caused such Notes to be made the subject of an invitation for subscription or purchase and will not offer or sell such Notes or cause such Notes 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 such Notes, 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.

Note:

Where the Notes are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

- (a) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or
- (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

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 Notes pursuant to an offer made under Section 275 of the SFA except:

- (i) to an institutional investor or to a relevant person defined in Section 275(2) of the SFA, or to any person arising from an offer referred to in Section 275(1A) or Section 276(4)(i)(B) of the SFA;
- (ii) where no consideration is or will be given for the transfer;
- (iii) where the transfer is by operation of law; or
- (iv) as specified in Section 276(7) of the SFA.

Japan

Each of the Managers has represented and warranted that the Notes have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (the “**Financial Instruments and Exchange Act**”) and that it has not, directly or indirectly, offered or sold and will not, directly or indirectly, offer or sell any Notes in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan) or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of, a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Act and any other applicable laws and regulations of Japan.

GENERAL INFORMATION

1. **Clearing Systems:** The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg with the Common Code of 052107342. The International Securities Identification Number (ISIN) for the Notes is XS0521073428.
2. **Listing:** Approval in-principle has been received for the listing of the Notes 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.
3. **Litigation:** Neither the Issuer nor any of its subsidiaries 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, nor is the Issuer or any of its subsidiaries aware that any such proceedings are pending or threatened.
4. **Authorisations:** The Issuer has obtained all necessary consents, approvals and authorisations as may be required in connection with the issue and performance of the Notes, including, but not limited to, approval by the HKMA. The issue of the Notes was authorised by resolutions of the Committee of the Board of Directors of the Issuer passed on 23 June 2010.
5. **No Material Adverse Change:** There has been no significant change in the financial or trading position of the Issuer and the Group since 31 December 2009 and no material adverse change in the financial position or prospects of the Group since 31 December 2009.
6. **Available Documents:** Copies of the following documents may be inspected at a specified office of the Principal Paying Agent at Deutsche Bank AG, Hong Kong Branch, 48th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong:
 - (a) the Memorandum and Articles of Association of the Issuer;
 - (b) a copy of the auditors' reports of KPMG, the Issuer's external auditors, and the audited consolidated financial statements of the Issuer as at and for the years ended 31 December 2007, 2008 and 2009;
 - (c) copies of the most recent annual and interim reports (including the financial statements) published by the Issuer; and
 - (d) the Trust Deed and the Agency Agreement, each to be dated on or about 16 July 2010.

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 Issuer and interim unaudited consolidated financial statements published by the Issuer, will be made available free of charge at a specified office of the Principal Paying Agent at Deutsche Bank AG, Hong Kong Branch, 48th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

7. **Auditors:** The consolidated financial statements of the Issuer as at and for the years ended 31 December 2007, 2008 and 2009 included in this Offering Circular have been audited by KPMG, Certified Public Accountants, as stated in the auditors' report appearing in this Offering Circular in relation to such consolidated financial statements.

KPMG has given and not withdrawn its consent to the issue of this Offering Circular with references to its auditors' reports on the published annual consolidated financial statements of the Issuer for the years ended 31 December 2007, 2008 and 2009 in the form and context in which they appear.

KPMG has audited and rendered unqualified audit reports on the financial statements of the Issuer for the years ended 31 December 2007, 2008 and 2009.

8. 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 Certificate is exchanged for definitive Certificates, the Issuer 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 Certificate is exchanged for definitive Certificates, an announcement of such exchange shall be made by or on behalf of the Issuer 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.

The information set forth below has been extracted without material adjustment from the Bank's audited consolidated financial statements for the year ended 31 December 2009.

**Report of the Auditors and Audited Financial Statements of The Bank of East Asia, Limited
as at and for the Year Ended 31 December 2009**

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**Report of the Auditors and Audited Financial Statements of The Bank of East Asia, Limited
as at and for the Year Ended 31 December 2008**

| | |
|--|-------|
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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-3 to F-106, which comprise the consolidated and the Bank statement of financial position as at 31st December 2009, and the consolidated income statement, the consolidated statement of comprehensive income, 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 accounts give a true and fair view of the state of affairs of the Bank and of the Group as at 31st December, 2009 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

11th February, 2010

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2009

| | | <u>2009</u> | <u>2008</u> |
|--|-------|----------------|-----------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| Interest income | 4 | 12,121 | 17,465 |
| Interest expense | 5 | <u>(5,374)</u> | <u>(10,672)</u> |
| Net interest income | | 6,747 | 6,793 |
| Fee and commission income | 6 | <u>2,799</u> | <u>2,618</u> |
| Fee and commission expense | | <u>(537)</u> | <u>(473)</u> |
| Net fee and commission | | 2,262 | 2,145 |
| Net trading profits/(losses) | 7 | 941 | (1,292) |
| Net result from financial instruments designated at fair value through profit or loss | 8 | (267) | (1,612) |
| Other operating income | 9 | 505 | 423 |
| Non-interest income/(expense) | | <u>3,441</u> | <u>(336)</u> |
| Operating income | | 10,188 | 6,457 |
| Operating expenses | 10 | <u>(6,129)</u> | <u>(5,779)</u> |
| Operating profit before impairment losses | | 4,059 | 678 |
| Impairment losses on loans and advances | 11 | (1,105) | (558) |
| Impairment losses on held-to-maturity investments | 27 | (9) | (44) |
| Impairment losses on available-for-sale financial assets | | (14) | (352) |
| (Charge for)/Write back of impairment losses on bank premises | 31 | <u>(13)</u> | <u>6</u> |
| Impairment losses | | <u>(1,141)</u> | <u>(948)</u> |
| Operating profit/(loss) after impairment losses | | 2,918 | (270) |
| Net (loss)/profit on sale of held-to-maturity investments | | (12) | 25 |
| Net profit on sale of available-for-sale financial assets | 12 | 102 | 197 |
| Net profit on sale of loans and receivables | | 2 | 1 |
| Net loss on sale of subsidiaries/associates | | — | (8) |
| Net profit on sale of fixed assets | | 16 | 178 |
| Valuation gains/(losses) on investment properties | 31 | 206 | (168) |
| Share of profits less losses on associates | | 264 | 53 |
| Profit for the year before taxation | | 3,496 | 8 |
| Income tax | 13 | <u>(858)</u> | <u>96</u> |
| Profit for the year after taxation | | <u>2,638</u> | <u>104</u> |
| Attributable to: | | | |
| Owners of the parent | | 2,565 | 39 |
| Minority interest | 39 | <u>73</u> | <u>65</u> |
| Profit after taxation | | <u>2,638</u> | <u>104</u> |
| Earnings per share | | HK\$ | HK\$ |
| Basic | 16 | 1.36 | 0.02 |
| Diluted | 16 | 1.36 | 0.02 |

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31ST DECEMBER, 2009

| | | <u>2009</u> | <u>2008</u> |
|---|-------|---------------------|---------------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| Net profit. | | <u>2,638</u> | <u>104</u> |
| Other comprehensive income/(expense) for the year (after taxation and reclassification adjustments): | | | |
| Premises: | | | |
| - unrealised surplus on revaluation of premises | 38(c) | 97 | 10 |
| - deferred taxes | 38(c) | (26) | 13 |
| - effect on opening balance resulting from decrease in tax rate | | — | (10) |
| - exchange differences. | | — | (1) |
| Available-for-sale investment revaluation reserve: | | | |
| - fair value changes taken to/(from) equity | 38(h) | 575 | (839) |
| - fair value changes transferred from/(to) income statement: | | | |
| - on impairment and amortisation. | 38(h) | 11 | 153 |
| - on disposal | 38(h) | (29) | (115) |
| - deferred taxes | 38(h) | (43) | 93 |
| - effect on opening balance resulting from decrease in tax rate | | — | 5 |
| Share of changes in equity of associates | 38(i) | 17 | (22) |
| Exchange differences on translation of: | | | |
| - financial statements of overseas branches, subsidiaries and associates | 38(f) | <u>163</u> | <u>356</u> |
| Other comprehensive income/(expense). | | <u>765</u> | <u>(357)</u> |
| Total comprehensive income/(expense). | | <u><u>3,403</u></u> | <u><u>(253)</u></u> |
| Total comprehensive income/(expense) attributable to: | | | |
| Owners of the parent | | 3,330 | (318) |
| Minority interest. | 39 | <u>73</u> | <u>65</u> |
| | | <u><u>3,403</u></u> | <u><u>(253)</u></u> |

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER, 2009

| | | <u>2009</u> | <u>2008</u> |
|--|-------|-------------|-------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| ASSETS | | | |
| Cash and balances with banks and other financial institutions . . | 20 | 29,712 | 28,105 |
| Placements with banks and other financial institutions | 21 | 67,945 | 96,574 |
| Trade bills | 22 | 1,847 | 1,164 |
| Trading assets | 23 | 5,722 | 3,437 |
| Financial assets designated at fair value through profit or loss . . | 24 | 10,392 | 4,130 |
| Advances to customers and other accounts | 25 | 261,803 | 243,725 |
| Available-for-sale financial assets | 26 | 30,883 | 18,560 |
| Held-to-maturity investments | 27 | 7,239 | 5,006 |
| Investments in associates | 29 | 2,615 | 2,486 |
| Fixed assets | 31 | 11,467 | 9,146 |
| - Investment properties | | 2,095 | 1,839 |
| - Other property and equipment | | 9,372 | 7,307 |
| Goodwill and intangible assets | 30 | 4,135 | 2,734 |
| Deferred tax assets | 33(b) | 322 | 187 |
| Total Assets | | 434,082 | 415,254 |
| EQUITY AND LIABILITIES | | | |
| Deposits and balances of banks and other financial institutions . | | 11,886 | 27,045 |
| Deposits from customers | | 342,528 | 323,802 |
| Trading liabilities | 34(a) | 1,455 | 2,846 |
| Certificates of deposit issued | | 2,812 | 5,491 |
| - At fair value through profit or loss | | 2,442 | 3,777 |
| - At amortised cost | | 370 | 1,714 |
| Current taxation | 33(a) | 147 | 333 |
| Debt securities issued | | 4,346 | — |
| Deferred tax liabilities | 33(b) | 520 | 77 |
| Other accounts and provisions | 34(b) | 18,506 | 12,139 |
| Loan capital | 35 | 12,359 | 11,036 |
| - At fair value through profit or loss | | 7,712 | 6,395 |
| - At amortised cost | | 4,647 | 4,641 |
| Total Liabilities | | 394,559 | 382,769 |
| Share capital | 37 | 4,623 | 4,183 |
| Reserves | 38 | 30,542 | 27,963 |
| Total equity attributable to owners of the parent | | 35,165 | 32,146 |
| Minority interest | 39 | 4,358 | 339 |
| Total Equity | | 39,523 | 32,485 |
| Total Equity and Liabilities | | 434,082 | 415,254 |

Approved and authorised for issue by the board of Directors on 11th February, 2010.

Chairman and Chief Executive

Directors

THE BANK OF EAST ASIA, LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER, 2009

| | | <u>2009</u> | <u>2008</u> |
|--|-------|-------------|-------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| ASSETS | | | |
| Cash and balances with banks and other financial institutions . . | 20 | 12,527 | 4,852 |
| Placements with banks and other financial institutions | 21 | 61,894 | 92,735 |
| Trade bills | 22 | 861 | 521 |
| Trading assets | 23 | 3,324 | 2,914 |
| Financial assets designated at fair value through profit or loss . . | 24 | 10,384 | 4,114 |
| Advances to customers and other accounts | 25 | 148,596 | 138,640 |
| Amounts due from subsidiaries | 32(a) | 12,719 | 16,398 |
| Available-for-sale financial assets | 26 | 18,935 | 10,985 |
| Held-to-maturity investments | 27 | 4,802 | 3,318 |
| Investments in subsidiaries | 28 | 13,457 | 11,673 |
| Investments in associates | 29 | 1,946 | 1,984 |
| Fixed assets | 31 | 6,220 | 5,587 |
| - Investment properties | | 1,798 | 1,819 |
| - Other property and equipment | | 4,422 | 3,768 |
| Goodwill and intangible assets | 30 | 1,460 | 1,460 |
| Deferred tax assets | 33(b) | 168 | 38 |
| Total Assets | | 297,293 | 295,219 |
| EQUITY AND LIABILITIES | | | |
| Deposits and balances of banks and other financial institutions . | | 3,521 | 1,093 |
| Deposits from customers | | 237,517 | 240,029 |
| Trading liabilities | 34(a) | 1,235 | 2,549 |
| Certificates of deposit issued | | 5,012 | 7,691 |
| - At fair value through profit or loss | | 2,442 | 3,777 |
| - At amortised cost | | 2,570 | 3,914 |
| Amounts due to subsidiaries | 32(b) | 1,642 | 1,994 |
| Current taxation | 33(a) | 18 | 60 |
| Deferred tax liabilities | 33(b) | 333 | 63 |
| Other accounts and provisions | 34(b) | 3,548 | 3,479 |
| Loan capital | 35 | 16,275 | 11,036 |
| - At fair value through profit or loss | | 11,628 | 6,395 |
| - At amortised cost | | 4,647 | 4,641 |
| Total Liabilities | | 269,101 | 267,994 |
| Share capital | 37 | 4,623 | 4,183 |
| Reserves | 38 | 23,569 | 23,042 |
| Total equity attributable to owners of the Bank | | 28,192 | 27,225 |
| Total Equity and Liabilities | | 297,293 | 295,219 |

Approved and authorised for issue by the Board of Directors on 11th February, 2010.

Chairman and Chief Executive

Directors

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31ST DECEMBER, 2009

| | Share capital | Share premium | Capital reserve —staff share options issued | Exchange revaluation reserve | Investment revaluation reserve | Revaluation reserve of bank premises | Capital reserve | General reserve | Other reserves | Retained profits | Total | Minority interest | Total 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 |
| 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 | 17 | (17) | — | — | — | — | — | 177 | — | — | 177 | — | 177 |
| Capitalisation issue | 418 | (418) | — | — | — | — | — | — | — | — | — | — | — |
| Shares issued under Staff Shares Option Schemes | 5 | 36 | — | — | — | — | — | — | — | — | 41 | — | 41 |
| Equity settled share-based transaction | — | — | 71 | — | — | — | — | — | — | — | 71 | — | 71 |
| Transfer | — | 3 | (26) | — | — | (6) | — | 55 | 285 | (311) | — | — | — |
| Dividends declared or approved during the year | — | — | — | — | — | — | — | — | — | (600) | (600) | (55) | (655) |
| Sale of interests in businesses to minority interests investors | — | — | — | — | — | — | — | — | — | — | — | 132 | 132 |
| Purchase of interests in businesses from minority interests investors | — | — | — | — | — | — | — | — | — | — | — | (10) | (10) |
| Hybrid Tier 1 note issue | — | — | — | — | — | — | — | — | — | — | — | 3,877 | 3,877 |
| Exchange adjustments | — | — | — | — | — | — | — | — | — | — | — | 2 | 2 |
| Total comprehensive income for the year | — | — | — | 163 | 514 | 71 | — | — | 17 | 2,565 | 3,330 | 73 | 3,403 |
| At 31st December, 2009 | <u>4,623</u> | <u>4,526</u> | <u>170</u> | <u>1,169</u> | <u>286</u> | <u>928</u> | <u>86</u> | <u>14,866</u> | <u>1,518</u> | <u>6,993</u> | <u>35,165</u> | <u>4,358</u> | <u>39,523</u> |
| As 1st January, 2008 | 3,936 | 1,118 | 68 | 650 | 475 | 866 | 86 | 14,004 | 22 | 8,874 | 30,099 | 347 | 30,446 |
| Changes in equity | | | | | | | | | | | | | |
| Shares issued in lieu of dividend | 38 | (38) | — | — | — | — | — | 597 | — | — | 597 | — | 597 |
| Subscription of new shares | 197 | 3,745 | — | — | — | — | — | — | — | — | 3,942 | — | 3,942 |
| Shares issued under Staff Shares Option Schemes | 12 | 88 | — | — | — | — | — | — | — | — | 100 | — | 100 |
| Equity settled share-based transaction | — | — | 66 | — | — | — | — | — | — | — | 66 | — | 66 |
| Transfer | — | 9 | (9) | — | — | (15) | — | 33 | 1,216 | (1,234) | — | — | — |
| Dividends declared or approved during the year | — | — | — | — | — | — | — | — | — | (2,340) | (2,340) | (7) | (2,347) |
| Purchase of interests in businesses from minority interests investors | — | — | — | — | — | — | — | — | — | — | — | (64) | (64) |
| Exchange adjustments | — | — | — | — | — | — | — | — | — | — | — | (2) | (2) |
| Total comprehensive income/(expense) for the year | — | — | — | 356 | (703) | 12 | — | — | (22) | 39 | (318) | 65 | (253) |
| At 31st December, 2008 | <u>4,183</u> | <u>4,922</u> | <u>125</u> | <u>1,006</u> | <u>(228)</u> | <u>863</u> | <u>86</u> | <u>14,634</u> | <u>1,216</u> | <u>5,339</u> | <u>32,146</u> | <u>339</u> | <u>32,485</u> |

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2009

| | | <u>2009</u> | <u>2008</u> |
|--|-------|--------------|--------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| OPERATING ACTIVITIES | | | |
| Profit for the year before taxation | | 3,496 | 8 |
| Adjustments for: | | | |
| Charge for impairment losses on loans and advances | 11 | 1,105 | 558 |
| Charge for impairment allowances on held-to-maturity investments, available-for-sale financial assets and associates | | 23 | 396 |
| Share of profits less losses of associates | | (264) | (53) |
| Net loss/(profit) on sale of held-to-maturity investments . . | | 12 | (25) |
| Net profit on sale of available-for-sale financial assets . . . | | (102) | (197) |
| Net loss on sale of subsidiaries, associates and equities . . | | — | 8 |
| Net profit on sale of fixed assets | | (16) | (178) |
| Interest expense on loan capital, certificates of deposit and bonds issued | | 641 | 1,014 |
| Depreciation on fixed assets | 10,31 | 512 | 437 |
| Charge for/(Write back of) impairment loss on bank premises | | 13 | (6) |
| Dividend income from available-for-sale financial assets . . | | (46) | (50) |
| Amortisation of intangible assets | 10 | 13 | 3 |
| Amortisation of premium/discount on certificates of deposit and loan capital issued | | 68 | 78 |
| Revaluation losses/(gains) on certificates of deposit and loan capital issued | | 1,236 | (2,624) |
| Valuation (gains)/losses on investment properties | 31 | (206) | 168 |
| Equity-settled share-based payment expenses | | 71 | 66 |
| OPERATING PROFIT/(LOSS) BEFORE CHANGES IN WORKING CAPITAL | | | |
| | | 6,556 | (397) |
| (Increase)/decrease in operating assets: | | | |
| Cash and balances with banks with original maturity beyond three months | | (2,405) | (4,397) |
| Placements with banks and other financial institutions with original maturity beyond three months | | (3,875) | (18,823) |
| Trade bills | | (683) | (352) |
| Trading assets | | (2,617) | 1,410 |
| Financial assets designated at fair value through profit or loss | | (6,262) | 4,525 |
| Advances to customers | | (18,095) | (12,366) |
| Advances to banks and other financial institutions | | 172 | 1,158 |
| Held-to-maturity debt securities | | (2,056) | 5,863 |
| Available-for-sale financial assets | | (11,489) | (6,000) |
| Other accounts and accrued interest | | (1,219) | (1,323) |
| Increase/(decrease) in operating liabilities: | | | |
| Deposits and balances of banks and other financial institutions | | (15,159) | (12,015) |
| Deposits from customers | | 18,726 | 39,616 |
| Trading liabilities | | (1,391) | 474 |
| Other accounts and provisions | | 6,328 | 1,273 |
| Exchange adjustments | | (114) | 362 |

| | | 2009 | 2008 |
|--|----------|-----------------|----------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| NET CASH OUTFLOW FROM OPERATIONS | | (33,583) | (992) |
| Income tax paid | | | |
| Hong Kong profits tax paid | | (53) | (143) |
| Overseas profits tax paid | | (527) | (383) |
| NET CASH USED IN OPERATING ACTIVITIES | | <u>(34,163)</u> | <u>(1,518)</u> |
| INVESTING ACTIVITIES | | | |
| Dividends received from associates | | 190 | 163 |
| Dividends received from available-for-sale equity securities | | 46 | 50 |
| Purchase of equity securities | | (851) | (444) |
| Proceeds from sale of equity securities | | 483 | 512 |
| Purchase of intangible assets | | (1,380) | (6) |
| Purchase of fixed assets | 31 | (2,561) | (2,557) |
| Purchase of investment properties | | — | (291) |
| Proceeds from disposal of fixed assets | | 50 | 213 |
| Disposal/(Purchase) of shareholding in associates | | 36 | (18) |
| Proceeds from disposal of associates | | — | 51 |
| Purchase of subsidiaries | 43(a) | (43) | (21) |
| Proceeds from sale of interest in a subsidiary | 43(b) | 1 | — |
| Sale of interests in business to minority interest investors | | 132 | — |
| Purchase of interests in business from minority interest investors | | (10) | (64) |
| NET CASH USED IN INVESTING ACTIVITIES | | <u>(3,907)</u> | <u>(2,412)</u> |
| FINANCING ACTIVITIES | | | |
| Ordinary dividends paid | | (427) | (1,750) |
| Distribution to Hybrid Tier 1 issue holders | | (51) | — |
| Issue of ordinary share capital | 37,38(a) | 41 | 100 |
| Issue of Hybrid Tier 1 note | | 3,877 | — |
| Subscription for new shares | | — | 3,942 |
| Issue of certificates of deposit | | 594 | 4,656 |
| Issue of debt securities | | 4,334 | — |
| Redemption of certificates of deposit issued | | (3,260) | (11,434) |
| Interest paid on loan capital | | (535) | (708) |
| Interest paid on certificates of deposit issued | | (79) | (488) |
| NET CASH GENERATED FROM/(USED IN) FINANCING ACTIVITIES | | <u>4,494</u> | <u>(5,682)</u> |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | | (33,576) | (9,612) |
| CASH AND CASH EQUIVALENTS AT 1ST JANUARY | 43(c) | <u>94,106</u> | <u>103,718</u> |
| CASH AND CASH EQUIVALENTS AT 31ST DECEMBER | 43(c) | <u>60,530</u> | <u>94,106</u> |
| Cash flows from operating activities included: | | | |
| Interest received | | 12,671 | 17,514 |
| Interest paid | | 6,238 | 10,305 |
| Dividend received | | 78 | 93 |

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. Note 3 provides information on the changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these accounts.

(b) Basis of Preparation of the Accounts

The accounts for the year ended 31st December, 2009 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 major sources of estimation uncertainty are discussed in Note 49.

(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.

An investment in a subsidiary is consolidated into the consolidated accounts from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated accounts. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

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 statement of financial position and consolidated 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 income statement as an allocation of the net profit and total comprehensive income for the year between minority interests and equity holders of the Group.

In the Bank's statement of financial position, 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 and any impairment loss relating to the investment (Note 2(j) and 2(k)). The Group's share of the post-acquisition, post-tax results of the associates and any impairment losses for the year are recognised in the consolidated income statement, whereas the Group's share of the post-acquisition post-tax items of the associate's other comprehensive income is recognised in the consolidated statement of comprehensive income.

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 income statement.

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 income statement. Differences arising on translation of available-for-sale equity instruments are recognised in other comprehensive income and accumulated separately in equity in the exchange reserve.

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 other comprehensive income and accumulated separately in equity in the exchange reserve. 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**

Revenue is measured at the fair value of the consideration received or receivable. 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 income statement 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 income statement 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 income statement 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 income statement 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.

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 income statement in the period in which they arise. Upon disposal or repurchase, the difference between the net sales proceeds or the net payment and the carrying value is included in the income statement.

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.

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. Unrealised gains and losses arising from changes in the fair value are recognised in other comprehensive income and accumulated separately in equity, except for impairment losses and foreign exchange gains and losses on monetary items such as debt securities which are recognised in the income statement.

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be measured reliably, and derivatives that are linked to and must be settled by delivery of such unquoted equity securities are carried at cost less impairment losses, if any (Note 2(k)).

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 previously recognised in other comprehensive income shall be reclassified from equity to the income statement.

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 income statement on derecognition.

(v) *Offsetting*

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position 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 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 income statement.

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 in other comprehensive income and accumulated separately in equity in the hedging reserve.

(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 income statement.

The hedging instrument is measured at fair value, with fair value changes recognised in the income statement. 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 income statement 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 statement of financial position 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 income statement, 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 income statement, to the extent that a deficit on revaluation in respect of that same asset had previously been charged to the income statement.

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 HKICPA, 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).

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 income statement 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 statement of financial position 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 arising on a business combination is allocated to each cash-generating unit, or groups of cash generating units, that is expected to benefit from the synergies of the combination 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 and the investment as a whole is tested for impairment whenever there is objective evidence of impairment (Note 2(k)).

Any excess of the Group's interest in the net fair value of the 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 income statement.

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 income statement.

(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 income statement. 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 income statement. 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.

(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 in the fair value reserve is reclassified to the income statement. The amount of the cumulative loss that is recognised in the income statement 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 income statement.

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 income statement in respect of available-for-sale equity securities are not reversed through the income statement. Any subsequent increase in the fair value of such assets is recognised directly in other comprehensive income.

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 income statement.

(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 fair value less costs to sell 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 income statement 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.

Reversals of impairment losses are credited to the income statement 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 HKAS 34, 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, available-for-sale equity securities and unquoted 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. Consequently, if the fair value of an available-for-sale equity security increases in the remainder of the annual period, or in any other period subsequently, the increase is recognised in other comprehensive income and not the income statement.

(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 statement of financial position 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 statement of financial position 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 income statement 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 income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the income statement 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.

Reposessed 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 income statement.

(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 income statement except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.
- (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.

(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 income statement 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.

(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 income statement 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 resulting adjustment to the cumulative fair value recognised in prior years is charged or credited to the income statement 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 equity amount is recognised in capital reserve 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**

Operating segments, and the amounts of each segment item reported in the accounts, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

(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 ACCOUNTING POLICIES

The HKICPA has issued one new HKFRS, a number of amendments to HKFRSs and new Interpretations that are first effective for the current accounting period of the Group and the Bank. Of these, the following developments are relevant to the Group's accounts:

- HKFRS 8, *Operating segments*
- HKAS 1 (revised 2007), *Presentation of financial statements*
- Amendments to HKFRS 7, Financial instruments: *Disclosures — improving disclosures about financial instruments*
- Improvements to HKFRSs (2008)
- Amendments to HKAS 27, *Consolidated and separate financial statements — cost of an investment in a subsidiary, jointly controlled entity or associate*
- Amendments to HKFRS 2, *Share-based payment — vesting conditions and cancellations*
- HK(IFRIC) 13, *Customer loyalty programmes*

The amendments to HKFRS 2 has had no material impact on the Group's accounts as the amendments and interpretations were consistent with policies already adopted by the Group. The impact of the remainder of these developments is as follows:

- HKFRS 8 requires segment disclosure to be based on the way that the Group's chief operating decision maker regards and manages the Group, with the amounts reported for each reportable segment being the measures reported to the Group's chief operating decision maker for the purposes of assessing segment performance and making decisions about operating matters. This contrasts with the presentation of the Group's financial statements into segments based on related products and services and on geographical areas. The adoption of HKFRS 8 has resulted in the presentation of segment information in a manner that is more consistent with internal reporting provided to the Group's most senior executive management, and has resulted in additional reportable segments being identified and presented (see Note 19). Corresponding amounts have been provided on a basis consistent with the revised segment information.
- As a result of the adoption of HKAS 1 (revised 2007), details of changes in equity during the period arising from transactions with equity shareholders in their capacity as such have been presented separately from all other income and expenses in a revised consolidated statement of changes in equity. All other items of income and expense are presented

in the consolidated income statement, if they are recognised as part of profit or loss for the period, or otherwise in a new primary statement, the consolidated statement of comprehensive income. Corresponding amounts have been restated to conform to the new presentation. This change in presentation has no effect on reported profit or loss, total income and expense or net assets for any period presented.

- As a result of the adoption of the amendments to HKFRS 7, the accounts include expanded disclosures in Note 41 about the fair value measurement of the Group’s financial instruments, categorising these fair value measurements into a three-level fair value hierarchy according to the extent to which they are based on observable market data. The Group has taken advantage of the transitional provisions set out in the amendments to HKFRS 7, under which comparative information for the newly required disclosures about the fair value measurements of financial instruments has not been provided.
- The “Improvements to HKFRSs (2008)” comprise a number of minor and non-urgent amendments to a range of HKFRSs which the HKICPA has issued as an omnibus batch of amendments. The impact of these amendments are not considered to be material to the Group, except for the following, which result in changes to the Group’s accounting policies:
 - As a result of amendments to HKAS 28, *Investments in associates*, impairment losses recognised in respect of the associates carried under the equity method are no longer allocated to the goodwill inherent in that carrying value. As a result, when there has been a favourable change in the estimates used to determine the recoverable amount, the impairment loss will be reversed. Previously, the Group allocated impairment losses to goodwill and, in accordance with the accounting policy for goodwill, did not consider the loss to be reversible. In accordance with the transitional provisions in the amendment, this new policy will be applied prospectively to any impairment losses that arise in the current or future periods and previous periods have not been restated.
- The amendments to HKAS 27 have removed the requirement that dividends out of pre-acquisition profits should be recognised as a reduction in the carrying amount of the investment in the investee, rather than as income. As a result, as from 1st January, 2009, all dividends receivable from subsidiaries and associates, whether out of pre- or post-acquisitions profits, will be recognised in the Bank’s profit or loss and the carrying amount of the investment in the investee will not be reduced unless that carrying amount is assessed to be impaired as a result of the investee declaring the dividend. In such cases, in addition to recognising dividend income in profit or loss, the Bank would recognise an impairment loss. In accordance with the transitional provisions in the amendment, this new policy will be applied prospectively to any dividends receivable in the current or future periods and previous periods have not been restated.
- HK(IFRIC) 13 addresses how reporting entities that grant their customers loyalty award credits when buying goods or services should account for their obligation to provide free or discounted goods and services, if and when the customers redeem these credits. HK(IFRIC) 13 requires reporting entities to allocate some of the proceeds of the initial sales to the award credits and recognise these proceeds as revenue when they have fulfilled their obligations to provide goods or services. The effect of the adoption of HK(IFRIC) 13 was not considered to be material for the Group and therefore, the prior year figures have not been restated.

4. INTEREST INCOME

| | 2009 | 2008 |
|---|---------------|---------------|
| | HK\$ Mn | HK\$ Mn |
| Listed securities classified as held-to-maturity or available-for-sale | 264 | 261 |
| Trading assets | | |
| - listed | 13 | 2 |
| - unlisted | 28 | 8 |
| Interest rate swaps | 959 | 917 |
| Financial assets designated at fair value through profit or loss | | |
| - listed | 206 | 128 |
| - unlisted | 81 | 310 |
| Loans, deposits with banks and financial institutions, trade bills, and other unlisted securities that are not at fair value through profit or loss | <u>10,570</u> | <u>15,839</u> |
| Total interest income | <u>12,121</u> | <u>17,465</u> |

Included above is interest income accrued on impaired financial assets of HK\$79 million (2008: HK\$73 million) which includes interest income on effect of discounting of HK\$40 million (2008: HK\$12 million) (Note 25(b)) for the year ended 31st December, 2009.

5. INTEREST EXPENSE

| | <u>2009</u> | <u>2008</u> |
|---|--------------|---------------|
| | HK\$ Mn | HK\$ Mn |
| Customer deposits, deposits of banks and other financial institutions and certificates of deposit issued which are stated at amortised cost | 3,650 | 8,696 |
| Debt securities issued | 61 | — |
| Subordinated notes carried at amortised cost | 68 | 184 |
| Interest rate swaps | 1,015 | 1,062 |
| Financial instruments designated at fair value through profit or loss | 566 | 725 |
| Other borrowings | <u>14</u> | <u>5</u> |
| Total interest expense | <u>5,374</u> | <u>10,672</u> |

6. FEE AND COMMISSION INCOME

Fee and commission income arises from the following services:

| | <u>2009</u> | <u>2008</u> |
|--|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Corporate services | 806 | 818 |
| Credit cards | 554 | 462 |
| Loans, overdrafts and guarantees | 444 | 382 |
| Securities and brokerage | 320 | 255 |
| Other retail banking services | 193 | 187 |
| Trade finance | 141 | 160 |
| Trust and other fiduciary activities | 79 | 102 |
| Others | <u>262</u> | <u>252</u> |
| Total fee and commission income | <u>2,799</u> | <u>2,618</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 | 2,214 | 2,134 |
| Fee income | <u>2,680</u> | <u>2,528</u> |
| Fee expenses | <u>(466)</u> | <u>(394)</u> |

7. NET TRADING PROFITS/(LOSSES)

| | <u>2009</u> | <u>2008</u> |
|--|-------------|----------------|
| | HK\$ Mn | HK\$ Mn |
| Profit on dealing in foreign currencies | 140 | 316 |
| Profit/(Loss) on trading securities | 616 | (618) |
| Net gain/(loss) on derivatives | 153 | (1,032) |
| Loss on other dealing activities | — | (1) |
| Dividend income from listed trading securities | <u>32</u> | <u>43</u> |
| Total net trading profits/(losses) | <u>941</u> | <u>(1,292)</u> |

8. NET RESULT FROM FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

| | <u>2009</u> | <u>2008</u> |
|--|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Revaluation and disposal loss on Collateralised Debt Obligations | — | (3,549) |
| Revaluation (loss)/gain on debts issued | (1,236) | 2,624 |
| Net (loss)/profit on sale of other financial assets designated at fair value through profit or loss. | (42) | 3 |
| Revaluation gain/(loss) on other financial assets designated at fair value through profit or loss. | <u>1,011</u> | <u>(690)</u> |
| Total net result from financial instruments designated at fair value through profit or loss | <u>(267)</u> | <u>(1,612)</u> |

9. OTHER OPERATING INCOME

| | <u>2009</u> | <u>2008</u> |
|--|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Dividend income from available-for-sale financial assets | | |
| - listed | 21 | 20 |
| - unlisted. | 25 | 30 |
| Rental from safe deposit boxes | 82 | 87 |
| Net revenue from insurance activities | 180 | 99 |
| Rental income on properties | 92 | 90 |
| Others | <u>105</u> | <u>97</u> |
| Total other operating income. | <u>505</u> | <u>423</u> |

10. OPERATING EXPENSES

| | 2009 | 2008 |
|--|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Contributions to defined contribution plan* | 193 | 225 |
| Equity-settled share-based payment expenses | 71 | 66 |
| Salaries and other staff costs | 2,905 | 2,689 |
| Total staff costs | 3,169 | 2,980 |
| Premises and equipment expenses excluding depreciation | | |
| - Rental of premises | 458 | 378 |
| - Maintenance, repairs and others | 447 | 445 |
| Total premises and equipment expenses excluding depreciation | 905 | 823 |
| Depreciation on fixed assets (Note 31) | 512 | 437 |
| Amortisation of intangible assets (Note 30(b)) | 13 | 3 |
| Other operating expenses | | |
| - Stamp duty, overseas and PRC** business taxes, and value added taxes | 304 | 373 |
| - Communications, stationery and printing | 272 | 274 |
| - Legal and professional fees | 190 | 193 |
| - Advertising expenses | 179 | 287 |
| - Business promotions and business travel | 114 | 97 |
| - Card related expenses | 91 | 72 |
| - Insurance expenses | 46 | 43 |
| - Donations | 13 | 9 |
| - Audit fee | 9 | 8 |
| - Administration expenses of corporate services | 8 | 7 |
| - Membership fees | 8 | 7 |
| - Bank charges | 6 | 7 |
| - Bank licence | 4 | 4 |
| - Others | 286 | 155 |
| Total other operating expenses | 1,530 | 1,536 |
| Total operating expenses*** | 6,129 | 5,779 |

* Forfeited contributions totalling HK\$4 million (2008: HK\$10 million) 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 (2008: Nil).

** PRC denotes the People's Republic of China.

*** Included in operating expenses are direct operating expenses of HK\$37 million (2008: \$19 million) in respect of investment properties which generated rental income during the year.

11. IMPAIRMENT LOSSES ON LOANS AND ADVANCES

| | 2009 | 2008 |
|--|--------------|------------|
| | HK\$ Mn | HK\$ Mn |
| Net charge for impairment losses on loans and advances | | |
| Individual impairment loss | | |
| - new provisions (Note 25(b)) | 827 | 596 |
| - releases (Note 25(b)) | (75) | (81) |
| - recoveries (Note 25(b)) | (66) | (140) |
| | 686 | 375 |
| Collective impairment loss | | |
| - new provisions (Note 25(b)) | 419 | 183 |
| - releases (Note 25(b)) | — | — |
| Net charge to income statement | 1,105 | 558 |

12. NET PROFIT ON SALE OF AVAILABLE-FOR-SALE FINANCIAL ASSETS

| | <u>2009</u> | <u>2008</u> |
|---|-------------------|-------------------|
| | HK\$ Mn | HK\$ Mn |
| Net revaluation gain transferred from reserves (Note 38(h)) | 29 | 115 |
| Profit arising in current year | <u>73</u> | <u>82</u> |
| | <u><u>102</u></u> | <u><u>197</u></u> |

13. INCOME TAX

(a) Taxation in the consolidated income statement represents:

| | <u>2009</u> | <u>2008</u> |
|--|-------------------|--------------------|
| | HK\$ Mn | HK\$ Mn |
| Current tax - provision for Hong Kong profits tax (Note 33(a)) | <u>73</u> | <u>64</u> |
| Current tax — overseas | | |
| Tax for the year | 479 | 601 |
| Write back of over-provision in respect of prior years | <u>(25)</u> | <u>(35)</u> |
| | <u>454</u> | <u>566</u> |
| Deferred tax (Note 33(b)) | | |
| Origination and reversal of temporary differences | 297 | (712) |
| Movements in the value of investment properties | <u>34</u> | <u>(14)</u> |
| | <u>331</u> | <u>(726)</u> |
| | <u><u>858</u></u> | <u><u>(96)</u></u> |

The provision for Hong Kong profits tax is calculated at 16.5% (2008: 16.5%) 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/(credit) and accounting profit at applicable tax rates:

| | <u>2009</u> | <u>2008</u> |
|---|-------------------|--------------------|
| | HK\$ Mn | HK\$ Mn |
| Profit before tax | <u>3,496</u> | <u>8</u> |
| Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned | 661 | 149 |
| Tax effect of non-deductible expenses | 339 | 389 |
| Tax effect of non-taxable revenue | (115) | (607) |
| Tax effect of tax losses not recognised | 10 | 32 |
| Recognition of deferred tax assets on prior year tax losses | (14) | (14) |
| 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 | (25) | (35) |
| Tax benefits derived from leasing partnerships | (12) | (6) |
| Others | <u>14</u> | <u>18</u> |
| Actual tax expense/(credit) | <u><u>858</u></u> | <u><u>(96)</u></u> |

14. PROFIT/(LOSS) ATTRIBUTABLE TO OWNERS OF THE PARENT

The consolidated profit/(loss) attributable to owners of the parent includes a profit/(loss) of HK\$995 million (2008: (HK\$882) million) which has been dealt with in the accounts of the Bank.

Reconciliation of the above amount to the Bank's profit/(loss) for the year

| | <u>2009</u> | <u>2008</u> |
|---|-------------------|---------------------|
| | HK\$ Mn | HK\$ Mn |
| Amount of consolidated profit/(loss) attributable to equity holders dealt with in the Bank's accounts | 974 | (924) |
| Final dividends from subsidiaries and associates attributable to the profits of the previous financial year and general reserves, approved and paid during the year | <u>21</u> | <u>42</u> |
| Bank's profit/(loss) for the year | <u><u>995</u></u> | <u><u>(882)</u></u> |

15. DIVIDENDS

(a) Dividends attributable to the year

| | <u>2009</u> | <u>2008</u> |
|--|---------------------|-------------------|
| | HK\$ Mn | HK\$ Mn |
| Interim dividend declared and paid of HK\$0.28 per share on 1,842 million shares (2008: HK\$0.23 per share on 1,671 million shares, or HK\$0.21 per share on 1,838 million shares after adjusting for the bonus issue in 2009) (Note 38(j)) | 516 | 384 |
| 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\$0.02 per share (2008: HK\$1.18 per share or HK\$1.07 per share after adjusting for the bonus issue in 2009) | — | 98 |
| Final dividend proposed after the balance sheet date of HK\$0.48 per share on 2,016 million shares (2008: HK\$0.02 per share on 1,673 million shares or HK\$0.02 per share on 1,841 million shares after adjusting for the bonus issue in 2009) | <u>968</u> | <u>33</u> |
| | <u><u>1,484</u></u> | <u><u>515</u></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>2009</u> | <u>2008</u> |
|---|-------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Final dividend in respect of the previous financial year, approved and paid during the year, of HK\$0.02 per share on 1,673 million shares or HK\$0.02 per share on 1,841 million shares after adjusting for the bonus issue in 2009 (2008: HK\$1.18 per share on 1,574 million shares or HK\$1.07 per share on 1,732 million shares after adjusting for the bonus issue in 2009) | <u>33</u> | <u>1,858</u> |

(c) **Distribution to holders of Hybrid Tier 1 capital instruments**

| | <u>2009</u> | <u>2008</u> |
|---|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Interest payable on the Hybrid Tier 1 capital instruments, the details of which are disclosed in Note 35. | <u>51</u> | <u>—</u> |

16. EARNINGS PER SHARE

(a) **Basic earnings per share**

The calculation of basic earnings per share is based on earnings of HK\$2,514 million (2008: HK\$39 million) after the distribution of HK\$51 million (2008: Nil) to Hybrid Tier 1 issue holders and on the weighted average of 1,843 million (2008: 1,833 million after adjusting for the bonus issue in 2009) ordinary shares outstanding during the year, calculated as follows:

Weighted average number of ordinary shares

| | <u>2009</u> | <u>2008</u> |
|--|---|---|
| | <u>Number of shares million</u> | <u>Number of shares million</u> |
| Issued ordinary shares at 1st January. | 1,841 | 1,732 |
| Effect of share options exercised and shares issued in lieu of dividends | <u>2</u> | <u>101</u> |
| Weighted average number of ordinary shares at 31st December. | <u>1,843</u> | <u>1,833</u> |

(b) **Diluted earnings per share**

The calculation of diluted earnings per share is based on earnings of HK\$2,514 million (2008: HK\$39 million) after the distribution of HK\$51 million (2008: Nil) to Hybrid Tier 1 issue holders and on 1,844 million (2008: 1,837 million after adjusting for the bonus issue in 2009) 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>2009</u> | <u>2008</u> |
|--|--------------------------------|--------------------------------|
| | Number of shares million | Number of shares million |
| Weighted average number of ordinary shares at 31st December | 1,843 | 1,833 |
| Effect of deemed issue of ordinary shares under the Bank's share option scheme for nil consideration | <u>1</u> | <u>4</u> |
| Weighted average number of ordinary shares (diluted) at 31st December | <u><u>1,844</u></u> | <u><u>1,837</u></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 | 2009 Total |
|---|--------------------|--|--------------------------|------------------|---------------------------------------|---------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Chairman and Chief Executive | | | | | | |
| Dr. The Hon. Sir David LI Kwok-po | 0.3 | 8.4 | 25.4 | 23.0 | 0.5 | 57.6 |
| Executive Director | | | | | | |
| Mr. Joseph PANG Yuk-wing * | — | 1.0 | — | 4.5 | — | 5.5 |
| Non-executive Directors | | | | | | |
| Prof. Arthur LI Kwok-cheung | 0.2 | — | — | — | — | 0.2 |
| 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 |
| Dr. Isidro Faine Casas | 0.1 | — | — | — | — | 0.1 |
| Independent Non-executive Directors | | | | | | |
| Dr. Allan WONG Chi-yun | 0.3 | — | — | — | — | 0.3 |
| Mr. WONG Chung-hin | 0.3 | — | — | — | — | 0.3 |
| Dr. LEE Shau-kee | 0.2 | — | — | — | — | 0.2 |
| Mr. Winston LO Yau-lai | 0.3 | — | — | — | — | 0.3 |
| Mr. Thomas KWOK Ping-kwong | 0.2 | — | — | — | — | 0.2 |
| Mr. Kenneth LO Chin-ming | 0.3 | — | — | — | — | 0.3 |
| Mr. William Doo Wai-hoi | 0.3 | — | — | — | — | 0.3 |
| Mr. Kuok Khoon-ean | 0.3 | — | — | — | — | 0.3 |
| Mr. Valiant CHEUNG Kin-piu | 0.3 | — | — | — | — | 0.3 |
| | <u>4.5</u> | <u>9.4</u> | <u>25.4</u> | <u>27.5</u> | <u>0.5</u> | <u>67.3</u> |

* The remuneration of Mr. Joseph Pang Yuk-wing is only for his service being an Executive Director from 1st January, 2009 to 15th April, 2009 (including the fair value of share option).

| | Directors' fees | Salaries, allowances and benefits in kind | Discretionary bonuses | Share options | Retirement scheme contributions HK\$ Mn | 2008 Total |
|---|-----------------|---|-----------------------|---------------|---|-------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Chairman and Chief Executive | | | | | | |
| Dr. The Hon. Sir David LI Kwok-po | 0.3 | 8.3 | — | 24.1 | 0.8 | 33.5 |
| Executive Directors | | | | | | |
| Mr. Joseph PANG Yuk-wing | 0.2 | 3.6 | — | 12.0 | 0.3 | 16.1 |
| Non-executive Directors | | | | | | |
| 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 |
| Independent Non-executive Directors | | | | | | |
| 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. William Doo Wai-hoi | 0.3 | — | — | — | — | 0.3 |
| Mr. Kuok Khoon-ean | 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> |

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 36.

18. FIVE TOP-PAID EMPLOYEES

| | 2009 | 2008 |
|---|------------|-----------|
| | HK\$ Mn | HK\$ Mn |
| Salaries and other emoluments | 20 | 21 |
| Performance-related bonuses | 39 | 3 |
| Share options | 50 | 52 |
| Pension contributions | 1 | 2 |
| | <u>110</u> | <u>78</u> |

The remuneration of the five top-paid employees is within the following bands:

| | <u>2009</u> | <u>2008</u> |
|-----------------------------------|----------------------------|----------------------------|
| | Number of employees | Number of employees |
| HK\$ | | |
| 8,500,001 - 9,000,000 | — | 2 |
| 10,500,001 - 11,000,000 | — | 1 |
| 12,000,001 - 12,500,000 | 2 | — |
| 13,500,001 - 14,000,000 | 2 | — |
| 16,000,001 - 16,500,000 | — | 1 |
| 33,500,001 - 34,000,000 | — | 1 |
| 57,500,001 - 58,000,000 | 1 | — |

Included in the emoluments of the five top-paid employees were the emoluments of 1 (2008: 2) Director. Their respective directors' emoluments have been included in Note 17 above.

19. SEGMENT REPORTING

The Group manages its businesses by divisions, which are organized by a mixture of both business lines and geography. In a manner consistent with the way in which information is reported internally to the Group's most senior executive management for the purposes of resource allocation and performance assessment, the Group has presented the following seven reportable segments. No operating segments have been aggregated to form the following reportable segments.

(a) Business segments

The Group has identified the following seven reportable segments.

Personal banking, which includes branch operations, personal internet banking, consumer finance, property loans and credit card business in Hong Kong.

Corporate banking, which includes corporate lending and loan syndication, asset based lending, commercial lending and securities lending in Hong Kong.

Treasury markets, which include treasury operations and securities dealing in Hong Kong.

Wealth management, which includes private banking business and related assets in Hong Kong.

China operations include all branches and subsidiaries in China, except those subsidiaries carrying out corporate services and associates operated in China.

Overseas operations include overseas branches and subsidiaries, except those subsidiaries carrying out corporate services and associates operated in overseas.

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, supporting units of Hong Kong operation, investment properties, bank premises, the net results of associates and other subsidiaries in Hong Kong.

For the purposes of assessing segment performance and allocating resources between segments, the Group's senior executive management monitors the results, assets and liabilities attributable to each reportable segment on the following bases:

Segment assets include all tangible except for properties, intangible assets and financial assets with the exception of interests in associates, deferred tax assets and other corporate assets. Segment liabilities include deposits, financial liabilities and other liabilities attributable to the banking activities of the individual segments.

Revenue and expenses are allocated to the reportable segments with reference to interest and fee and commission income generated by those segments and the expenses incurred by those segments or which otherwise arise from the depreciation or amortisation of assets attributable to those segments. Segment revenue and expenses do not include the Group's share of revenue and expenses arising from the activities of the Group's associates. Other than reporting inter-segment income, assistance provided by one segment to another, including sharing of assets, is not measured.

In addition to receiving segment information concerning profit before taxation, management is provided with segment information concerning revenue (including inter segment lending), interest expense, depreciation, amortisation and impairment losses and additions to non-current segment assets used by the segments in their operations.

| 2009 | | | | | | | | | | | |
|---|---------------------|----------------------|---------------------|----------------------|---------------------|------------------------|-----------------------|---------------------------------|---------|----------------------------------|---------|
| Hong Kong banking operations | | | | | | | | | | | |
| | Personal banking | Corporate banking | Treasury markets | Wealth management | China operations | Overseas operations | Corporate services | Total reportable segments | Others | Inter- segment 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) | 1,972 | 763 | 377 | 147 | 2,974 | 731 | 1 | 6,965 | (337) | 119 | 6,747 |
| Non-interest income/(expense) | 463 | 647 | (247) | 195 | 498 | 346 | 816 | 2,718 | 1,573 | (850) | 3,441 |
| Operating income | 2,435 | 1,410 | 130 | 342 | 3,472 | 1,077 | 817 | 9,683 | 1,236 | (731) | 10,188 |
| Operating expenses | (1,341) | (114) | (129) | (107) | (1,997) | (514) | (512) | (4,714) | (1,877) | 462 | (6,129) |
| Operating profit/(loss) before impairment losses | 1,094 | 1,296 | 1 | 235 | 1,475 | 563 | 305 | 4,969 | (641) | (269) | 4,059 |
| (Charge for)/Write back of impairment losses on loans and advances and other accounts | (70) | (46) | (3) | (12) | 21 | (977) | (6) | (1,093) | (12) | — | (1,105) |
| Impairment losses on available-for-sale financial assets and held-to-maturity investments | — | — | (9) | — | — | — | — | (9) | (14) | — | (23) |
| Impairment losses on bank premises | — | — | — | — | — | — | — | — | (13) | — | (13) |
| Operating profit/(loss) after impairment losses | 1,024 | 1,250 | (11) | 223 | 1,496 | (414) | 299 | 3,867 | (680) | (269) | 2,918 |
| Profit/(Loss) on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments, loans and receivables and subsidiaries/ associates | (3) | — | 16 | — | 22 | 1 | — | 36 | 73 | (1) | 108 |
| Valuation gains/ (losses) on investment properties | — | — | — | — | 7 | (3) | — | 4 | 235 | (33) | 206 |
| Share of profits less losses of associates | — | — | — | — | — | — | — | — | 264 | — | 264 |
| Profit/(Loss) before taxation | 1,021 | 1,250 | 5 | 223 | 1,525 | (416) | 299 | 3,907 | (108) | (303) | 3,496 |
| Depreciation for the year | (70) | (1) | (3) | (2) | (189) | (29) | (17) | (311) | (198) | (3) | (512) |
| Segment assets | 44,005 | 66,998 | 132,107 | 7,359 | 154,030 | 50,764 | 4,144 | 459,407 | 19,395 | (47,335) | 431,467 |
| Investments in associates | — | — | — | — | — | — | — | — | 2,615 | — | 2,615 |
| Total assets | 44,005 | 66,998 | 132,107 | 7,359 | 154,030 | 50,764 | 4,144 | 459,407 | 22,010 | (47,335) | 434,082 |
| Total liabilities | 208,366 | 582 | 24,824 | 14,719 | 138,531 | 40,873 | 1,645 | 429,540 | 6,821 | (41,802) | 394,559 |
| Capital expenditure incurred during the year | 54 | — | 4 | 1 | 3,182 | 624 | 32 | 3,897 | 66 | — | 3,963 |

| Hong Kong banking operations | | | | | | | | | | | |
|--|------------------|-------------------|------------------|-------------------|------------------|---------------------|--------------------|---------------------------|---------|---------------------------|---------|
| | Personal banking | Corporate banking | Treasury markets | Wealth management | China operations | Overseas operations | Corporate services | Total reportable segments | Others | Inter-segment 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) . . . | 1,404 | 571 | 1,200 | 15 | 2,967 | 722 | — | 6,879 | (154) | 68 | 6,793 |
| Non-interest income/(expense) . . . | 539 | (487) | (2,206) | 237 | 410 | (49) | 816 | (740) | 1,131 | (727) | (336) |
| Operating income/ (expense) . . . | 1,943 | 84 | (1,006) | 252 | 3,377 | 673 | 816 | 6,139 | 977 | (659) | 6,457 |
| Operating expenses | (1,306) | (114) | (74) | (92) | (1,824) | (528) | (504) | (4,442) | (1,756) | 419 | (5,779) |
| Operating profit/(loss) before impairment losses | 637 | (30) | (1,080) | 160 | 1,553 | 145 | 312 | 1,697 | (779) | (240) | 678 |
| (Charge for)/Write back of impairment losses on loans and advances and other accounts | (74) | (110) | — | (48) | (98) | (211) | (10) | (551) | (13) | 6 | (558) |
| Impairment losses on available-for-sale financial assets and held-to-maturity investments | — | — | (264) | — | — | — | — | (264) | (132) | — | (396) |
| Write back of impairment losses on bank premises | — | — | — | — | — | — | — | — | 6 | — | 6 |
| Operating profit/(loss) after impairment losses | 563 | (140) | (1,344) | 112 | 1,455 | (66) | 302 | 882 | (918) | (234) | (270) |
| Profit/(Loss) on sale of fixed assets, available-for-sale financial assets, held-to-maturity investments, loans and receivables and subsidiaries/ associates | — | — | 206 | — | (1) | 181 | (1) | 385 | 4 | 4 | 393 |
| Valuation gains/ (losses) on investment properties | — | — | — | — | (1) | (20) | — | (21) | (181) | 34 | (168) |
| Share of profits less losses of associates | — | — | — | — | — | — | — | — | 53 | — | 53 |
| Profit/(Loss) before taxation | 563 | (140) | (1,138) | 112 | 1,453 | 95 | 301 | 1,246 | (1,042) | (196) | 8 |
| Depreciation for the year | (64) | (3) | (2) | (3) | (128) | (26) | (17) | (243) | (191) | (3) | (437) |
| Segment assets | 40,869 | 60,239 | 143,582 | 5,656 | 139,736 | 40,215 | 4,056 | 434,353 | 18,583 | (40,168) | 412,768 |
| Investments in associates | — | — | — | — | — | — | — | — | 2,486 | — | 2,486 |
| Total assets | 40,869 | 60,239 | 143,582 | 5,656 | 139,736 | 40,215 | 4,056 | 434,353 | 21,069 | (40,168) | 415,254 |
| Total liabilities | 213,785 | 561 | 21,014 | 14,723 | 128,728 | 35,552 | 1,653 | 416,016 | 5,355 | (38,602) | 382,769 |
| Capital expenditure incurred during the year | 126 | — | 7 | 5 | 2,028 | 47 | 72 | 2,285 | 330 | — | 2,615 |

(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.

| | 2009 | | | | | Consolidated |
|--|-----------|----------------------------|-----------------------|---------|---------------------------|--------------|
| | Hong Kong | People's Republic of China | Other Asian Countries | Others | Inter-segment elimination | |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| The Group | | | | | | |
| Operating income | 6,461 | 3,527 | 585 | 883 | (1,268) | 10,188 |
| Profit/(Loss) before taxation | 1,931 | 1,598 | 163 | (196) | — | 3,496 |
| Total assets | 287,184 | 155,920 | 19,369 | 34,708 | (63,099) | 434,082 |
| Total liabilities | 255,572 | 138,697 | 16,210 | 26,904 | (42,824) | 394,559 |
| Contingent liabilities and commitments | 57,919 | 23,262 | 3,111 | 2,946 | — | 87,238 |
| Capital expenditure during the year | 157 | 3,182 | 618 | 6 | — | 3,963 |

| | 2008 (restated) | | | | | Consolidated |
|--|-----------------|----------------------------|-----------------------|---------|---------------------------|--------------|
| | Hong Kong | People's Republic of China | Other Asian Countries | Others | Inter-segment elimination | |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| The Group | | | | | | |
| Operating income | 2,962 | 3,447 | 525 | 492 | (969) | 6,457 |
| Profit/(Loss) before taxation | (1,876) | 1,484 | 381 | 19 | — | 8 |
| Total assets | 285,121 | 141,036 | 18,735 | 27,890 | (57,528) | 415,254 |
| Total liabilities | 255,902 | 129,147 | 15,778 | 24,329 | (42,387) | 382,769 |
| Contingent liabilities and commitments | 53,162 | 15,944 | 3,818 | 3,244 | — | 76,168 |
| Capital expenditure during the year | 541 | 2,027 | 8 | 39 | — | 2,615 |

20. CASH AND BALANCES WITH BANKS AND OTHER FINANCIAL INSTITUTIONS (NOTE 43(C))

| | The Group | | The Bank | |
|--|---------------|---------------|---------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Cash in hand | 1,101 | 1,083 | 706 | 698 |
| Balances with central banks | 15,813 | 17,911 | 736 | 167 |
| Balances with banks and other financial institutions | 12,798 | 9,111 | 11,085 | 3,987 |
| | <u>29,712</u> | <u>28,105</u> | <u>12,527</u> | <u>4,852</u> |

21. PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

| | The Group | | The Bank | |
|---|---------------|---------------|---------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Placements with banks and authorised institutions | 67,638 | 96,458 | 61,894 | 92,735 |
| Placements with other financial institutions | 307 | 116 | — | — |
| | <u>67,945</u> | <u>96,574</u> | <u>61,894</u> | <u>92,735</u> |
| Maturing | | | | |
| - within one month | 35,006 | 46,714 | 31,895 | 43,009 |
| - between one month and one year | 32,939 | 49,860 | 29,999 | 49,726 |
| | <u>67,945</u> | <u>96,574</u> | <u>61,894</u> | <u>92,735</u> |

22. TRADE BILLS

| | The Group | | The Bank | |
|-----------------------------|--------------|--------------|------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Gross trade bills | <u>1,847</u> | <u>1,164</u> | <u>861</u> | <u>521</u> |

23. TRADING ASSETS

| | The Group | | The Bank | |
|--|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Treasury bills (including Exchange Fund Bills) | 34 | 400 | — | 400 |
| Debt securities | 3,090 | 126 | 904 | 126 |
| Equity securities | 1,429 | 989 | 1,374 | 949 |
| Investment funds | 201 | 188 | 201 | 188 |
| Trading securities | 4,754 | 1,703 | 2,479 | 1,663 |
| Positive fair values of derivatives (Note 42(b)) | 968 | 1,734 | 845 | 1,251 |
| | <u>5,722</u> | <u>3,437</u> | <u>3,324</u> | <u>2,914</u> |
| Issued by: | | | | |
| Central governments and central banks | 1,857 | 400 | — | 400 |
| Public sector entities | 299 | 13 | 299 | 13 |
| Banks and other financial institutions | 1,093 | 443 | 716 | 433 |
| Corporate entities | 1,492 | 840 | 1,451 | 810 |
| Other entities | 13 | 7 | 13 | 7 |
| | <u>4,754</u> | <u>1,703</u> | <u>2,479</u> | <u>1,663</u> |
| Analysed by place of listing: | | | | |
| Listed in Hong Kong | 1,484 | 825 | 1,428 | 785 |
| Listed outside Hong Kong | 574 | 294 | 574 | 294 |
| | 2,058 | 1,119 | 2,002 | 1,079 |
| Unlisted | 2,696 | 584 | 477 | 584 |
| | <u>4,754</u> | <u>1,703</u> | <u>2,479</u> | <u>1,663</u> |

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

| | The Group | | The Bank | |
|--|---------------|--------------|---------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Debt securities | 10,043 | 4,130 | 10,035 | 4,114 |
| Equity securities | 349 | — | 349 | — |
| | <u>10,392</u> | <u>4,130</u> | <u>10,384</u> | <u>4,114</u> |
| Issued by: | | | | |
| Central governments and central banks | 235 | — | 235 | — |
| Public sector entities | 177 | 142 | 177 | 142 |
| Banks and other financial institutions | 4,338 | 1,642 | 4,330 | 1,634 |
| Corporate entities | 5,642 | 2,346 | 5,642 | 2,338 |
| | <u>10,392</u> | <u>4,130</u> | <u>10,384</u> | <u>4,114</u> |
| Analysed by place of listing: | | | | |
| Listed in Hong Kong | 2,946 | 1,325 | 2,946 | 1,325 |
| Listed outside Hong Kong | 4,003 | 1,178 | 3,995 | 1,161 |
| | 6,949 | 2,503 | 6,941 | 2,486 |
| Unlisted | 3,443 | 1,627 | 3,443 | 1,628 |
| | <u>10,392</u> | <u>4,130</u> | <u>10,384</u> | <u>4,114</u> |

25. ADVANCES TO CUSTOMERS AND OTHER ACCOUNTS
(a) Advances to customers and other accounts

| | The Group | | The Bank | |
|--|----------------|----------------|----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| (i) Advances to customers | 247,654 | 230,339 | 143,374 | 131,123 |
| Less: Impairment allowances | | | | |
| - Individual | (534) | (523) | (499) | (438) |
| - Collective | (811) | (521) | (678) | (392) |
| | <u>246,309</u> | <u>229,295</u> | <u>142,197</u> | <u>130,293</u> |
| (ii) Other accounts | | | | |
| Advances to banks and other financial institutions * | 678 | 850 | 583 | 205 |
| Notes and bonds | 65 | 129 | 61 | 125 |
| Certificates of deposit held | 39 | 39 | 39 | 39 |
| Accrued interest | 1,313 | 1,863 | 951 | 1,119 |
| Bankers acceptances | 7,976 | 2,989 | 203 | 272 |
| Other accounts | 5,463 | 8,592 | 4,565 | 6,587 |
| | <u>15,534</u> | <u>14,462</u> | <u>6,402</u> | <u>8,347</u> |
| Less: Impairment allowances | | | | |
| - Individual | (31) | (23) | (3) | — |
| - Collective | (9) | (9) | — | — |
| | <u>15,494</u> | <u>14,430</u> | <u>6,399</u> | <u>8,347</u> |
| | <u>261,803</u> | <u>243,725</u> | <u>148,596</u> | <u>138,640</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, 2009, the fair value of financial assets accepted as collateral that the Group is permitted to sell or re-pledge under such terms is Nil (2008: HK\$155 million).

(b) **Impairment allowances against advances and other accounts for 2009**

| | The Group | | | | | |
|--|------------------------------|-------------------|-----------------------|-------------------|-------------------|-------------------|
| | Advances to customers | | Other accounts | | Total | |
| | Individual | Collective | Individual | Collective | Individual | Collective |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 523 | 521 | 23 | 9 | 546 | 530 |
| New provisions charged to income statement (Note 11) | 813 | 420 | 14 | (1) | 827 | 419 |
| Net provisions released back to income statement (Note 11) | (98) | — | (3) | — | (101) | — |
| Amounts written off | (743) | (138) | (4) | — | (747) | (138) |
| Recoveries (Note 11) | 65 | — | 1 | — | 66 | — |
| Additions through acquisition of subsidiaries | — | — | — | 1 | — | 1 |
| Effect of discounting (Note 4) | (40) | — | — | — | (40) | — |
| Exchange adjustments | 14 | 8 | — | — | 14 | 8 |
| At 31st December | <u>534</u> | <u>811</u> | <u>31</u> | <u>9</u> | <u>565</u> | <u>820</u> |

| | The Bank | | | | | |
|--|------------------------------|-------------------|-----------------------|-------------------|-------------------|-------------------|
| | Advances to customers | | Other accounts | | Total | |
| | Individual | Collective | Individual | Collective | Individual | Collective |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 438 | 392 | — | — | 438 | 392 |
| New provisions charged to income statement | 752 | 407 | 3 | — | 755 | 407 |
| Net provisions released back to income statement | (81) | — | — | — | (81) | — |
| Amounts written off | (641) | (128) | — | — | (641) | (128) |
| Recoveries | 57 | — | — | — | 57 | — |
| Effect of discounting | (38) | — | — | — | (38) | — |
| Exchange adjustments | 12 | 7 | — | — | 12 | 7 |
| At 31st December | <u>499</u> | <u>678</u> | <u>3</u> | <u>—</u> | <u>502</u> | <u>678</u> |

(b) Impairment allowances against advances and other accounts for 2008

| | The Group | | | | | |
|--|------------------------------|-------------------|-----------------------|-------------------|-------------------|-------------------|
| | Advances to customers | | Other accounts | | Total | |
| | Individual | Collective | Individual | Collective | Individual | Collective |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 264 | 433 | 25 | 6 | 289 | 439 |
| New provisions charged to income statement (Note 11) | 583 | 183 | 13 | — | 596 | 183 |
| Net provisions released back to income statement (Note 11) | (204) | — | (5) | — | (209) | — |
| Amounts written off | (245) | (96) | (10) | — | (255) | (96) |
| Recoveries (Note 11) | 140 | — | — | — | 140 | — |
| Additions through acquisition of subsidiaries | — | — | — | 3 | — | 3 |
| Effect of discounting (Note 4) | (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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 79 | 332 | — | — | 79 | 332 |
| New provisions charged to income statement | 460 | 149 | 6 | — | 466 | 149 |
| Net provisions released back to income statement | (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> |

(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.

| | 2009 | | 2008 | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | Gross advances | % of secured advances | Gross advances | % of secured advances |
| | HK\$ Mn | % | HK\$ Mn | % |
| The Group | | | | |
| Loans for use in Hong Kong Industrial, commercial and financial | | | | |
| - Property development | 9,411 | 73.43 | 8,855 | 61.25 |
| - Property investment | 29,766 | 91.11 | 27,431 | 86.88 |
| - Financial concerns | 2,699 | 75.10 | 2,542 | 69.94 |
| - Stockbrokers | 1,190 | 50.35 | 550 | 99.75 |
| - Wholesale and retail trade | 3,265 | 68.46 | 2,405 | 64.60 |
| - Manufacturing | 2,177 | 57.94 | 2,055 | 52.54 |
| - Transport and transport equipment | 3,794 | 79.39 | 3,642 | 74.80 |
| - Recreational activities | 45 | 47.90 | 285 | 91.11 |
| - Information technology | 8 | 38.02 | 4 | 49.13 |
| - Others | 13,006 | 77.87 | 9,954 | 71.52 |
| - Sub-total | <u>65,361</u> | 81.57 | <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 | 1,529 | 100.00 | 1,318 | 100.00 |
| - Loans for the purchase of other residential properties | 25,220 | 99.87 | 24,297 | 99.74 |
| - Credit card advances | 2,675 | 0.00 | 2,997 | 0.00 |
| - Others | 8,839 | 68.17 | 6,553 | 74.35 |
| - Sub-total | <u>38,263</u> | 85.57 | <u>35,165</u> | 86.52 |
| Total loans for use in Hong Kong | 103,624 | 83.05 | 92,888 | 80.47 |
| Trade finance | 2,652 | 53.27 | 2,905 | 59.03 |
| Loans for use outside Hong Kong* | <u>141,378</u> | 75.75 | <u>134,546</u> | 76.56 |
| Total advances to customers | <u><u>247,654</u></u> | 78.56 | <u><u>230,339</u></u> | 77.91 |

* Loans for use outside Hong Kong include the following loans for use in the PRC.

| | 2009 | | 2008 | |
|--------------------------------------|----------------|-----------------------|----------------|-----------------------|
| | Gross advances | % of secured advances | Gross advances | % of secured advances |
| | HK\$ Mn | % | HK\$ Mn | % |
| Property development | 14,156 | 72.70 | 14,351 | 78.64 |
| Property investment | 22,441 | 88.36 | 24,215 | 87.95 |
| Wholesale and retail trade | 18,574 | 95.28 | 19,021 | 88.93 |
| Manufacturing | 7,299 | 48.78 | 9,547 | 63.58 |
| Others | 41,180 | 69.34 | 31,906 | 69.99 |
| | <u>103,650</u> | 77.12 | <u>99,040</u> | 78.66 |

| | 2009 | | 2008 | |
|---|----------------|-----------------------|----------------|-----------------------|
| | Gross advances | % of secured advances | Gross advances | % of secured advances |
| | HK\$ Mn | % | HK\$ Mn | % |
| The Bank | | | | |
| Loans for use in Hong Kong Industrial, commercial and financial | | | | |
| - Property development | 9,401 | 73.50 | 8,844 | 61.32 |
| - Property investment | 29,650 | 91.08 | 27,345 | 86.84 |
| - Financial concerns | 2,699 | 75.11 | 2,542 | 69.95 |
| - Stockbrokers | 1,190 | 50.35 | 550 | 99.75 |
| - Wholesale and retail trade | 3,220 | 68.02 | 2,353 | 63.82 |
| - Manufacturing | 2,157 | 57.55 | 2,055 | 52.54 |
| - Transport and transport equipment | 3,794 | 79.39 | 3,642 | 74.80 |
| - Recreational activities | 45 | 47.90 | 285 | 91.11 |
| - Information technology | 8 | 38.02 | 4 | 49.13 |
| - Others | 12,732 | 77.39 | 9,830 | 71.16 |
| - Sub-total | <u>64,896</u> | 81.46 | <u>57,450</u> | 76.69 |
| Individuals | | | | |
| - Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | 1,529 | 100.00 | 1,318 | 100.00 |
| - Loans for the purchase of other residential properties | 25,180 | 99.87 | 24,273 | 99.75 |
| - Credit card advances | 2,675 | 0.00 | 2,997 | 0.00 |
| - Others | 8,046 | 67.44 | 6,147 | 74.92 |
| - Sub-total | <u>37,430</u> | 85.76 | <u>34,735</u> | 86.76 |
| Total loans for use in Hong Kong | 102,326 | 83.03 | 92,185 | 80.49 |
| Trade finance | 2,322 | 52.35 | 2,684 | 58.87 |
| Loans for use outside Hong Kong * | <u>38,726</u> | 56.01 | <u>36,254</u> | 57.35 |
| Total advances to customers | <u>143,374</u> | 75.24 | <u>131,123</u> | 73.65 |

* Loans for use outside Hong Kong include the following loans for use in the PRC.

| | 2009 | | 2008 | |
|--------------------------------------|----------------|-----------------------|----------------|-----------------------|
| | Gross advances | % of secured advances | Gross advances | % of secured advances |
| | HK\$ Mn | % | HK\$ Mn | % |
| Property development | 3,075 | 12.30 | 2,310 | 0.00 |
| Property investment | 866 | 100.00 | 951 | 98.95 |
| Wholesale and retail trade | 111 | 9.88 | 12 | 99.97 |
| Manufacturing | 1,531 | 53.61 | 1,878 | 74.86 |
| Others | 3,271 | 3.48 | 2,733 | 8.17 |
| | <u>8,854</u> | <u>24.74</u> | <u>7,884</u> | <u>32.75</u> |

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 | |
|--|-----------|---------|----------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| (i) Property development | | | | |
| a. Individually impaired loans | 805 | 207 | 771 | 171 |
| b. Individual impairment allowance | 50 | 8 | 37 | 2 |
| c. Collective impairment allowance | 83 | 36 | 69 | 20 |
| d. Provision charged to income statement | | | | |
| - individual impairment loss | 324 | 2 | 315 | 2 |
| - collective impairment loss | 59 | 12 | 54 | 7 |
| e. Written off | 272 | 84 | 271 | — |
| (ii) Property investment | | | | |
| a. Individually impaired loans | 334 | 145 | 168 | 6 |
| b. Individual impairment allowance | 25 | 29 | 11 | — |
| c. Collective impairment allowance | 193 | 96 | 138 | 62 |
| d. Provision charged to income statement | | | | |
| - individual impairment loss | 56 | 29 | 35 | — |
| - collective impairment loss | 111 | 24 | 78 | 16 |
| e. Written off | 52 | — | 22 | — |
| (iii) Loans for purchase of residential properties | | | | |
| a. Individually impaired loans | 137 | 117 | 127 | 108 |
| b. Individual impairment allowance | — | 2 | — | 2 |
| c. Collective impairment allowance | 32 | 30 | 30 | 21 |
| d. Provision charged to income statement | | | | |
| - individual impairment loss | 1 | 5 | 1 | 5 |
| - collective impairment loss | 23 | 6 | 22 | 3 |
| e. Written off | 1 | 3 | 1 | 3 |
| (iv) Wholesale and retail trade | | | | |
| a. Individually impaired loans | 327 | 222 | 290 | 181 |
| b. Individual impairment allowance | 162 | 129 | 162 | 120 |
| c. Collective impairment allowance | 56 | 48 | 38 | 24 |
| d. Provision charged to income statement | | | | |
| - individual impairment loss | 185 | 133 | 184 | 116 |
| - collective impairment loss | 18 | 21 | 16 | 12 |
| e. Written off | 131 | 4 | 121 | 4 |

(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.

| The Group | | | | | |
|---|--|---|---|--|--|
| 2009 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Hong Kong | 121,538 | 217 | 407 | 103 | 299 |
| People's Republic of China | 93,084 | 177 | 373 | 34 | 86 |
| Other Asian Countries | 10,103 | 213 | 382 | 247 | 178 |
| Others | 22,929 | 284 | 1,286 | 150 | 248 |
| Total | <u>247,654</u> | <u>891</u> | <u>2,448</u> | <u>534</u> | <u>811</u> |
| % of total advances to customers | | | <u>0.99%</u> | | |
| Market value of security held against impaired advances to customers | | | <u>4,839</u> | | |

| The Group | | | | | |
|---|--|---|---|--|--|
| 2008 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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> | | |

| The Bank | | | | | |
|---|--|---|---|--|--|
| 2009 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Hong Kong | 103,784 | 185 | 357 | 87 | 278 |
| People's Republic of China | 16,419 | 23 | 207 | 33 | 26 |
| Other Asian Countries | 9,021 | 213 | 381 | 246 | 177 |
| Others | 14,150 | 270 | 1,166 | 133 | 197 |
| Total | 143,374 | 691 | 2,111 | 499 | 678 |
| % of total advances to customers | | | <u>1.48%</u> | | |
| Market value of security held against impaired advances to customers | | | <u>3,048</u> | | |

| The Bank | | | | | |
|---|--|---|---|--|--|
| 2008 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | 131,123 | 437 | 1,274 | 438 | 392 |
| % of total advances to customers | | | <u>0.97%</u> | | |
| Market value of security held against impaired advances to customers | | | <u>2,168</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, 2009 and 31st December, 2008, 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 | | | | | |
|--|--|---|-------------------------------------|--|---|-------------------------------------|
| | 2009 | | | 2008 | | |
| | 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 |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| Amounts receivable: | | | | | | |
| Within one year | 1,004 | 116 | 1,120 | 1,280 | 152 | 1,432 |
| After one year but within five years | 1,100 | 186 | 1,286 | 1,512 | 206 | 1,718 |
| After five years. | <u>1,729</u> | <u>265</u> | <u>1,994</u> | <u>1,468</u> | <u>246</u> | <u>1,714</u> |
| | 3,833 | <u>567</u> | <u>4,400</u> | 4,260 | <u>604</u> | <u>4,864</u> |
| Less: Individual impairment allowances | <u>(10)</u> | | | <u>(21)</u> | | |
| Net investment in finance leases | <u>3,823</u> | | | <u>4,239</u> | | |

The net investment in finance leases is carried on the statement of financial position 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 | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Treasury bills (including Exchange Fund Bills) | 5,425 | 10,391 | 5,364 | 4,558 |
| Certificates of deposit held | 972 | 762 | 595 | 508 |
| Debt securities | 22,599 | 6,398 | 11,990 | 5,210 |
| Equity securities | 1,810 | 899 | 909 | 611 |
| Investment funds | 77 | 110 | 77 | 98 |
| | <u>30,883</u> | <u>18,560</u> | <u>18,935</u> | <u>10,985</u> |
| Issued by: | | | | |
| Central governments and central banks | 12,787 | 10,419 | 6,416 | 4,558 |
| Public sector entities | 236 | 231 | — | 126 |
| Banks and other financial institutions | 14,199 | 5,773 | 10,649 | 4,759 |
| Corporate entities | 3,584 | 2,027 | 1,793 | 1,444 |
| Other entities | 77 | 110 | 77 | 98 |
| | <u>30,883</u> | <u>18,560</u> | <u>18,935</u> | <u>10,985</u> |
| Analysed by place of listing: | | | | |
| Listed in Hong Kong | 1,957 | 397 | 1,495 | 197 |
| Listed outside Hong Kong | 5,512 | 9,329 | 3,986 | 2,619 |
| | 7,469 | 9,726 | 5,481 | 2,816 |
| Unlisted | 23,414 | 8,834 | 13,454 | 8,169 |
| | <u>30,883</u> | <u>18,560</u> | <u>18,935</u> | <u>10,985</u> |

27. HELD-TO-MATURITY INVESTMENTS

| | The Group | | The Bank | |
|--|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Treasury bills (including Exchange Fund Bills) | 189 | 180 | 112 | 180 |
| Certificates of deposit held. | 2,245 | 1,717 | 1,584 | 1,056 |
| Debt securities | 4,843 | 3,216 | 3,144 | 2,189 |
| | 7,277 | 5,113 | 4,840 | 3,425 |
| Less: Impairment allowances. | (38) | (107) | (38) | (107) |
| | <u>7,239</u> | <u>5,006</u> | <u>4,802</u> | <u>3,318</u> |
| Issued by: | | | | |
| Central governments and central banks | 1,510 | 243 | 1,506 | 239 |
| Public sector entities | 621 | 318 | 276 | 231 |
| Banks and other financial institutions. | 4,328 | 3,344 | 2,629 | 2,117 |
| Corporate entities | 780 | 1,101 | 391 | 731 |
| | <u>7,239</u> | <u>5,006</u> | <u>4,802</u> | <u>3,318</u> |
| Analysed by place of listing: | | | | |
| Listed in Hong Kong | 952 | 287 | 848 | 268 |
| Listed outside Hong Kong | 2,984 | 1,863 | 2,263 | 1,477 |
| | 3,936 | 2,150 | 3,111 | 1,745 |
| Unlisted | 3,303 | 2,856 | 1,691 | 1,573 |
| | <u>7,239</u> | <u>5,006</u> | <u>4,802</u> | <u>3,318</u> |
| Fair value: | | | | |
| Listed securities. | 3,998 | 2,028 | 3,150 | 1,640 |
| Unlisted securities | 3,320 | 2,870 | 1,696 | 1,569 |
| | <u>7,318</u> | <u>4,898</u> | <u>4,846</u> | <u>3,209</u> |

Movement of impairment allowances

| | The Group | | The Bank | |
|---|-----------|------------|-----------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 107 | 42 | 107 | 42 |
| Charge for the year | 9 | 44 | 9 | 44 |
| Write-off. | (78) | — | (78) | — |
| Exchange and other adjustments. | — | 21 | — | 21 |
| At 31st December | <u>38</u> | <u>107</u> | <u>38</u> | <u>107</u> |

Reclassification of Available-for-sale Financial Assets

On 1st January, 2009, the management have assessed the intention and ability to hold to maturity the Group's available-for-sale financial assets. Based on this assessment, the management concluded that they have the positive intention ability hold them to maturity and therefore have reclassified the portfolio from the available-for-sale category to held-to-maturity. The amount reclassified on the date of reclassification is as follows:

| | Carrying amount on 1st January, 2009 |
|--|---|
| | HK\$ Mn |
| Reclassified from available-for-sale debt securities | |
| Listed in Hong Kong | (83) |
| Listed outside Hong Kong | (229) |
| Unlisted | (364) |
| | <u>(676)</u> |
| Reclassified to held-to-maturity securities | |
| Listed in Hong Kong | 83 |
| Listed outside Hong Kong | 229 |
| Unlisted | 364 |
| | <u>676</u> |

There are no unrealised gains and losses arising from changes in fair value recognised in the investment revaluation reserve during the year.

The net unamortised revaluation deficit was HK\$19 million as at 31st December, 2009.

| | HK\$ Mn |
|---|----------------|
| Reclassification | 16 |
| Amortisation during the year | 3 |
| Balance as at 31st December, 2009 | <u>19</u> |

The unamortised revaluation surplus or deficit of individual investments reclassified shall be amortised to the income statement over the respective remaining life of investment using the effective interest method.

28. INVESTMENTS IN SUBSIDIARIES

| | The Bank | |
|---------------------------------------|-----------------|----------------|
| | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn |
| Unlisted shares, at cost | 13,690 | 11,906 |
| Less: Impairment allowances | (233) | (233) |
| | <u>13,457</u> | <u>11,673</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 | |
| Ample Delight Limited | Hong Kong | HK\$450,000,000 | | 100% | Investment holding |
| 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\$374,580,000 | 51% | | Asset management |
| BEA Wealth Management Services (Taiwan) Limited | Taiwan, Republic of China | NTD218,000,000 | | 100% | Wealth management services |
| CCSL St. Lucia Limited | St. Lucia | US\$1,200 | | 60.49% | Holding company |
| Central Town Limited | Hong Kong | HK\$2 | 100% | | Property investment |
| Century Able Limited | Hong Kong | HK\$866,951,045 | | 100% | Investment holding |
| Corona Light Limited | BVI | HK\$866,951,045 | | 100% | Investment holding |
| Credit Gain Finance Company Limited | Hong Kong | HK\$1 | 100% | | Money lenders |
| Crystal Gleaming Limited | BVI | HK\$866,951,045 | 100% | | Investment holding |
| East Asia Corporate Services (BVI) Limited | BVI | US\$250,000 | | 75.61% | Registered agent and trustee services |
| 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. | 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% | | Investment Holding |
| East Asia Investments Holdings (BVI) Ltd. | BVI | HK\$186,038,725 | 100% | | Investment holding |
| East Asia Marketing Limited | BVI | US\$1 | | 75.61% | Marketing services to related companies |
| East Asia Property Agency Company Limited | Hong Kong | HK\$1,000,000 | 100% | | Property agency |
| East Asia Properties Holding Company Limited | Hong Kong | HK\$10,000 | 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 | | 75.61% | 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 |

| Name of company | Place of incorporation and operation | Issued and paid-up capital | % Held by | | Nature of business |
|--|--------------------------------------|----------------------------|-----------|-----------|---|
| | | | The Bank | The Group | |
| Innovate Holdings Limited | BVI | US\$1 | 100% | | Special purpose vehicle 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 (Note 1) | PRC | CNY8,000,000,000 | 100% | | Banking and related financial services |
| * The Bank of East Asia (U.S.A.) N.A. | U.S.A. | US\$4,500 | | 100% | Banking |
| Tricor Consultancy (Beijing) Limited (Note 1) | 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. Ltd. | Singapore | S\$2 | | 75.61% | Investment holding |
| Tricor Investor Services Limited | Hong Kong | HK\$2 | | 75.61% | Investor services |
| Tricor Services Limited | Hong Kong | HK\$2 | | 75.61% | Business, corporate and investor services |
| Tricor Services (BVI) Limited | BVI | US\$250,000 | | 75.61% | Registered agent and trustee services |
| Tricor Services (Malaysia) Sdn. Bhd. | Malaysia | RM5,672,484 | | 60.49% | Investment holding |
| 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 6.3% and 2.1% respectively of the related consolidated totals.

29. INVESTMENTS IN ASSOCIATES

| | The Group | | The Bank | |
|--------------------------------------|-----------|---------|----------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Listed shares, at cost | — | — | 1,781 | 1,743 |
| Unlisted shares, at cost | — | — | 196 | 271 |
| Share of net assets | 2,389 | 2,260 | — | — |
| Goodwill | 226 | 226 | — | — |
| | 2,615 | 2,486 | 1,977 | 2,014 |
| Less: Impairment allowances. | — | — | (31) | (30) |
| | 2,615 | 2,486 | 1,946 | 1,984 |

Loans to associates amounting to HK\$497 million (2008: HK\$76 million) are included under advances to customers.

Share of associates' taxation for the year amounted to HK\$81 million (2008: HK\$59 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 | |
| Listed | | | | |
| Affin Holdings Berhad | Malaysia | 21.095% | | Investment holding |
| Unlisted | | | | |
| 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% | | Inactive |

Notes: BVI denotes the British Virgin Islands and PRC denotes the People's Republic of China.

Summary financial information on associates

| | Assets | Liabilities | Equity | Revenue | Profit |
|-------------------------------------|---------------|---------------|--------------|------------|------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 2009 | | | | | |
| 100 per cent. | 102,075 | 89,071 | 13,004 | 3,506 | 1,052 |
| Group's effective interest. | <u>21,425</u> | <u>19,036</u> | <u>2,389</u> | <u>762</u> | <u>264</u> |
| 2008 | | | | | |
| 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> |

30. 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 | |
|--------------------------------------|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Goodwill | 2,738 | 2,705 | 1,460 | 1,460 |
| Acquired intangible assets | 1,397 | 29 | — | — |
| | <u>4,135</u> | <u>2,734</u> | <u>1,460</u> | <u>1,460</u> |

(a) Goodwill

| | The Group | | The Bank | |
|---|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January | 2,705 | 2,656 | 1,460 | 1,460 |
| Additions through acquisition of subsidiaries | 22 | 52 | — | — |
| Exchange adjustments | 11 | (3) | — | — |
| At 31st December | <u>2,738</u> | <u>2,705</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 segments as follows:

| | 2009 | 2008 |
|------------------------------|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Personal banking | 849 | 849 |
| Corporate banking | 453 | 453 |
| Treasury markets | 158 | 158 |
| Corporate services | 1,100 | 1,067 |
| Others | 178 | 178 |
| | <u>2,738</u> | <u>2,705</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 14.37% (2008: 8.28%) and the long-term growth rate is 3% (2008: 4%).

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 internal forecasts.

(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 income statement 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 | |
|--|--------------|------------|----------|----------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Cost | | | | |
| At 1st January | 38 | 16 | — | — |
| Additions | 1,380 | 6 | — | — |
| Exchange and other adjustments. | — | 16 | — | — |
| At 31st December | <u>1,418</u> | <u>38</u> | <u>—</u> | <u>—</u> |
| Accumulated amortisation | | | | |
| At 1st January | (9) | (4) | — | — |
| Amortisation charge for the year (Note 10) | (13) | (3) | — | — |
| Exchange adjustments | 1 | (2) | — | — |
| At 31st December | <u>(21)</u> | <u>(9)</u> | <u>—</u> | <u>—</u> |
| Carrying amount at 31st December | <u>1,397</u> | <u>29</u> | <u>—</u> | <u>—</u> |

31. FIXED ASSETS

| | 2009 | | | | |
|--|--------------------------|------------------|---|---------------|---------------|
| | 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, 2009 | 1,839 | 6,293 | 3,507 | 9,800 | 11,639 |
| Additions | — | 2,264 | 297 | 2,561 | 2,561 |
| Additions through acquisition | — | — | 16 | 16 | 16 |
| Revaluation surplus | 206 | — | — | — | 206 |
| Revaluation of bank premises transferred to investment properties | — | 97 | — | 97 | 97 |
| Transfer from bank premises to investment properties | 61 | (61) | — | (61) | — |
| Disposals | (14) | (24) | (162) | (186) | (200) |
| Exchange adjustments | 3 | 3 | 15 | 18 | 21 |
| At 31st December, 2009 | <u>2,095</u> | <u>8,572</u> | <u>3,673</u> | <u>12,245</u> | <u>14,340</u> |
| Accumulated depreciation and amortisation | | | | | |
| At 1st January, 2009 | — | 675 | 1,818 | 2,493 | 2,493 |
| Additions through acquisition | — | — | 7 | 7 | 7 |
| Charge for the year (Note 10) | — | 99 | 413 | 512 | 512 |
| Impairment loss | — | 13 | — | 13 | 13 |
| Written back on disposals | (12) | (154) | (166) | (166) | — |
| Exchange adjustments | — | — | 14 | 14 | 14 |
| At 31st December, 2009 | <u>—</u> | <u>775</u> | <u>2,098</u> | <u>2,873</u> | <u>2,873</u> |
| Net book value at 31st December, 2009 | <u>2,095</u> | <u>7,797</u> | <u>1,575</u> | <u>9,372</u> | <u>11,467</u> |
| The gross amounts of the above assets are stated: | | | | | |
| At cost | — | 7,745 | 3,673 | 11,418 | 11,418 |
| At Directors' valuation | | | | | |
| - 1989 | — | 827 | — | 827 | 827 |
| At professional valuation | | | | | |
| - 2009 | 2,095 | — | — | — | 2,095 |
| | <u>2,095</u> | <u>8,572</u> | <u>3,673</u> | <u>12,245</u> | <u>14,340</u> |

| The Bank | | | | | |
|---|----------------------------------|--------------------------|--|------------------|----------------|
| | 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 | 1,819 | 3,135 | 2,246 | 5,381 | 7,200 |
| Additions | — | 602 | 135 | 737 | 737 |
| Revaluation surplus | 205 | — | — | — | 205 |
| Transfer from investment properties to bank premises | (212) | 212 | — | 212 | — |
| Disposals | (14) | — | (133) | (133) | (147) |
| Exchange adjustments | — | — | 7 | 7 | 7 |
| At 31st December, 2009 | <u>1,798</u> | <u>3,949</u> | <u>2,255</u> | <u>6,204</u> | <u>8,002</u> |
| Accumulated depreciation and amortisation | | | | | |
| At 1st January, 2009 | — | 323 | 1,290 | 1,613 | 1,613 |
| Charge for the year | — | 46 | 232 | 278 | 278 |
| Impairment loss | — | 13 | — | 13 | 13 |
| Written back on disposals | — | — | (128) | (128) | (128) |
| Exchange adjustments | — | — | 6 | 6 | 6 |
| At 31st December, 2009 | <u>—</u> | <u>382</u> | <u>1,400</u> | <u>1,782</u> | <u>1,782</u> |
| Net book value at 31st December, 2009 | <u>1,798</u> | <u>3,567</u> | <u>855</u> | <u>4,422</u> | <u>6,220</u> |
| The gross amounts of the above assets are stated: | | | | | |
| At cost | — | 3,122 | 2,255 | 5,377 | 5,377 |
| At Directors' valuation - 1989 | — | 827 | — | 827 | 827 |
| At professional valuation - 2009 | 1,798 | — | — | — | 1,798 |
| | <u>1,798</u> | <u>3,949</u> | <u>2,255</u> | <u>6,204</u> | <u>8,002</u> |

| 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 10) | — | 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 | 1,839 | — | — | — | 1,839 |
| | <u>1,839</u> | <u>6,293</u> | <u>3,507</u> | <u>9,800</u> | <u>11,639</u> |

| The Bank | | | | | |
|--|----------------------------------|--------------------------|--|------------------|----------------|
| | 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 | 1,829 | 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>1,819</u> | <u>2,812</u> | <u>956</u> | <u>3,768</u> | <u>5,587</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 | 1,819 | — | — | — | 1,819 |
| | <u>1,819</u> | <u>3,135</u> | <u>2,246</u> | <u>5,381</u> | <u>7,200</u> |

The net book value of bank premises and investment properties comprises:

| | The Group | | | |
|--|----------------------------------|--------------------------|----------------------------------|--------------------------|
| | 2009 | | 2008 | |
| | Investment properties | Bank premises | Investment properties | Bank premises |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Freeholds — Held outside Hong Kong | 79 | 3,841 | 78 | 1,748 |
| Leaseholds | | | | |
| Held in Hong Kong | | | | |
| On long lease (over 50 years) | 1,489 | 1,586 | 1,449 | 1,477 |
| On medium-term lease (10 - 50 years) | 209 | 1,428 | 303 | 1,354 |
| Held outside Hong Kong | | | | |
| On long lease (over 50 years) | — | 161 | — | 193 |
| On medium-term lease (10 - 50 years) | 318 | 781 | 9 | 846 |
| | <u>2,095</u> | <u>7,797</u> | <u>1,839</u> | <u>5,618</u> |

| | The Bank | | | |
|--|----------------------------------|--------------------------|----------------------------------|--------------------------|
| | 2009 | | 2008 | |
| | Investment properties | Bank premises | Investment properties | Bank premises |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Freeholds — Held outside Hong Kong | — | 748 | — | 150 |
| Leaseholds | | | | |
| Held in Hong Kong | | | | |
| On long lease (over 50 years) | 1,391 | 1,503 | 1,365 | 1,391 |
| On medium-term lease (10 - 50 years) | 407 | 1,313 | 454 | 1,267 |
| Held outside Hong Kong | | | | |
| On long lease (over 50 years) | — | 3 | — | 3 |
| On medium-term lease (10 - 50 years) | — | — | — | 1 |
| | <u>1,798</u> | <u>3,567</u> | <u>1,819</u> | <u>2,812</u> |

The carrying amount of the bank premises of the Group and the Bank would have been HK\$6,933 million (2008: HK\$4,624 million) and HK\$2,498 million (2008: HK\$1,929 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\$1,698 million as at 31st December, 2009 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, 2009 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\$92 million in 2009 (2008: HK\$90 million). There was no contingent rental recognised during the year 2009 (2008: 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 | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Within one year | 78 | 74 | 67 | 69 |
| After one year but within five years | 81 | 62 | 62 | 47 |
| | <u>159</u> | <u>136</u> | <u>129</u> | <u>116</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 | |
|----------------------------------|-----------------|----------------|
| | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn |
| Financial institutions | 11,781 | 15,454 |
| Others | 938 | 944 |
| | <u>12,719</u> | <u>16,398</u> |

(b) Amounts due to subsidiaries

| | The Bank | |
|----------------------------------|-----------------|----------------|
| | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn |
| Financial institutions | 17 | 47 |
| Others | 1,625 | 1,947 |
| | <u>1,642</u> | <u>1,994</u> |

33. INCOME TAX IN THE STATEMENT OF FINANCIAL POSITION

(a) Current taxation in the statement of financial position represents:

| | The Group | | The Bank | |
|--|------------|------------|-----------|-----------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Provision for Hong Kong profits tax for the year (Note 13(a)) | 73 | 64 | — | — |
| Provisional profits tax paid | (49) | (51) | — | — |
| | 24 | 13 | — | — |
| Balance of profits tax provision relating to prior years | 9 | (1) | (14) | (14) |
| Overseas taxation | 114 | 321 | 32 | 74 |
| | <u>147</u> | <u>333</u> | <u>18</u> | <u>60</u> |

(b) 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 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 |
| Deferred tax arising from: | 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 income statement (Note 13(a)) | (56) | 34 | (33) | — | 447 | (61) | 331 |
| Credited to reserves (Notes 38(c) and (h)) | — | 26 | — | 43 | — | — | 69 |
| Exchange and other adjustments | — | 32 | 105 | — | (2) | (227) | (92) |
| At 31st December, 2009 | <u>305</u> | <u>349</u> | <u>23</u> | <u>39</u> | <u>(216)</u> | <u>(302)</u> | <u>198</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 |
|---|--|--|--|--|-------------------|----------------|----------------|
| Deferred tax arising from: | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January, 2008 . . . | 321 | 274 | 58 | 94 | (59) | 114 | 802 |
| Charged/(credited) to income statement (Note 13(a)) | 26 | (14) | (114) | — | (601) | (23) | (726) |
| Credited to reserves (Notes 38(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 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 |
|---|--|--|--|--|-------------------|----------------|----------------|
| Deferred tax arising from: | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January, 2009 . . . | 347 | 257 | (44) | (5) | (528) | (2) | 25 |
| Charged/(credited) to income statement . . . | (58) | 34 | (83) | — | 421 | 7 | 321 |
| Credited to reserves (Notes 38(c) and (h)) . | — | (2) | — | 49 | — | — | 47 |
| Exchange and other adjustments | — | — | 1 | — | (3) | (226) | (228) |
| At 31st December, 2009 . | <u>289</u> | <u>289</u> | <u>(126)</u> | <u>44</u> | <u>(110)</u> | <u>(221)</u> | <u>165</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 |
| Deferred tax arising from: | | | | | | | |
| At 1st January, 2008 . . . | 313 | 274 | (43) | 94 | (9) | 113 | 742 |
| Charged/(credited) to income statement . . . | 34 | (14) | (1) | — | (519) | (11) | (511) |
| Credited to reserves (Notes 38(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 Group | | The Bank | |
|--|------------------|--------------|-----------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Net deferred tax assets recognised on the statement of financial position | (322) | (187) | (168) | (38) |
| Net deferred tax liabilities recognised on the statement of financial position | <u>520</u> | <u>77</u> | <u>333</u> | <u>63</u> |
| | <u>198</u> | <u>(110)</u> | <u>165</u> | <u>25</u> |

(c) **Deferred tax assets not recognised**

The Group has not recognised deferred tax assets in respect of cumulative tax losses of HK\$744 million (2008: HK\$737 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:

| | 2009 | 2008 |
|--------------------------------------|-------------|-------------|
| | HK\$ Mn | HK\$ Mn |
| Expiring within 5 years | 34 | 57 |
| Expiring more than 5 years | 52 | 7 |
| No expiry date | <u>658</u> | <u>673</u> |
| | <u>744</u> | <u>737</u> |

34. OTHER LIABILITIES

| | The Group | | The Bank | |
|---|---------------|---------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| (a) Trading liabilities | | | | |
| Exchange fund bills sold | — | 330 | — | 330 |
| Shares sold | 6 | — | 6 | — |
| | 6 | 330 | 6 | 330 |
| Negative fair value of derivatives (Note 42(b)) | 1,449 | 2,516 | 1,229 | 2,219 |
| | <u>1,455</u> | <u>2,846</u> | <u>1,235</u> | <u>2,549</u> |
| (b) Other accounts and provisions | | | | |
| Accrued interest payable | 1,089 | 1,953 | 595 | 1,035 |
| Acceptance draft payable | 7,976 | 2,989 | 203 | 272 |
| Other accounts | 9,441 | 7,197 | 2,750 | 2,172 |
| | <u>18,506</u> | <u>12,139</u> | <u>3,548</u> | <u>3,479</u> |

35. LOAN CAPITAL

| | The Group | | The Bank | |
|---|---------------|---------------|---------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| USD550 million 5.625% subordinated notes, measured at fair value through profit or loss | 4,281 | 3,644 | 4,281 | 3,644 |
| GBP300 million 6.125% step-up perpetual subordinated notes, measured at fair value through profit or loss | 3,431 | 2,751 | 3,431 | 2,751 |
| USD600 million floating rate step-up subordinated notes, measured at amortised cost | 4,647 | 4,641 | 4,647 | 4,641 |
| USD500 million Hybrid Tier 1 | — | — | 3,916 | — |
| | <u>12,359</u> | <u>11,036</u> | <u>16,275</u> | <u>11,036</u> |

Loan capital of face value of HK\$4,265 million (USD550 million) and carrying amount of HK\$4,281 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\$3,749 million (GBP300 million) and carrying amount of HK\$3,431 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 for the Group as at 31st December, 2009 was HK\$303 million (2008: HK\$1,232 million) and for the Bank was HK\$264 million (2008: HK\$1,232 million) lower than the contractual amount at maturity. The difference in the accumulated amount of the changes in fair value attributable to changes in credit risk for the Group were HK\$618 million (2008: HK\$1,858 million) and for the Bank were HK\$689 million (2008: HK\$1,858 million). The change for the year ended 31st December, 2009 for the Group was HK\$1,240 million (2008: HK\$2,183 million) and for the Bank was HK\$1,169 million (2008: HK\$2,183 million).

Loan capital of face value of HK\$4,653 million (USD600 million) and carrying amount of HK\$4,647 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, 2009 was HK\$4,211 million (USD543 million) (2008: HK\$3,953 million) (USD510 million).

Hybrid Tier 1 capital instruments comprising step-up subordinated notes (“Notes”) of face value HK\$3,878 million (USD500 million) and carrying amount of HK\$3,916 million and HK\$3,878 million (USD500 million) non-cumulative preference shares

(“Innovate Preference Shares”) were issued respectively by the Bank and by Innovate Holdings Limited, a wholly owned subsidiary of the Bank, on 5th November, 2009. The Notes bear a fixed interest rate of 8.5% per annum and will mature on 5th November, 2059. The Innovate Preference Shares are perpetual securities on which no dividend is payable. The Notes and the Innovate Preference Shares are listed, and traded together as units, on the Singapore Stock Exchange. The Hybrid Tier 1 capital instruments are qualified as tier 1 capital of the Bank and the Group. In the consolidated accounts, the Notes are eliminated and the Innovate Preference Shares are classified as minority interest.

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

| <u>Date of grant</u> | <u>Vesting period</u> | <u>Exercise period</u> | <u>Exercise price per share HK\$</u> |
|----------------------|-----------------------|------------------------|--------------------------------------|
| 22/4/2004 | 22/4/2004 - 21/4/2005 | 22/4/2005 - 22/4/2009 | 21.11* |
| 03/5/2005 | 03/5/2005 - 02/5/2006 | 03/5/2006 - 03/5/2010 | 20.86* |
| 03/5/2006 | 03/5/2006 - 02/5/2007 | 03/5/2007 - 03/5/2011 | 30.04* |
| 10/5/2007 | 10/5/2007 - 09/5/2008 | 10/5/2008 - 10/5/2012 | 42.84* |
| 05/5/2008 | 05/5/2008 - 04/5/2009 | 05/5/2009 - 05/5/2013 | 40.09* |
| 05/5/2009 | 05/5/2009 - 04/5/2010 | 05/5/2010 - 05/5/2014 | 21.25 |

(b) The number and weighted average exercise prices of share options are as follows:

| | <u>2009</u> | | <u>2008</u> | |
|--|--|--------------------------|---|---------------------------|
| | <u>Weighted average exercise price</u> | <u>Number of options</u> | <u>Weighted average exercise Price*</u> | <u>Number of options*</u> |
| | <u>HK\$</u> | <u>Mn</u> | <u>HK\$</u> | <u>Mn</u> |
| Outstanding at the beginning of the year | 30.53 | 22 | 24.73 | 21 |
| Exercised during the year. | 20.86 | (2) | 18.56 | (5) |
| Granted during the year. | 21.25 | 6 | 40.09 | 6 |
| Lapsed during the year | 25.67 | (4) | 21.11 | — |
| Outstanding at the end of the year | 29.55 | <u>22</u> | 30.53 | <u>22</u> |
| Exercisable at the end of the year | 33.04 | 16 | 26.86 | 16 |

The weighted average share price at the date of exercise for shares options exercised during the year was HK\$23.60 (2008: HK\$33.72 or HK\$30.65 after adjusting for the bonus issue in 2009).

The options outstanding at 31st December, 2009 had an exercise price from HK\$20.86 to HK\$42.84 (2008: from HK\$22.95 to HK\$47.13 or from HK\$20.86 to HK\$42.84 after adjusting for the bonus issue in 2009) and a weighted average remaining contractual life of 2.63 years (2008: 2.44 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.

| | <u>2009</u> | <u>2008</u> |
|--|-------------|-------------|
| Fair value at measurement date | HK\$9.66 | HK\$13.88* |
| Share price | HK\$21.25 | HK\$40.09* |
| Exercise price. | HK\$21.25 | HK\$40.09* |
| Expected volatility (expressed as weighted average volatility used in the modelling under trinomial lattice model) | 59.96% | 48.88% |
| Option life | 5 years | 5 years |
| Expected dividends | 2.35% | 4.64% |
| Risk-free interest rate (based on Exchange Fund Notes) | 1.64% | 2.48% |

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.

* The Bank made a one for 10 bonus issue of shares on 17th April, 2009 (the “Bonus Issue”). For share options remained exercisable on 17th April, 2009, adjustments for the Bonus Issue were made to the effect that the number of share options have been increased by 10% and the exercise prices have been decreased accordingly. These adjustments were made in accordance with the Rules of the relevant share option schemes.

37. SHARE CAPITAL

| | <u>2009</u> | | <u>2008</u> | |
|--|----------------------|----------------------|----------------------|----------------------|
| | <u>No. of shares</u> | <u>Nominal value</u> | <u>No. of shares</u> | <u>Nominal value</u> |
| | <u>million</u> | | <u>million</u> | |
| Authorised: | | | | |
| Ordinary shares of HK\$2.50 each | <u>2,600</u> | <u>HK\$6,500Mn</u> | <u>2,600</u> | <u>HK\$6,500Mn</u> |
| Substitute preference shares of US\$1,000 each | <u>0.5</u> | <u>US\$500Mn</u> | <u>—</u> | <u>—</u> |
| | | <u>HK\$ Mn</u> | | <u>HK\$ Mn</u> |
| Issued and fully paid: | | | | |
| At 1st January. | 1,673 | 4,183 | 1,574 | 3,936 |
| Shares issued under Staff Share Option Schemes | 2 | 5 | 5 | 12 |
| Subscription for new shares. | — | — | 79 | 197 |
| Capitalisation issue. | 167 | 418 | — | — |
| Shares issued in lieu of dividends | <u>7</u> | <u>17</u> | <u>15</u> | <u>38</u> |
| At 31st December. | <u>1,849</u> | <u>4,623</u> | <u>1,673</u> | <u>4,183</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 2 million ordinary shares in the Bank at a consideration of HK\$41 million of which HK\$5 million was credited to share capital and the balance of HK\$36 million was credited to the share premium account (Note 38). HK\$3 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**

| Date of options granted | Option price | 2009 | 2008 |
|-------------------------|--------------|-------------------|--------------------|
| | | No. of shares | No. of shares |
| 22/4/2004 | HK\$21.11* | — | 3,041,500* |
| 03/5/2005 | HK\$20.86* | 4,737,000 | 6,715,500* |
| 03/5/2006 | HK\$30.04* | 2,695,000 | 2,970,000* |
| 10/5/2007 | HK\$42.84* | 2,750,000 | 3,025,000* |
| 05/5/2008 | HK\$40.09* | 5,500,000 | 6,050,000* |
| 05/5/2009 | HK\$21.25* | 6,600,000 | — |
| | | <u>22,282,000</u> | <u>21,802,000*</u> |

* After adjusting for the bonus issue in 2009.

38. RESERVES

| | 2009 | |
|--|---------------|---------------|
| | The Group | The Bank |
| | HK\$ Mn | HK\$ Mn |
| (a) Share premium (undistributable) | | |
| At 1st January | 4,922 | 4,922 |
| Net premium on shares issued under Staff Share Option Schemes | 36 | 36 |
| Transfer of the fair value of options from capital reserve — share options issued. | 3 | 3 |
| Shares issued in lieu of dividends | (17) | (17) |
| Capitalisation issue | <u>(418)</u> | <u>(418)</u> |
| At 31st December | <u>4,526</u> | <u>4,526</u> |
| (b) General reserve | | |
| At 1st January | 14,634 | 14,369 |
| Transfer from retained profits | 49 | — |
| Shares issued in lieu of dividends | 177 | 177 |
| Realised surplus on disposals transferred from property revaluation reserve | <u>6</u> | <u>6</u> |
| At 31st December | <u>14,866</u> | <u>14,552</u> |
| (c) Revaluation reserve on bank premises (undistributable) | | |
| At 1st January | 863 | 899 |
| Recognition of net deferred tax liabilities (Note 33(b)). | (26) | 2 |
| Revaluation surplus on bank premises transferred to investment properties | 97 | — |
| Realised surplus on disposals transferred to general reserve | <u>(6)</u> | <u>(6)</u> |
| At 31st December | <u>928</u> | <u>895</u> |

| | <u>The Group</u> | <u>The Bank</u> |
|--|------------------|-----------------|
| | HK\$ Mn | HK\$ Mn |
| (d) Statutory reserves (undistributable) | | |
| At 1st January | 1,216 | — |
| Transfer from retained profits | 285 | 7 |
| At 31st December | <u>1,501</u> | <u>7</u> |
| (e) Capital reserve (undistributable) | | |
| At 1st January and 31st December | <u>86</u> | <u>—</u> |
| (f) Exchange revaluation reserve (undistributable) | | |
| At 1st January | 1,006 | 48 |
| Exchange adjustments | 163 | 7 |
| At 31st December | <u>1,169</u> | <u>55</u> |
| (g) Capital reserve — staff share options issued (undistributable) | | |
| At 1st January | 125 | 125 |
| Transfer of the fair value of options to share premium | (3) | (3) |
| Forfeited options transfer to retained profits | (23) | (23) |
| Additions | 71 | 71 |
| At 31st December | <u>170</u> | <u>170</u> |
| (h) Investment revaluation reserve (undistributable) | | |
| At 1st January | (228) | (45) |
| Changes in fair value of securities | 575 | 267 |
| Reversal upon disposal (Note 12) | (29) | 5 |
| Recognition of deferred tax liabilities (Note 33(b)) | (43) | (49) |
| Impairment loss and amortisation | 11 | — |
| At 31st December | <u>286</u> | <u>178</u> |
| (i) Other reserves | | |
| At 1st January | — | — |
| Share of changes in equity of associates | 17 | — |
| At 31st December | <u>17</u> | <u>—</u> |
| (j) Retained profits | | |
| At 1st January | 5,339 | 2,724 |
| Net profit for the year | 2,565 | 995 |
| Transfer to general reserve | (49) | — |
| Transfer to statutory reserve | (285) | (7) |
| Forfeited options transfer to retained profits | 23 | 23 |
| Dividends (Note 15) | | |
| - Interim dividend | (516) | (516) |
| - Final dividend in respect of previous year | (33) | (33) |
| - Hybrid Tier 1 USD500M | (51) | — |
| At 31st December | <u>6,993</u> | <u>3,186</u> |
| (k) Total reserves | <u>30,542</u> | <u>23,569</u> |

| | <u>The Group</u> | <u>The Bank</u> |
|---|------------------|-----------------|
| | HK\$ Mn | HK\$ Mn |
| (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 |
| At 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 33(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> |
| (e) Capital reserve (undistributable) | | |
| At 1st January and 31st December | <u>86</u> | <u>—</u> |
| (f) Exchange revaluation reserve (undistributable) | | |
| At 1st January | 650 | 80 |
| Exchange adjustments | 356 | (32) |
| At 31st December | <u>1,006</u> | <u>48</u> |
| (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 | <u>125</u> | <u>125</u> |
| (h) Investment revaluation reserve (undistributable) | | |
| At 1st January | 475 | 422 |
| Changes in fair value of securities | (830) | (472) |
| Reversal upon disposal (Note 12) | (115) | (114) |
| Recognition of deferred tax liabilities (Note 33(b)) | 98 | 99 |
| Impairment loss | 153 | 20 |
| Exchange adjustments | (9) | — |
| At 31st December | <u>(228)</u> | <u>(45)</u> |

| | | 2008 | |
|-----|---|------------------|-----------------|
| | | <u>The Group</u> | <u>The Bank</u> |
| | | HK\$ Mn | HK\$ Mn |
| (i) | Other reserves | | |
| | At 1st January | 22 | — |
| | Share of changes in equity of associates. | (22) | — |
| | At 31st December | <u>—</u> | <u>—</u> |
| (j) | 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 15) | | |
| | - Interim dividend | (384) | (384) |
| | - Final dividend in respect of previous year. | (1,956) | (1,956) |
| | At 31st December | <u>5,339</u> | <u>2,724</u> |
| (k) | Total reserves. | <u>27,963</u> | <u>23,042</u> |

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 recognized 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).

Other reserve represents share of changes in equity of associates of investment revaluation reserve and revaluation reserve of bank premises.

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, 2009, HK\$1,857 million (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.

At 31st December, 2009 the aggregate amount of reserves available for distribution to equity holders of the Bank was HK\$17,738 million (2008: HK\$17,093 million). After the balance sheet date the directors proposed a final dividend of HK\$0.48 per ordinary share (2008: HK\$0.02 per share), amounting to HK\$968 million (2008: HK\$33 million). The dividend has not been recognised as a liability at the balance sheet date.

39. MINORITY INTERESTS

| | <u>2009</u> | <u>2008</u> |
|---|---------------------|-------------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| At 1st January | 339 | 347 |
| - sale of interests in businesses to minority interests investors. | 132 | — |
| - purchase of interests in businesses from minority interests investors | (10) | (64) |
| - Hybrid Tier 1 note issue. | 3,877 | — |
| - final dividend in respect of previous year | (55) | (7) |
| - exchange adjustments | 2 | (2) |
| Profit for the year | <u>73</u> | <u>65</u> |
| At 31st December | <u><u>4,358</u></u> | <u><u>339</u></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, strategic risk, legal risk and reputation risk of the Group are reviewed regularly by the Management and specialised risk management committees, and recommendations are made by the Risk Management Committee, which comprises the Group's Chairman and Chief Executive, Senior Advisors, Deputy Chief Executives and the Group Chief Risk Officer, for the approval of the Board of Directors. There is an independent centralised risk management unit, Risk Management Division, 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. Credit Risk Management Department under Risk Management Division 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 Specialised 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 being 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 statement of financial position after deducting any impairment allowance. A summary of the maximum exposure is as follows:

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Cash and balances with banks, central banks and other financial institutions | 28,611 | 27,022 | 11,821 | 4,154 |
| Placements with banks, central banks and other financial institutions | 67,945 | 96,574 | 61,894 | 92,735 |
| Trade bills | 1,847 | 1,164 | 861 | 521 |
| Trading assets | 4,092 | 2,260 | 1,749 | 1,777 |
| Financial assets designated at fair value through profit or loss . . | 10,043 | 4,130 | 10,035 | 4,114 |
| Loans and advances to customers | 246,309 | 229,295 | 142,197 | 130,293 |
| Available-for-sale financial assets | 28,996 | 17,551 | 17,949 | 10,276 |
| Held-to-maturity investments | 7,239 | 5,006 | 4,802 | 3,318 |
| Other assets | 14,369 | 11,478 | 5,491 | 7,376 |
| Financial guarantees and other credit related contingent liabilities | 9,965 | 10,088 | 7,616 | 9,138 |
| Loan commitments and other credit related commitments | <u>77,273</u> | <u>66,080</u> | <u>59,169</u> | <u>53,283</u> |
| | <u>496,689</u> | <u>470,648</u> | <u>323,584</u> | <u>316,985</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, 2009 and 2008, 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 | |
|---|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Gross loans and advances to customers | | | | |
| - neither past due nor impaired | 245,149 | 228,479 | 141,219 | 129,683 |
| - past due but not impaired | 57 | 274 | 44 | 166 |
| - impaired | <u>2,448</u> | <u>1,586</u> | <u>2,111</u> | <u>1,274</u> |
| | <u>247,654</u> | <u>230,339</u> | <u>143,374</u> | <u>131,123</u> |

Of which:

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Gross loans and advances to customers that are neither past due nor impaired | | | | |
| - Pass | 242,617 | 226,550 | 139,187 | 128,219 |
| - Special mention | <u>2,532</u> | <u>1,929</u> | <u>2,032</u> | <u>1,464</u> |
| | <u>245,149</u> | <u>228,479</u> | <u>141,219</u> | <u>129,683</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 | |
|--|-----------|---------|----------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | 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 | 57 | 274 | 44 | 166 |

Loans and advances that would be past due or impaired had the terms not been renegotiated amounted to HK\$234 million as at 31st December, 2009 (2008: HK\$239 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 | |
|-------------------------|-----------|---------|----------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Aaa | 4,783 | 1,790 | 4,571 | 1,608 |
| Aa1 to Aa3 | 11,672 | 5,706 | 10,395 | 4,604 |
| A1 to A3 | 7,616 | 2,706 | 6,384 | 2,029 |
| Lower than A3 | 1,967 | 1,121 | 1,462 | 851 |
| | 26,038 | 11,323 | 22,812 | 9,092 |
| P-1 | 10,176 | — | — | — |
| Unrated | 4,323 | 2,440 | 3,223 | 2,440 |
| Total | 40,537 | 13,763 | 26,035 | 11,532 |

(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 | |
|--|----------------|----------------|----------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| | 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 | 192,357 | 178,200 | 106,004 | 95,567 |
| - past due but not impaired | <u>57</u> | <u>210</u> | <u>42</u> | <u>147</u> |
| | <u>192,414</u> | <u>178,410</u> | <u>106,046</u> | <u>95,714</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 statement of financial position 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

| | 2009 | | | | 2008 | | | |
|--|-----------------|------------------|--------------------------------|------------------|-----------------|------------------|--------------------------------|------------------|
| | 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 |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 2,241 | 17,427 | 1,453 | 21,121 | 2,425 | 23,215 | 1,263 | 26,903 |
| Placements with banks and other financial institutions | 14,832 | 4,169 | 24,609 | 43,610 | 28,670 | 1,252 | 18,795 | 48,717 |
| Trade bills | 1,782 | 8 | 44 | 1,834 | 1,078 | — | 72 | 1,150 |
| Trading assets | 836 | 2,327 | 312 | 3,475 | 652 | 438 | 160 | 1,250 |
| Financial assets designated at fair value through profit or loss | 6,709 | — | 908 | 7,617 | 2,158 | — | 631 | 2,789 |
| Advances to customers and other accounts | 44,193 | 83,346 | 19,252 | 146,791 | 42,442 | 75,119 | 17,419 | 134,980 |
| Available-for-sale financial assets | 7,324 | 9,650 | 5,233 | 22,207 | 3,261 | 6,184 | 3,594 | 13,039 |
| Held-to-maturity investments . | 3,088 | — | 2,106 | 5,194 | 1,941 | — | 1,864 | 3,805 |
| Investment in associates . . . | 360 | — | — | 360 | 292 | — | — | 292 |
| Fixed assets | 190 | 4,805 | 879 | 5,874 | 211 | 3,083 | 267 | 3,561 |
| Goodwill and intangible assets | 239 | 20 | 404 | 663 | 241 | 20 | 386 | 647 |
| Deferred tax assets | 230 | — | 80 | 310 | 161 | — | 8 | 169 |
| Spot assets | <u>82,024</u> | <u>121,752</u> | <u>55,280</u> | <u>259,056</u> | <u>83,532</u> | <u>109,311</u> | <u>44,459</u> | <u>237,302</u> |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | (4,715) | (4,582) | (1,949) | (11,246) | (1,456) | (25,020) | (297) | (26,773) |
| Deposits from customers . . . | (60,630) | (97,918) | (48,141) | (206,689) | (59,678) | (73,464) | (41,000) | (174,142) |
| Trading liabilities | (1,042) | (26) | (59) | (1,127) | (1,595) | (148) | (199) | (1,942) |
| Certificates of deposit issued. | (1,639) | — | — | (1,639) | (2,452) | — | (426) | (2,878) |
| Current taxation | 13 | (58) | (70) | (115) | (27) | (192) | (31) | (250) |
| Debt securities issued | — | (4,346) | — | (4,346) | — | — | — | — |
| Deferred tax liabilities | (4) | (82) | (42) | (128) | (4) | — | — | (4) |
| Other accounts and provisions | (2,716) | (9,333) | (1,394) | (13,443) | (2,176) | (4,524) | (966) | (7,666) |
| Loan capital | <u>(8,928)</u> | <u>—</u> | <u>(3,431)</u> | <u>(12,359)</u> | <u>(8,285)</u> | <u>—</u> | <u>(2,751)</u> | <u>(11,036)</u> |
| Spot liabilities | <u>(79,661)</u> | <u>(116,345)</u> | <u>(55,086)</u> | <u>(251,092)</u> | <u>(75,673)</u> | <u>(103,348)</u> | <u>(45,670)</u> | <u>(224,691)</u> |
| Forward purchases | 59,917 | 27,419 | 11,016 | 98,352 | 51,244 | 18,872 | 11,843 | 81,959 |
| Forward sales | (57,946) | (27,850) | (8,726) | (94,522) | (55,976) | (18,781) | (8,713) | (83,470) |
| Net option position | <u>(45)</u> | <u>—</u> | <u>34</u> | <u>(11)</u> | <u>3</u> | <u>—</u> | <u>(4)</u> | <u>(1)</u> |
| Net long non-structural position | <u>4,289</u> | <u>4,976</u> | <u>2,518</u> | <u>11,783</u> | <u>3,130</u> | <u>6,054</u> | <u>1,915</u> | <u>11,099</u> |
| Net structural position . . . | <u>2,432</u> | <u>6,605</u> | <u>1,012</u> | <u>10,049</u> | <u>2,179</u> | <u>6,602</u> | <u>940</u> | <u>9,721</u> |

The Bank

| | 2009 | | | | 2008 | | | |
|--|---------------|--------------|--------------------------|----------------|---------------|--------------|--------------------------|----------------|
| | 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 |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 1,220 | 1,946 | 1,055 | 4,221 | 1,107 | 1,373 | 962 | 3,442 |
| Placements with banks and other financial institutions | 13,504 | — | 24,506 | 38,010 | 26,730 | — | 18,795 | 45,525 |
| Trade bills | 838 | — | 10 | 848 | 454 | — | 55 | 509 |
| Trading assets | 819 | 1 | 311 | 1,131 | 611 | 1 | 159 | 771 |
| Financial assets designated at fair value through profit or loss | 6,701 | — | 908 | 7,609 | 2,141 | — | 631 | 2,772 |
| Advances to customers and other accounts | 19,052 | 21 | 15,385 | 34,458 | 20,184 | 18 | 14,602 | 34,804 |
| Available-for-sale financial assets | 5,638 | 135 | 4,991 | 10,764 | 2,178 | 428 | 3,511 | 6,117 |
| Amounts due from subsidiaries | 7,525 | 730 | 695 | 8,950 | 12,663 | 549 | — | 13,212 |
| Held-to-maturity investments | 1,788 | — | 1,985 | 3,773 | 1,098 | — | 1,738 | 2,836 |
| Investment in subsidiaries and associates | 2,075 | — | 361 | 2,436 | 1,786 | — | 361 | 2,147 |
| Fixed assets | 7 | — | 807 | 814 | 9 | — | 203 | 212 |
| Deferred tax assets | 91 | — | 77 | 168 | 33 | — | 5 | 38 |
| Spot assets | <u>59,258</u> | <u>2,833</u> | <u>51,091</u> | <u>113,182</u> | <u>68,994</u> | <u>2,369</u> | <u>41,022</u> | <u>112,385</u> |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | (1,227) | — | (1,654) | (2,881) | (620) | — | (202) | (822) |
| Deposits from customers | (42,215) | (2,614) | (45,959) | (90,788) | (48,260) | (2,488) | (39,107) | (89,855) |
| Trading liabilities | (861) | — | (46) | (907) | (1,464) | — | (181) | (1,645) |
| Certificates of deposit issued | (1,639) | — | — | (1,639) | (2,452) | — | (426) | (2,878) |
| Amounts due to subsidiaries | (543) | — | (26) | (569) | (552) | — | (198) | (750) |
| Current taxation | 2 | — | (35) | (33) | (29) | — | (45) | (74) |
| Other accounts and provisions | (455) | (6) | (1,248) | (1,709) | (821) | (6) | (829) | (1,656) |
| Loan capital | (12,844) | — | (3,431) | (16,275) | (8,285) | — | (2,751) | (11,036) |
| Spot liabilities | (59,782) | (2,620) | (52,399) | (114,801) | (62,483) | (2,494) | (43,739) | (108,716) |
| Forward purchases | 72,537 | 161 | 10,725 | 83,423 | 44,169 | 15 | 11,820 | 56,004 |
| Forward sales | (71,256) | (153) | (8,429) | (79,838) | (49,326) | (19) | (8,184) | (57,529) |
| Net option position | (45) | — | 34 | (11) | 3 | — | (4) | (1) |
| Net long/(short) non-structural position | <u>712</u> | <u>221</u> | <u>1,022</u> | <u>1,955</u> | <u>1,357</u> | <u>(129)</u> | <u>915</u> | <u>2,143</u> |
| Net structural position | <u>2,432</u> | <u>6,605</u> | <u>1,012</u> | <u>10,049</u> | <u>2,179</u> | <u>6,602</u> | <u>940</u> | <u>9,721</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 Markets Division 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

| | 2009 | | | |
|---|---------------------|---------|---------|---------|
| | At 31st December | Maximum | Minimum | Mean |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| VaR for total trading activities | 45 | 76 | 43 | 59 |
| VaR for foreign exchange trading positions* | 7 | 21 | 5 | 11 |
| VaR for interest rate trading positions | 3 | 4 | 1 | 3 |
| VaR for equity trading positions | 37 | 61 | 35 | 46 |

| | 2008 | | | |
|---|---------------------|---------|---------|---------|
| | At 31st December | Maximum | Minimum | Mean |
| | 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 |

* 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 centralised 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. Operational Risk Management Department under Risk Management Division 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, Operational Risk Management Department under Risk Management Division 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 had been reviewed independently by 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 capitalise 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 Markets Division within the limits approved by the Board of Directors. Asset and Liability Management Department under Risk Management Division of the Group is responsible for monitoring the activities of Treasury Markets Division 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 analyse 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

2009

| | Repayable on demand | Within 1 month | 3 months or less but over 1 month | 1 year or less but over 3 months | 5 years or less but over 1 year | Over 5 years | Undated or overdue | Total |
|---|------------------------|-------------------|--|---|---------------------------------------|-----------------|-----------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 18,156 | 26 | 48 | — | — | — | 11,482 | 29,712 |
| Placements with banks and other financial institutions | — | 35,006 | 15,471 | 17,468 | — | — | — | 67,945 |
| Trade bills | 38 | 332 | 1,028 | 443 | — | — | 6 | 1,847 |
| Trading assets | — | — | 126 | 949 | 1,949 | 100 | 2,598 | 5,722 |
| Financial assets designated at fair value through profit or loss | — | — | 15 | 108 | 7,835 | 2,085 | 349 | 10,392 |
| Advances to customers and other accounts | 4,410 | 26,242 | 14,803 | 50,376 | 100,562 | 61,317 | 4,093 | 261,803 |
| Available-for-sale financial assets | — | 1,438 | 3,639 | 9,241 | 13,012 | 1,666 | 1,887 | 30,883 |
| Held-to-maturity investments | — | 729 | 602 | 1,306 | 4,011 | 591 | — | 7,239 |
| Undated assets | — | — | — | — | — | — | 18,539 | 18,539 |
| Total assets | 22,604 | 63,773 | 35,732 | 79,891 | 127,369 | 65,759 | 38,954 | 434,082 |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | 291 | 5,774 | 4,155 | 1,613 | 20 | — | 33 | 11,886 |
| Deposits from customers | 129,231 | 104,732 | 53,276 | 44,222 | 11,067 | — | — | 342,528 |
| - Demand deposits and current accounts | 46,380 | — | — | — | — | — | — | 46,380 |
| - Savings deposit | 81,711 | — | — | — | — | — | — | 81,711 |
| - Time, call and notice deposits | 1,140 | 104,732 | 53,276 | 44,222 | 11,067 | — | — | 214,437 |
| Trading liabilities | — | — | — | — | — | — | 1,455 | 1,455 |
| Certificates of deposit issued | — | — | 295 | 1,119 | 1,094 | 304 | — | 2,812 |
| Current taxation | — | — | — | 147 | — | — | — | 147 |
| Debt securities issued | — | — | — | — | 4,346 | — | — | 4,346 |
| Loan capital | — | — | — | 4,281 | 8,078 | — | — | 12,359 |
| Other liabilities | 590 | 2,391 | 2,522 | 4,940 | 873 | — | 7,710 | 19,026 |
| Total liabilities | 130,112 | 112,897 | 60,248 | 56,322 | 25,478 | 304 | 9,198 | 394,559 |
| Net gap | (107,508) | (49,124) | (24,516) | 23,569 | 101,891 | 65,455 | | |

The Group

2008

| | Repayable on demand | Within 1 month | 3 months or less but over 1 month | 1 year or less but over 3 months | 5 years or less but over 1 year | Over 5 years | Undated or overdue | Total |
|---|------------------------|-------------------|--|---|---------------------------------------|-----------------|-----------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 19,099 | 42 | 25 | — | — | — | 8,939 | 28,105 |
| Placements with banks and other financial institutions | — | 46,714 | 35,910 | 13,950 | — | — | — | 96,574 |
| Trade bills | 18 | 371 | 620 | 139 | — | — | 16 | 1,164 |
| Trading assets | — | 400 | — | 2 | 81 | 43 | 2,911 | 3,437 |
| Financial assets designated at fair value through profit or loss | — | 23 | 117 | 448 | 3,104 | 438 | — | 4,130 |
| Advances to customers and other accounts | 4,431 | 25,229 | 18,521 | 42,249 | 86,169 | 55,285 | 11,841 | 243,725 |
| Available-for-sale financial assets | — | 2,523 | 2,918 | 5,651 | 5,510 | 949 | 1,009 | 18,560 |
| Held-to-maturity investments | — | 483 | 497 | 1,546 | 2,160 | 320 | — | 5,006 |
| Undated assets | — | — | — | — | — | — | 14,553 | 14,553 |
| Total assets | 23,548 | 75,785 | 58,608 | 63,985 | 97,024 | 57,035 | 39,269 | 415,254 |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | 871 | 7,105 | 11,045 | 7,644 | 362 | 10 | 8 | 27,045 |
| Deposits from customers | 86,109 | 121,332 | 70,761 | 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 | 121,332 | 70,761 | 35,341 | 9,237 | 1,022 | — | 241,689 |
| Trading liabilities | — | 100 | 30 | 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 |
| Other liabilities | 714 | 539 | 1,645 | 2,237 | — | — | 7,081 | 12,216 |
| Total liabilities | 87,694 | 129,076 | 85,422 | 46,636 | 22,663 | 1,673 | 9,605 | 382,769 |
| Net gap | (64,146) | (53,291) | (26,814) | 17,349 | 74,361 | 55,362 | | |

The Bank

2009

| | Repayable on demand | Within 1 month | 3 months or less but over 1 month | 1 year or less but over 3 months | 5 years or less but over 1 year | Over 5 years | Undated or overdue | Total |
|---|------------------------|-------------------|--|---|---------------------------------------|-----------------|-----------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 11,767 | — | — | — | — | — | 760 | 12,527 |
| Placements with banks and other financial institutions | — | 31,895 | 13,313 | 16,686 | — | — | — | 61,894 |
| Trade bills | 36 | 132 | 528 | 159 | — | — | 6 | 861 |
| Trading assets | — | — | 1 | 1 | 802 | 100 | 2,420 | 3,324 |
| Financial assets designated at fair value through profit or loss | — | — | 15 | 108 | 7,827 | 2,085 | 349 | 10,384 |
| Advances to customers and other accounts | 4,078 | 19,841 | 7,398 | 17,595 | 59,910 | 35,731 | 4,043 | 148,596 |
| Available-for-sale financial assets | — | 1,421 | 3,061 | 3,692 | 8,979 | 796 | 986 | 18,935 |
| Held-to-maturity investments | — | 613 | 563 | 820 | 2,805 | 1 | — | 4,802 |
| Undated assets | — | — | — | — | — | — | 35,970 | 35,970 |
| Total assets | 15,881 | 53,902 | 24,879 | 39,061 | 80,323 | 38,713 | 44,534 | 297,293 |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | 277 | 1,300 | 1,557 | 354 | — | — | 33 | 3,521 |
| Deposits from customers | 93,026 | 87,296 | 37,746 | 18,685 | 764 | — | — | 237,517 |
| - Demand deposits and current accounts | 14,860 | — | — | — | — | — | — | 14,860 |
| - Savings deposit | 78,024 | — | — | — | — | — | — | 78,024 |
| - Time, call and notice deposits | 142 | 87,296 | 37,746 | 18,685 | 764 | — | — | 144,633 |
| Trading liabilities | — | — | — | — | — | — | 1,235 | 1,235 |
| Certificates of deposit issued | — | — | 295 | 1,119 | 1,094 | 2,504 | — | 5,012 |
| Current taxation | — | — | — | 18 | — | — | — | 18 |
| Loan capital | — | — | — | 4,281 | 8,078 | 3,916 | — | 16,275 |
| Other liabilities | — | 686 | 115 | 39 | 18 | — | 4,665 | 5,523 |
| Total liabilities | 93,303 | 89,282 | 39,713 | 24,496 | 9,954 | 6,420 | 5,933 | 269,101 |
| Net gap | (77,422) | (35,380) | (14,834) | 14,565 | 70,369 | 32,293 | | |

The Bank

2008

| | Repayable on demand | Within 1 month | 3 months or less but over 1 month | 1 year or less but over 3 months | 5 years or less but over 1 year | Over 5 years | Undated or overdue | Total |
|---|------------------------|-------------------|--|---|---------------------------------------|-----------------|-----------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Cash and balances with banks and other financial institutions | 4,189 | — | — | — | — | — | 663 | 4,852 |
| Placements with banks and other financial institutions | — | 43,010 | 35,777 | 13,948 | — | — | — | 92,735 |
| Trade bills | 14 | 182 | 174 | 135 | — | — | 16 | 521 |
| Trading assets | — | 400 | — | 2 | 81 | 43 | 2,388 | 2,914 |
| Financial assets designated at fair value through profit or loss | — | 23 | 117 | 448 | 3,088 | 438 | — | 4,114 |
| Advances to customers and other accounts | 4,319 | 19,054 | 8,034 | 16,085 | 51,694 | 31,570 | 7,884 | 138,640 |
| Available-for-sale financial assets | — | 574 | 562 | 3,947 | 5,067 | 126 | 709 | 10,985 |
| Held-to-maturity investments | — | 315 | 147 | 1,092 | 1,653 | 111 | — | 3,318 |
| Undated assets | — | — | — | — | — | — | 37,140 | 37,140 |
| Total assets | 8,522 | 63,558 | 44,811 | 35,657 | 61,583 | 32,288 | 48,800 | 295,219 |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions | 329 | 327 | 422 | 7 | — | — | 8 | 1,093 |
| Deposits from customers | 54,219 | 110,232 | 56,082 | 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 | 110,232 | 56,082 | 18,439 | 1,057 | — | — | 186,495 |
| Trading liabilities | — | 100 | 30 | 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 |
| Other liabilities | — | 153 | 142 | 28 | — | — | 5,213 | 5,536 |
| Total liabilities | 54,548 | 110,812 | 58,617 | 19,615 | 14,121 | 2,841 | 7,440 | 267,994 |
| Net gap | (46,026) | (47,254) | (13,806) | 16,042 | 47,462 | 29,447 | | |

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

| 2009 | | | | | | | |
|---|--------------------|---------------------|------------------------|-----------------------------------|----------------------------|----------------------|--------------|
| 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Deposits and balances of banks and other financial institutions | 11,886 | 12,213 | 291 | 9,966 | 1,869 | 54 | 33 |
| Deposits from customers | 342,528 | 343,883 | 129,350 | 158,358 | 44,627 | 11,548 | — |
| - Demand deposits and current accounts | 46,380 | 46,380 | 46,380 | — | — | — | — |
| - Savings deposit | 81,711 | 81,730 | 81,730 | — | — | — | — |
| - Time, call and notice deposits | 214,437 | 215,773 | 1,240 | 158,358 | 44,627 | 11,548 | — |
| Trading liabilities | 1,455 | 1,455 | — | — | — | — | 1,455 |
| Certificates of deposit issued | 2,812 | 2,854 | — | 314 | 1,136 | 1,100 | 304 |
| Current taxation | 147 | 147 | — | — | 147 | — | — |
| Debt securities issued | 4,346 | 4,600 | — | 65 | 62 | 4,473 | — |
| Loan capital | 12,359 | 13,266 | — | 124 | 4,664 | 8,478 | — |
| Interest rate swaps | 4,364 | 4,364 | — | 266 | 863 | 1,029 | — |
| Other liabilities | 19,026 | 19,026 | 590 | 4,913 | 4,940 | 873 | 7,710 |
| Total | 398,923 | 401,808 | 130,231 | 174,006 | 58,308 | 28,732 | 9,198 |

The Group

| 2008 | | | | | | | |
|---|--------------------|---------------------|------------------------|-----------------------------------|----------------------------|----------------------|--------------|
| 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\$ Mn | 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 |
| 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 | 714 | 2,184 | 2,237 | — | 7,081 |
| Total | 384,561 | 389,518 | 87,874 | 216,218 | 48,456 | 25,334 | 9,605 |

The Bank

2009

| | 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\$ Mn | HK\$ Mn | HK\$ Mn | |
| Deposits and balances of banks and other financial institutions | 3,521 | 3,523 | 277 | 2,859 | 354 | — | — | 33 |
| Deposits from customers | 237,517 | 237,777 | 93,026 | 125,202 | 18,782 | 767 | — | — |
| - Demand deposits and current accounts | 14,860 | 14,860 | 14,860 | — | — | — | — | — |
| - Savings deposit | 78,024 | 78,024 | 78,024 | — | — | — | — | — |
| - Time, call and notice deposits | 144,633 | 144,893 | 142 | 125,202 | 18,782 | 767 | — | — |
| Trading liabilities | 1,235 | 1,235 | — | — | — | — | — | 1,235 |
| Certificates of deposit issued | 5,012 | 5,054 | — | 314 | 1,136 | 1,100 | 2,504 | — |
| Current taxation | 18 | 18 | — | — | 18 | — | — | — |
| Loan capital | 16,275 | 20,478 | — | 124 | 4,993 | 9,797 | 5,564 | — |
| Interest rate swaps | 3,639 | 3,639 | — | 166 | 540 | 1,959 | 974 | — |
| Other liabilities | 5,523 | 5,762 | — | 801 | 39 | 18 | — | 4,904 |
| Total | 272,740 | 277,486 | 93,303 | 129,466 | 25,862 | 13,641 | 9,042 | 6,172 |

The Bank

2008

| | 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\$ 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 | — | 305 | 51 | 68 | 58 | 5,213 |
| Total | 269,279 | 272,330 | 54,548 | 170,581 | 20,768 | 16,024 | 2,969 | 7,440 |

(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 Markets Division within the limit approved by the Board of Directors. Asset and Liability Management Department under Risk Management Division of the Group is responsible for monitoring the activities of Treasury Markets Division 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:

| | 2009 | | | 2008 | | |
|--|---------|---------|---------|---------|---------|---------|
| | HKD | USD | CNY | HKD | USD | CNY |
| | HK\$ Mn |
| Impact on earnings over the next 12 months if interest rates rise by 200 basis points. | (112) | (72) | (25) | 64 | (26) | 185 |
| Impact on economic value if interest rates rise by 200 basis points | (231) | (312) | (152) | (98) | (203) | 113 |

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 are 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

| | 2009 | | | | | |
|--|-----------------------------|--|---------------------------------------|-------------------------|---------------------------------|----------------|
| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| Cash and balances with banks and other financial institutions | 27,130 | 22 | — | — | 2,560 | 29,712 |
| Placements with banks and other financial institutions | 50,477 | 17,468 | — | — | — | 67,945 |
| Trade bills | 1,359 | 443 | — | — | 45 | 1,847 |
| Trading assets | 126 | 949 | 1,949 | 100 | 2,598 | 5,722 |
| Financial assets designated at fair value through profit or loss | 653 | 192 | 7,113 | 2,085 | 349 | 10,392 |
| Advances to customers | 191,994 | 39,853 | 8,875 | 3,033 | 2,554 | 246,309 |
| Other accounts | 786 | 146 | — | — | 14,562 | 15,494 |
| Available-for-sale financial assets | 11,350 | 8,257 | 8,156 | 1,233 | 1,887 | 30,883 |
| Held-to-maturity investments | 2,383 | 1,050 | 3,215 | 591 | — | 7,239 |
| Non-interest bearing assets | — | — | — | — | 18,539 | 18,539 |
| Total assets | <u>286,258</u> | <u>68,380</u> | <u>29,308</u> | <u>7,042</u> | <u>43,094</u> | <u>434,082</u> |
| Liabilities | | | | | | |
| Deposits and balances of banks and other financial institutions | 11,217 | 589 | 33 | 10 | 37 | 11,886 |
| Deposits from customers | 277,844 | 47,220 | 4,227 | — | 13,237 | 342,528 |
| Trading liabilities | 6 | — | — | — | 1,449 | 1,455 |
| Certificates of deposit issued | 798 | 999 | 711 | 304 | — | 2,812 |
| Debt securities issued | — | — | 4,346 | — | — | 4,346 |
| Loan capital | 4,647 | 4,281 | 3,431 | — | — | 12,359 |
| Non-interest bearing liabilities | — | — | — | — | 19,173 | 19,173 |
| Total liabilities | <u>294,512</u> | <u>53,089</u> | <u>12,748</u> | <u>314</u> | <u>33,896</u> | <u>394,559</u> |
| Interest rate sensitivity gap | <u>(8,254)</u> | <u>15,291</u> | <u>16,560</u> | <u>6,728</u> | | |

The Group

2008

| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|--|---------------------|-------------------------------|------------------------------|-----------------|-------------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 | 181,640 | 36,159 | 6,237 | 2,680 | 2,579 | 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 |
| Total assets | <u>303,072</u> | <u>58,525</u> | <u>12,467</u> | <u>4,375</u> | <u>36,815</u> | <u>415,254</u> |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | <u>296,257</u> | <u>47,834</u> | <u>12,023</u> | <u>1,363</u> | <u>25,292</u> | <u>382,769</u> |
| Interest rate sensitivity gap | <u>6,815</u> | <u>10,691</u> | <u>444</u> | <u>3,012</u> | | |

The Bank

2009

| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|--|---------------------|-------------------------------|------------------------------|-----------------|-------------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| Cash and balances with banks and other financial institutions | 11,233 | — | — | — | 1,294 | 12,527 |
| Placements with banks and other financial institutions | 45,208 | 16,686 | — | — | — | 61,894 |
| Trade bills | 657 | 159 | — | — | 45 | 861 |
| Trading assets | 1 | 1 | 802 | 100 | 2,420 | 3,324 |
| Financial assets designated at fair value through profit or loss | 653 | 192 | 7,105 | 2,085 | 349 | 10,384 |
| Advances to customers | 133,403 | 4,198 | 1,689 | 521 | 2,386 | 142,197 |
| Other accounts | 655 | 126 | — | — | 5,618 | 6,399 |
| Available-for-sale financial assets | 10,816 | 2,647 | 4,122 | 364 | 986 | 18,935 |
| Held-to-maturity investments | 2,228 | 563 | 2,010 | 1 | — | 4,802 |
| Non-interest bearing assets | — | — | — | — | 35,970 | 35,970 |
| Total assets | <u>204,854</u> | <u>24,572</u> | <u>15,728</u> | <u>3,071</u> | <u>49,068</u> | <u>297,293</u> |
| Liabilities | | | | | | |
| Deposits and balances of banks and other financial institutions | 3,130 | 354 | — | — | 37 | 3,521 |
| Deposits from customers | 205,842 | 18,685 | 764 | — | 12,226 | 237,517 |
| Trading liabilities | 6 | — | — | — | 1,229 | 1,235 |
| Certificates of deposit issued | 798 | 999 | 711 | 2,504 | — | 5,012 |
| Loan capital | 4,647 | 4,281 | 3,431 | 3,916 | — | 16,275 |
| Non-interest bearing liabilities | — | — | — | — | 5,541 | 5,541 |
| Total liabilities | <u>214,423</u> | <u>24,319</u> | <u>4,906</u> | <u>6,420</u> | <u>19,033</u> | <u>269,101</u> |
| Interest rate sensitivity gap | <u>(9,569)</u> | <u>253</u> | <u>10,822</u> | <u>(3,349)</u> | | |

The Bank

2008

| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|--|---------------------|-------------------------------|------------------------------|-----------------|-------------------------|----------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 | 118,503 | 5,034 | 3,106 | 1,120 | 2,530 | 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 |
| Total assets | <u>208,440</u> | <u>24,757</u> | <u>8,370</u> | <u>1,779</u> | <u>51,873</u> | <u>295,219</u> |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | <u>220,086</u> | <u>19,260</u> | <u>8,466</u> | <u>3,520</u> | <u>16,662</u> | <u>267,994</u> |
| Interest rate sensitivity gap | <u>(11,646)</u> | <u>5,497</u> | <u>(96)</u> | <u>(1,741)</u> | | |

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 | |
|---|------------|------------|------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| | % | % | % | % |
| Assets | | | | |
| Cash and short-term funds and placements with banks and other financial institutions | 0-6.46 | 0-10.28 | 0-6.46 | 0-10.28 |
| Trade bills, advances to customers and advances to banks and other financial institutions | 0-45.70 | 0.50-36.10 | 0-18.52 | 0.60-18.33 |
| Securities (<i>Note</i>) | 0.01-7.75 | 0.04-8.23 | 0.01-7.75 | 0.04-8.23 |
| Liabilities | | | | |
| Deposits and balances of banks and other financial institutions | 0-9.17 | 0.02-13.21 | 0-9.17 | 0.02-13.21 |
| Deposits from customers | 0-10.50 | 0-9.00 | 0-8.90 | 0-9.00 |
| Certificates of deposit issued and loan capital | 0.01-10.01 | 0.92-10.14 | 0.01-10.01 | 0.92-10.14 |

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 that the Group's reputation is damaged by one or more than one reputation event, as reflected from negative publicity about the Group's business practices, conduct or financial condition. Such negative publicity, whether true or not, may impair public confidence in the Group, result in costly litigation, or lead to a decline in the customer base, business or revenue.

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.

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.

The capital adequacy ratios as at 31st December, 2009 and 31st December, 2008 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, 2009 and 31st December, 2008 and are well above the minimum required ratio set by the HKMA.

41. FAIR VALUES OF FINANCIAL INSTRUMENTS

(a) Financial instruments carried at fair value

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. The Group measures fair values using the following hierarchy of methods:

Level 1 — Quoted market price in an active market for an identical instrument.

Level 2 — Valuation techniques based on observable input. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3 — Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs could have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or counterparty quotations. For all other financial instruments the Group determines fair values using valuation techniques. Valuation techniques include net present value and discounted cash flow models and various market widely recognised option pricing models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, equity prices, foreign currency exchange rates, index prices, historical or implied volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date, that would have been determined by market participants acting at arm's length.

The Group uses widely recognised valuation models for determining the fair value of common and simpler financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over-the-counter (OTC) derivatives like interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Group uses valuation models, which usually are developed from recognised valuation methodologies. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determination of fair value. Management judgement and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of probability of counterparty default and prepayments and selection of appropriate discount rates.

The Group has an established control framework with respect to the measurement of fair values. This framework includes a valuation control function, namely Financial Instruments Valuation Group (“FIVG”) which comprises control units independent of front office management. Procedures for price verification have been established. Any pricing models to be used would be subject to a rigorous validation and approval process.

The table below analyses financial instruments carried at fair value, by valuation method:

| | 2009 | | | | | | | |
|---|---------------|---------------|-------------|---------------|---------------|---------------|-------------|---------------|
| | The Group | | | | The Bank | | | |
| | Level One | Level Two | Level Three | Total | Level One | Level Two | Level Three | Total |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | | |
| Trading assets | 4,467 | 1,154 | 101 | 5,722 | 2,193 | 1,110 | 21 | 3,324 |
| Financial assets designated at fair value through profit or loss | 5,290 | 5,102 | — | 10,392 | 5,281 | 5,103 | — | 10,384 |
| Available-for-sale financial assets | 21,922 | 8,568 | 393 | 30,883 | 10,845 | 7,749 | 341 | 18,935 |
| | <u>31,679</u> | <u>14,824</u> | <u>494</u> | <u>46,997</u> | <u>18,319</u> | <u>13,962</u> | <u>362</u> | <u>32,643</u> |
| Liabilities | | | | | | | | |
| Trading liabilities | 6 | 1,357 | 92 | 1,455 | 6 | 1,139 | 90 | 1,235 |
| Financial liabilities designated at fair value through profit or loss | 7,712 | 2,442 | — | 10,154 | 11,628 | 2,442 | — | 14,070 |
| | <u>7,718</u> | <u>3,799</u> | <u>92</u> | <u>11,609</u> | <u>11,634</u> | <u>3,581</u> | <u>90</u> | <u>15,305</u> |

During the year there were no significant transfers of financial instruments between Level 1 and Level 2 of the fair value hierarchy.

(1) Valuation of financial instruments with significant unobservable inputs

Movements in the recognised fair values of instruments with significant unobservable inputs were as follows:

Assets

| | The Group | | |
|--|--|--|----------------|
| | Trading assets — Positive fair value of derivatives | Available-for-sale financial assets | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January, 2009 | 169 | 471 | 640 |
| Purchases. | — | 44 | 44 |
| Sales | — | (31) | (31) |
| Settlements. | (154) | — | (154) |
| Changes in fair value recognised in the income statement | 86 | — | 86 |
| Changes in fair value recognised in the other comprehensive income. | — | (91) | (91) |
| At 31st December, 2009 | <u>101</u> | <u>393</u> | <u>494</u> |
| Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the balance sheet date | <u>—</u> | <u>(91)</u> | <u>(91)</u> |
| Total gains or losses for the year included in the income statement for assets held at the balance sheet date recorded in net trading income | <u>86</u> | <u>—</u> | <u>86</u> |

Assets

| | The Bank | | |
|--|--|--|----------------|
| | Trading assets — Positive fair value of derivatives | Available-for-sale financial assets | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| At 1st January, 2009 | 7 | 420 | 427 |
| Purchases. | — | 43 | 43 |
| Sales | — | (31) | (31) |
| Settlements. | (1) | — | (1) |
| Changes in fair value recognised in the income statement | 15 | — | 15 |
| Changes in fair value recognised in the other comprehensive income. | — | (91) | (91) |
| At 31st December, 2009 | <u>21</u> | <u>341</u> | <u>362</u> |
| Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the balance sheet date | <u>—</u> | <u>(91)</u> | <u>(91)</u> |
| Total gains or losses for the year included in the income statement for assets held at the balance sheet date recorded in net trading income | <u>15</u> | <u>—</u> | <u>15</u> |

Liabilities

| | <u>The Group</u> | <u>The Bank</u> |
|---|---|---|
| | Trading liabilities — Negative fair value of derivatives | Trading liabilities — Negative fair value of derivatives |
| | HK\$ Mn | HK\$ Mn |
| At 1st January, 2009 | 169 | 168 |
| Settlements | (155) | (154) |
| Changes in fair value recognised in the income statement | 78 | 76 |
| At 31st December, 2009 | <u>92</u> | <u>90</u> |
| Total gains or losses for the year included in the income statement for liabilities held at the balance sheet date recorded in net trading income | <u>78</u> | <u>76</u> |

(2) *Effects of changes in significant unobservable assumptions to reasonably possible alternative assumptions*

| | 2009 | | | |
|---|--|-----------------------|---|-----------------------|
| | <u>Effect recorded in profit or loss</u> | | <u>Effect recorded directly in equity</u> | |
| | <u>Favourable</u> | <u>(Unfavourable)</u> | <u>Favourable</u> | <u>(Unfavourable)</u> |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Trading assets | 8 | (8) | — | — |
| Available-for-sale financial assets | — | — | 33 | (33) |
| | <u>8</u> | <u>(8)</u> | <u>33</u> | <u>(33)</u> |
| Trading liabilities | <u>8</u> | <u>(8)</u> | <u>—</u> | <u>—</u> |

The fair values of financial instruments are in certain circumstances, measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data. The table above shows the sensitivity of fair values due to parallel movement of plus or minus 10 per cent of change in fair value to reasonably possible alternative assumptions.

(b) **Fair values of financial instruments carried at other than fair value**

The following methods and significant assumptions have been applied in determining the fair values of financial instruments presented below:

- (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 be approximated by 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 amortised 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 the applicable dividend discount model, or share of net asset value in the investment, or applying a discount to the market value of investment with lock-up period.

- (v) The fair value of unlisted open-ended investment funds is estimated using the net asset value per share as reported by the managers of such funds.
- (vi) The fair value of financial guarantees issued is determined by reference to fees charged in an arm's length transaction for similar services, when such information is obtainable, or is otherwise estimated by reference to interest rate differentials, by comparing the actual rates charted by lenders when the guarantee is made available with the estimated rates that lenders would have charged, had the guarantees not been available, where reliable estimates of such information can be made.

The carrying amounts of the Group's and the Bank's financial instruments carried at cost or amortised cost are not materially different from their fair values as at 31st December, 2009 and 2008 except as follows:

The Group

| | 2009 | | 2008 | |
|--|-----------------|------------|-----------------|------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Financial assets | | | | |
| Held-to-maturity investments | 7,239 | 7,318 | 5,006 | 4,898 |
| Financial liabilities | | | | |
| Debt securities issued | 4,346 | 4,601 | — | — |
| Subordinated liabilities | 4,647 | 4,211 | 4,641 | 3,953 |

The Bank

| | 2009 | | 2008 | |
|--|-----------------|------------|-----------------|------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Financial assets | | | | |
| Held-to-maturity investments | 4,802 | 4,846 | 3,318 | 3,209 |
| Financial liabilities | | | | |
| Subordinated liabilities | 4,647 | 4,211 | 4,641 | 3,953 |

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 | |
|---|---------------|---------------|---------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Direct credit substitutes | 7,341 | 7,272 | 5,792 | 6,888 |
| Transaction-related contingencies | 1,293 | 1,771 | 1,024 | 1,529 |
| Trade-related contingencies | 1,331 | 1,045 | 800 | 721 |
| Commitments that are unconditionally cancellable without prior notice | 41,555 | 41,692 | 40,386 | 38,683 |
| Other commitments | | | | |
| - up to 1 year | 21,606 | 5,651 | 6,097 | 3,049 |
| - over 1 year | 14,112 | 18,737 | 12,686 | 11,551 |
| | <u>87,238</u> | <u>76,168</u> | <u>66,785</u> | <u>62,421</u> |
| Credit risk weighted amounts | <u>27,305</u> | <u>20,642</u> | <u>16,441</u> | <u>14,002</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 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:

| | The Group | | | | | |
|--------------------------------|---------------|---------------|----------------|---------------|---------------|---------------|
| | 2009 | | | 2008 | | |
| | Trading | Non-trading | Total | Trading | Non-trading | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Exchange rate contracts | | | | | | |
| Forwards and futures | 19,590 | — | 19,590 | 23,860 | — | 23,860 |
| Swaps | 12,140 | 4,664 | 16,804 | 1,633 | 12,863 | 14,496 |
| Options purchased | 1,885 | 1,209 | 3,094 | 919 | 151 | 1,070 |
| Options written | 3,085 | 1,236 | 4,321 | 1,075 | 151 | 1,226 |
| Interest rate contracts | | | | | | |
| Forwards and futures | — | 88 | 88 | 25 | — | 25 |
| Swaps | — | 70,669 | 70,669 | — | 44,699 | 44,699 |
| Equity contracts | | | | | | |
| Options purchased | 261 | 1,638 | 1,899 | 82 | 1,638 | 1,720 |
| Options written | 177 | 975 | 1,152 | 427 | 1,039 | 1,466 |
| | <u>37,138</u> | <u>80,479</u> | <u>117,617</u> | <u>28,021</u> | <u>60,541</u> | <u>88,562</u> |

The Bank

| | 2009 | | | 2008 | | |
|--------------------------------|---------------|---------------|----------------|---------------|---------------|---------------|
| | Trading | Non-trading | Total | Trading | Non-trading | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Exchange rate contracts | | | | | | |
| Forwards and futures | 8,390 | — | 8,390 | 10,842 | — | 10,842 |
| Swaps | 11,137 | 4,664 | 15,801 | 1,311 | 12,253 | 13,564 |
| Options purchased | 1,885 | 1,209 | 3,094 | 971 | 151 | 1,122 |
| Options written | 3,085 | 1,236 | 4,321 | 1,075 | 151 | 1,226 |
| Interest rate contracts | | | | | | |
| Forwards and futures | — | 88 | 88 | 25 | — | 25 |
| Swaps | — | 67,505 | 67,505 | — | 42,684 | 42,684 |
| Equity contracts | | | | | | |
| Options purchased | 261 | 1,638 | 1,899 | 82 | 2,307 | 2,389 |
| Options written | 177 | 1,638 | 1,815 | 427 | 1,039 | 1,466 |
| | <u>24,935</u> | <u>77,978</u> | <u>102,913</u> | <u>14,733</u> | <u>58,585</u> | <u>73,318</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

| | 2009 | | 2008 | |
|-------------------------------------|------------|--------------|--------------|--------------|
| | Assets | Liabilities | Assets | Liabilities |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Fair value (Notes 23 and 34) | | | | |
| Exchange rate contracts | 317 | 139 | 488 | 505 |
| Interest rate contracts | 587 | 1,279 | 1,012 | 1,928 |
| Options purchased/written | | | | |
| - exchange rate contracts | 9 | 9 | 3 | 5 |
| - equity contracts | 55 | 22 | 231 | 78 |
| | <u>968</u> | <u>1,449</u> | <u>1,734</u> | <u>2,516</u> |

The Bank

| | 2009 | | 2008 | |
|-------------------------------------|------------|--------------|--------------|--------------|
| | Assets | Liabilities | Assets | Liabilities |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Fair value (Notes 23 and 34) | | | | |
| Exchange rate contracts | 275 | 114 | 262 | 365 |
| Interest rate contracts | 506 | 1,084 | 755 | 1,771 |
| Options purchased/written | | | | |
| - exchange rate contracts | 9 | 9 | 3 | 5 |
| - equity contracts | 55 | 22 | 231 | 78 |
| | <u>845</u> | <u>1,229</u> | <u>1,251</u> | <u>2,219</u> |

| | The Group | | The Bank | |
|---|--------------|------------|--------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Credit risk weighted amounts* | | | | |
| Exchange rate contracts | 567 | 391 | 549 | 340 |
| Interest rate contracts | 350 | 225 | 408 | 321 |
| Equity contracts | 90 | 181 | 184 | 248 |
| Debt security & other commodity | 6 | 22 | 11 | 38 |
| | <u>1,013</u> | <u>819</u> | <u>1,152</u> | <u>947</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, 2009.

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 | | | | | | | |
| | 2009 | | | | 2008 | | | |
| | 1 year 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| Interest rate derivatives | 46,714 | 15,727 | 8,316 | 70,757 | 26,641 | 14,193 | 3,890 | 44,724 |
| Currency derivatives | 37,856 | 5,953 | — | 43,809 | 35,145 | 5,507 | — | 40,652 |
| Other derivatives | <u>2,387</u> | <u>268</u> | <u>396</u> | <u>3,051</u> | <u>2,514</u> | <u>8</u> | <u>664</u> | <u>3,186</u> |
| | <u>86,957</u> | <u>21,948</u> | <u>8,712</u> | <u>117,617</u> | <u>64,300</u> | <u>19,708</u> | <u>4,554</u> | <u>88,562</u> |

| | The Bank | | | | | | | |
|-------------------------------------|---|------------------------|--------------|----------------|----------------|------------------------|--------------|---------------|
| | Notional amounts with remaining life of | | | | | | | |
| | 2009 | | | | 2008 | | | |
| | 1 year 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| Interest rate derivatives | 46,123 | 13,162 | 8,308 | 67,593 | 26,341 | 12,384 | 3,984 | 42,709 |
| Currency derivatives | 25,811 | 5,795 | — | 31,606 | 21,247 | 5,507 | — | 26,754 |
| Other derivatives | <u>2,387</u> | <u>535</u> | <u>792</u> | <u>3,714</u> | <u>3,183</u> | <u>8</u> | <u>664</u> | <u>3,855</u> |
| | <u>74,321</u> | <u>19,492</u> | <u>9,100</u> | <u>102,913</u> | <u>50,771</u> | <u>17,899</u> | <u>4,648</u> | <u>73,318</u> |

(c) **Capital commitments**

Capital commitments outstanding at 31st December and not provided for in the accounts were as follows:

| | The Group | | The Bank | |
|---|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Expenditure authorised and contracted for | 338 | 1,611 | 100 | 608 |
| Expenditure authorised but not contracted for | 65 | 107 | 48 | 98 |
| | <u>403</u> | <u>1,718</u> | <u>148</u> | <u>706</u> |

(d) **Operating lease commitments**

At 31st December, 2009, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Properties | | | | |
| Within one year | 365 | 338 | 127 | 135 |
| After one year but within five years | 736 | 684 | 117 | 117 |
| After five years | 249 | 358 | — | — |
| | <u>1,350</u> | <u>1,380</u> | <u>244</u> | <u>252</u> |

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Equipment | | | | |
| Within one year | 6 | 7 | 2 | 2 |
| After one year but within five years | 11 | 10 | 4 | 2 |
| After five years | — | — | — | — |
| | <u>17</u> | <u>17</u> | <u>6</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.

(e) **Litigation**

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 the Bank 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 the Bank acting as the client relationship manager.

The Bank intends to defend these proceedings rigorously and is in the course of preparing the relevant court documents. If the Bank is unsuccessful in defending the claim, the Bank estimates the maximum amount of exposure is approximately HK\$150 million. As these proceedings are in the preliminary stage and based on the evidence available, the Bank's external lawyers are optimistic on mounting a successful defence to both proceedings, no provisions have been made by the Bank as at 31st December, 2009.

43. NOTES ON CONSOLIDATED CASH FLOW STATEMENT

(a) Purchase of subsidiaries

| | <u>2009</u> | <u>2008</u> |
|---|-------------|-------------|
| | HK\$ Mn | HK\$ Mn |
| Net assets acquired | | |
| Cash and balances with banks and other financial institutions | 23 | 12 |
| Advances and other accounts less provisions | 24 | 10 |
| Fixed assets | 9 | 4 |
| Goodwill | — | 25 |
| Other accounts and provisions | (12) | (45) |
| | <u>44</u> | <u>6</u> |
| Goodwill arising on consolidation | 22 | 27 |
| Total purchase price | 66 | 33 |
| Less: cash and cash equivalents acquired | (23) | (12) |
| Cash flow on acquisition net of cash acquired | <u>43</u> | <u>21</u> |

(b) Disposal of subsidiary

| | <u>2009</u> | <u>2008</u> |
|---|-------------|-------------|
| | HK\$ Mn | HK\$ Mn |
| Advances and other accounts less provisions | 1 | — |
| Taxation | — | — |
| Other accounts and provisions | — | — |
| | <u>1</u> | <u>—</u> |
| Add: gain on disposal | — | — |
| Cash flow on disposal of subsidiary | <u>1</u> | <u>—</u> |

(c) Cash and cash equivalents

(i) Components of cash and cash equivalents in the consolidated cash flow statement

| | <u>2009</u> | <u>2008</u> |
|---|---------------|---------------|
| | HK\$ Mn | HK\$ Mn |
| Cash and balances with banks and other financial institutions | 19,244 | 20,042 |
| Placements with banks and other financial institutions with original maturity within three months | 37,938 | 70,442 |
| Treasury bills with original maturity within three months | 2,814 | 3,251 |
| Certificates of deposit held with original maturity within three months | 534 | 371 |
| | <u>60,530</u> | <u>94,106</u> |

(ii) *Reconciliation with the consolidated statement of financial position*

| | 2009 | 2008 |
|---|-----------------|----------------|
| | HK\$ Mn | HK\$ Mn |
| Cash and balances with banks and other financial institutions (Note 20) | 29,712 | 28,105 |
| Placements with banks and other financial institutions (Note 21) | 67,945 | 96,574 |
| Treasury bills and certificates of deposit held | | |
| - trading assets (Note 23) | 34 | 400 |
| - advances and other accounts (Note 25) | 39 | 39 |
| - available-for-sale (Note 26) | 6,397 | 11,153 |
| - held-to-maturity (Note 27) | 2,434 | 1,897 |
| | <u>8,904</u> | <u>13,489</u> |
| Amounts shown in the consolidated statement of financial position | 106,561 | 138,168 |
| Less: Amounts with an original maturity of beyond three months | (35,563) | (35,999) |
| Cash balance with central bank subject to regulatory restriction | <u>(10,468)</u> | <u>(8,063)</u> |
| Cash and cash equivalents in the consolidated cash flow statement | <u>60,530</u> | <u>94,106</u> |

44. ASSETS PLEDGED AS SECURITY

The following assets have been pledged as collateral for own liabilities at the balance sheet date:

| | The Group | | The Bank | |
|---|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Secured liabilities | <u>1,514</u> | <u>1,161</u> | <u>810</u> | <u>1,102</u> |
| Assets pledged: | | | | |
| Available-for-sale financial assets | 736 | 76 | — | — |
| Held-to-maturity investments | <u>96</u> | <u>96</u> | <u>96</u> | <u>96</u> |
| | <u>832</u> | <u>172</u> | <u>96</u> | <u>96</u> |

The following balances with banks have been pledged as collateral for securities borrowings and margin deposits of derivatives.

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Cash collateral for borrowed securities | 18 | 7 | 18 | 7 |
| Margin accounts for open futures and forward contracts | <u>921</u> | <u>912</u> | <u>876</u> | <u>912</u> |
| | <u>939</u> | <u>919</u> | <u>894</u> | <u>919</u> |
| Capital equivalency deposit | <u>39</u> | <u>39</u> | <u>39</u> | <u>39</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:

| | <u>2009</u> | <u>2008</u> |
|--|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Aggregate amount of relevant loans outstanding at 31st December | | |
| By the Bank | 3,711 | 4,169 |
| By subsidiaries | <u>1,261</u> | <u>1,073</u> |
| | <u>4,972</u> | <u>5,242</u> |
| The maximum aggregate amount of relevant loans outstanding during the year | | |
| By the Bank | 5,543 | 4,573 |
| By subsidiaries | <u>1,656</u> | <u>1,492</u> |
| | <u>7,199</u> | <u>6,065</u> |

There was no interest due but unpaid nor any impairment allowance made against these loans at 31st December, 2009 and 31st December, 2008.

46. MATERIAL RELATED PARTY TRANSACTIONS

The Group maintains certain retirement benefit schemes for its staff as per Note 2(q)(iii). In 2009, the total amount of contributions the Group made to the schemes was HK\$65 million (2008: HK\$107 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. 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:

| | <u>Key management personnel</u> | | <u>Subsidiaries</u> | | <u>Associates</u> | |
|------------------------------------|-------------------------------------|----------------|---------------------|----------------|-------------------|----------------|
| | <u>2009</u> | <u>2008</u> | <u>2009</u> | <u>2008</u> | <u>2009</u> | <u>2008</u> |
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Interest income | 125 | 264 | 588 | 1,079 | 3 | 8 |
| Interest expense | 25 | 88 | 560 | 148 | — | — |
| Amounts due from | 6,971 | 8,209 | 12,719 | 16,398 | 626 | 124 |
| Amounts due to | 5,147 | 3,696 | 1,642 | 1,994 | 4 | 7 |
| Maximum amounts due from | 10,443 | 12,429 | 15,953 | 22,072 | 924 | 446 |
| Maximum amounts due to | 9,826 | 8,527 | 2,295 | 2,850 | 14 | 34 |

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\$ |
|---------------------|-----------------------|-----------------------|-------------------------------|
| 22/4/2004 | 22/4/2004 - 21/4/2005 | 22/4/2005 - 22/4/2009 | 21.11* |
| 03/5/2005 | 03/5/2005 - 02/5/2006 | 03/5/2006 - 03/5/2010 | 20.86* |
| 03/5/2006 | 03/5/2006 - 02/5/2007 | 03/5/2007 - 03/5/2011 | 30.04* |
| 10/5/2007 | 10/5/2007 - 09/5/2008 | 10/5/2008 - 10/5/2012 | 42.84* |
| 05/5/2008 | 05/5/2008 - 04/5/2009 | 05/5/2009 - 05/5/2013 | 40.09* |
| 05/5/2009 | 05/5/2009 - 04/5/2010 | 05/5/2010 - 05/5/2014 | 21.25* |

(b) Movement of share options

2009

| Date of grant | Number of share options | | | | | Outstanding at 31/12/2009 |
|---------------------|-------------------------|---|------------------|------------------|------------------|---------------------------|
| | Outstanding at 1/1/2009 | Additional share options for bonus issue* | Granted | Exercised | Lapsed | |
| 22/4/2004 | 2,765,000 | 276,500 | — | — | 3,041,500 | — |
| 03/5/2005 | 6,105,000 | 610,500 | — | 1,978,500 | — | 4,737,000 |
| 03/5/2006 | 2,700,000 | 270,000 | — | — | 275,000 | 2,695,000 |
| 10/5/2007 | 2,750,000 | 275,000 | — | — | 275,000 | 2,750,000 |
| 05/5/2008 | 5,500,000 | 550,000 | — | — | 550,000 | 5,500,000 |
| 05/5/2009 | — | — | 6,600,000 | — | — | 6,600,000 |
| Total | <u>19,820,000</u> | <u>1,982,000</u> | <u>6,600,000</u> | <u>1,978,500</u> | <u>4,141,500</u> | <u>22,282,000</u> |

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 | — | — |
| 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> |

* After adjusting for the bonus issue in 2009.

(c) No share options were cancelled during the years ended 31st December, 2009 and 2008.

(d) Details of share options exercised

| Exercise period | Date of grant | Number of share options | |
|---------------------|---------------|-------------------------|------------------|
| | | 2009 | 2008 |
| January | 02/5/2003 | — | 1,005,000 |
| | 22/4/2004 | — | 130,000 |
| | 03/5/2005 | — | 75,000 |
| February | 02/5/2003 | — | 20,000 |
| | 22/4/2004 | — | 20,000 |
| | 03/5/2005 | — | 25,000 |
| March | 02/5/2003 | — | 1,060,000 |
| | 22/4/2004 | — | 665,000 |
| | 03/5/2005 | — | 715,000 |
| | 03/5/2006 | — | 500,000 |
| April | 02/5/2003 | — | 30,000 |
| | 22/4/2004 | — | 165,000 |
| | 03/5/2005 | — | 110,000 |
| May | 02/5/2003 | — | 90,000 |
| | 22/4/2004 | — | 20,000 |
| | 03/5/2005 | 190,500 | 75,000 |
| June | 22/4/2004 | — | 25,000 |
| | 03/5/2005 | 208,500 | 25,000 |
| July | 22/4/2004 | — | 5,000 |
| | 03/5/2005 | 14,000 | 55,000 |
| August | 22/4/2004 | — | 30,000 |
| | 03/5/2005 | 79,000 | 45,000 |
| September | 22/4/2004 | — | 20,000 |
| | 03/5/2005 | 243,500 | — |
| October | 03/5/2005 | 292,500 | — |
| November | 03/5/2005 | 755,500 | — |
| December | 03/5/2005 | 195,000 | — |
| | | <u>1,978,500</u> | <u>4,910,000</u> |

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 30th December, 2009, the Bank entered into a subscription agreement with Negocio de Finanzas e Inversiones I, SLU, a subsidiary of Criteria Caixa Corp., SA and Sumitomo Mitsui Banking Corporation respectively in relation to the subscription as principal of an aggregate of 167,104,200 shares in the share capital of the Bank at HK\$30.60 per new share subject to regulatory approval. These 167,104,200 shares represent approximately 8.29% of the entire issued share capital of the Bank as enlarged by the subscriptions. The subscription price represents a discount of approximately 2.08% to the closing price of HK\$31.25 per share quoted on the Stock Exchange on 30th December, 2009. Following with a regulatory approval, shares issued and proceeds are received on 14th January, 2010.

In June 2009, BEA signed a Sale and Purchase Agreement with the Industrial and Commercial Bank of China Limited (“ICBC”) to sell a 70% interest in its banking subsidiary in Canada, The Bank of East Asia (Canada), to ICBC. The transaction closed on 28th January, 2010.

49. 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 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.

50. COMPARATIVE FIGURES

As a result of the application of HKAS 1 (revised 2007), *Presentation of financial statement*, and HKFRS 8, *Operating segments*, certain comparative figures have been adjusted to conform to current year's presentation and to provide comparative amounts in respect of items disclosed for the first time in 2009. Further details of these developments are disclosed in Note 3.

The Group has reviewed the disclosures in the financial statements and has made a number of presentation changes in Note 40. In such case, comparative figures in the notes have been amended to ensure consistency with the current year.

51. PROPOSED IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31ST DECEMBER, 2009

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, 2009 and which have not been adopted in these accounts.

| | <u>Effective for accounting periods beginning on or after</u> |
|---|---|
| HKFRS 3 (Revised), <i>Business combinations</i> | 1st July, 2009 |
| Amendment to HKAS 27, <i>Consolidated and separate financial statements</i> | 1st July, 2009 |
| Amendment to HKAS 39, <i>Financial instruments: Recognition and measurement</i> — | |
| <i>Eligible hedged items</i> | 1st July, 2009 |
| HK(IFRIC) 17, <i>Distributions of non-cash assets to owners</i> | 1st July, 2009 |
| Improvements to HKFRSs 2009 | 1st July, 2009 or 1st January, 2010 |
| HKFRS 9, <i>Financial instruments</i> | 1st January, 2013 |

The Group is in the process of making an assessment of what the impact of these amendments 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 Group's results of operations and financial position except for HKFRS 9, Financial instruments, which may have an impact on the Group's results and financial position arising from changes in the Group's classification and measurement of financial instruments.

**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-108 to F-203, 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

| | | <u>2008</u> | <u>2007</u> |
|---|-------|-----------------|-----------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| Interest income | 3 | 17,465 | 18,309 |
| Interest expense | 4 | <u>(10,672)</u> | <u>(12,332)</u> |
| Net interest income | | <u>6,793</u> | <u>5,977</u> |
| Fee and commission income | 5 | <u>2,618</u> | <u>2,608</u> |
| Fee and commission expense | | <u>(473)</u> | <u>(471)</u> |
| 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 | | <u>(336)</u> | <u>2,837</u> |
| Operating income | | 6,457 | 8,814 |
| Operating expenses | 9 | <u>(5,779)</u> | <u>(4,691)</u> |
| Operating profit before impairment losses | | <u>678</u> | <u>4,123</u> |
| 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 | | <u>(948)</u> | <u>(395)</u> |
| 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 | | <u>104</u> | <u>4,221</u> |
| Attributable to: | | | |
| Equity holders of the Group | | 39 | 4,144 |
| Minority interests | 38 | 65 | 77 |
| Profit after taxation | | <u>104</u> | <u>4,221</u> |
| 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-114 to F-203 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED BALANCE SHEET
AS AT 31ST DECEMBER, 2008

| | | <u>2008</u> | <u>2007</u> |
|--|-------|-------------|-------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| ASSETS | | | |
| 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 |
| Total Assets | | 415,254 | 393,979 |
| EQUITY AND LIABILITIES | | | |
| 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 |
| Total Liabilities | | 382,769 | 363,533 |
| Share capital | 36 | 4,183 | 3,936 |
| Reserves | 37 | 27,963 | 26,163 |
| Total equity attributable to equity holders of the Group | | 32,146 | 30,099 |
| Minority interests | 38 | 339 | 347 |
| Total Equity | | 32,485 | 30,446 |
| Total Equity and Liabilities | | 415,254 | 393,979 |

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-114 to F-203 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
BALANCE SHEET
AS AT 31ST DECEMBER, 2008

| | | <u>2008</u> | <u>2007</u> |
|--|-------|-------------|-------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| ASSETS | | | |
| 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 |
| Total Assets | | 295,219 | 298,473 |
| EQUITY AND LIABILITIES | | | |
| 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 |
| Total Liabilities | | 267,994 | 272,292 |
| Share capital | 36 | 4,183 | 3,936 |
| Reserves | 37 | 23,042 | 22,245 |
| Total equity attributable to equity holders of the Bank | | 27,225 | 26,181 |
| Total Equity and Liabilities | | 295,219 | 298,473 |

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-114 to F-203 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

| | Notes | <u>2008</u> | <u>2007</u> |
|---|------------------------|----------------|----------------|
| | | HK\$ Mn | HK\$ Mn |
| 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-114 to F-203 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2008

| | | <u>2008</u> | <u>2007</u> |
|--|-------|-------------------|-------------------|
| | Notes | HK\$ Mn | HK\$ Mn |
| OPERATING ACTIVITIES | | | |
| 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 |
| | | <u> </u> | <u> </u> |
| OPERATING (LOSS)/PROFIT BEFORE CHANGES IN WORKING CAPITAL | | (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 |
| | | <u> </u> | <u> </u> |

| | | 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 | | (383) | (306) |
| 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 | | (64) | (15) |
| 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 | | (488) | (224) |
| 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>94,106</u> | <u>103,718</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-114 to F-203 form part of these accounts.

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.

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 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.

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.

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 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).

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(1).

- (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.

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.

(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.

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.

(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.

(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.

(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> |
|---|----------------------|----------------------|
| | HK\$ Mn | HK\$ Mn |
| 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><u>17,465</u></u> | <u><u>18,309</u></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> |
|---|----------------------|----------------------|
| | HK\$ Mn | HK\$ Mn |
| 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><u>10,672</u></u> | <u><u>12,332</u></u> |

5. FEE AND COMMISSION INCOME

Fee and commission income arises from the following services:

| | <u>2008</u> | <u>2007</u> |
|--|---------------------|---------------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>252</u> | <u>238</u> |
| Total fee and commission income | <u><u>2,618</u></u> | <u><u>2,608</u></u> |

6. NET TRADING (LOSSES)/PROFITS

| | <u>2008</u> | <u>2007</u> |
|--|-----------------------|---------------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>43</u> | <u>38</u> |
| Total net trading (losses)/profits | <u><u>(1,292)</u></u> | <u><u>1,417</u></u> |

7. NET RESULT FROM FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

| | <u>2008</u> | <u>2007</u> |
|---|-----------------------|-----------------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>(690)</u> | <u>17</u> |
| Total net result from financial instruments designated at fair value through profit or loss | <u><u>(1,612)</u></u> | <u><u>(1,154)</u></u> |

8. OTHER OPERATING INCOME

| | <u>2008</u> | <u>2007</u> |
|--|-------------|-------------|
| | 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

| | <u>2008</u> | <u>2007</u> |
|--|--------------|--------------|
| | 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

| | <u>2008</u> | <u>2007</u> |
|--|-------------------|-------------------|
| | HK\$ Mn | HK\$ Mn |
| 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)) | <u>(140)</u> | <u>(107)</u> |
| | 375 | 151 |
| Collective impairment loss | | |
| - new provisions (Note 24(b)) | 183 | 68 |
| - releases (Note 24(b)) | <u>—</u> | <u>(3)</u> |
| Net charge to profit and loss account | <u><u>558</u></u> | <u><u>216</u></u> |

11. NET PROFIT ON SALE OF AVAILABLE-FOR-SALE FINANCIAL ASSETS

| | <u>2008</u> | <u>2007</u> |
|--|-------------------|-------------------|
| | HK\$ Mn | HK\$ Mn |
| Net revaluation gain/(loss) transferred from reserves (Note 37(h)) | 115 | (27) |
| Profit arising in current year | <u>82</u> | <u>694</u> |
| | <u><u>197</u></u> | <u><u>667</u></u> |

12. INCOME TAX

(a) **Taxation in the consolidated profit and loss account represents:**

| | <u>2008</u> | <u>2007</u> |
|--|--------------------|-------------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>—</u> | <u>(7)</u> |
| | 64 | 258 |
| Current tax - overseas | | |
| Tax for the year | 601 | 347 |
| Write back of over-provision in respect of prior years | <u>(35)</u> | <u>(16)</u> |
| | 566 | 331 |
| Deferred tax (Note 32(b)) | | |
| Origination and reversal of temporary differences | (712) | 318 |
| Movements in the value of investment properties | <u>(14)</u> | <u>57</u> |
| | <u>(726)</u> | <u>375</u> |
| | <u><u>(96)</u></u> | <u><u>964</u></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:**

| | <u>2008</u> | <u>2007</u> |
|--|-------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Profit before tax | <u>8</u> | <u>5,185</u> |
| 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 | <u>18</u> | <u>(10)</u> |
| Actual tax (credit)/expense | <u>(96)</u> | <u>964</u> |

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

| | <u>2008</u> | <u>2007</u> |
|---|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| 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 | <u>42</u> | <u>128</u> |
| Bank's (loss)/profit for the year | <u>(882)</u> | <u>3,004</u> |

14. DIVIDENDS

(a) Dividends attributable to the year

| | <u>2008</u> | <u>2007</u> |
|--|-------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| 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> |
|---|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| 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> |
|--|----------------------|----------------------|
| | Number of Shares | Number of Shares |
| 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> |
|--|-------------------------|-------------------------|
| | <u>Number of Shares</u> | <u>Number of Shares</u> |
| 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 | 3,217,376 | 9,483,952 |
| Weighted average number of ordinary shares (diluted) at 31st December | <u>1,669,663,642</u> | <u>1,574,625,151</u> |

16. DIRECTORS' REMUNERATION

Directors' remuneration disclosed pursuant to Section 161 of the Hong Kong Companies Ordinance is as follows:

| | <u>Directors' fees</u> | <u>Salaries, allowances and benefits in kind</u> | <u>Discretionary bonuses</u> | <u>Share options</u> | <u>Retirement scheme contributions</u> | <u>2008 Total</u> |
|---|------------------------|--|------------------------------|----------------------|--|-------------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Chairman and Chief Executive | | | | | | |
| Dr. The Hon. Sir David LI Kwok-po | 0.3 | 8.3 | — | 24.1 | 0.8 | 33.5 |
| Executive Directors | | | | | | |
| Mr. Joseph PANG Yuk-wing | 0.2 | 3.6 | — | 12.0 | 0.3 | 16.1 |
| Non-executive Directors | | | | | | |
| 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 |
| Independent Non-executive Directors | | | | | | |
| 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 |
|---|-----------------|---|-----------------------|---------------|---------------------------------|-------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Chairman and Chief Executive | | | | | | |
| Dr. The Hon. Sir David LI Kwok-po | 0.3 | 7.9 | 15.4 | 9.6 | 0.7 | 33.9 |
| Executive Directors | | | | | | |
| 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 |
| Non-executive Directors | | | | | | |
| 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 |
| Independent Non-executive Directors | | | | | | |
| 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 |
|---|-----------|-----------|
| | HK\$ Mn | HK\$ M |
| 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:

| | <u>2008</u> | <u>2007</u> |
|-----------------------------------|--------------------------------|--------------------------------|
| | Number of Employees | Number of Employees |
| 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.

| | 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 |
| The Group | | | | | | | | |
| 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 |

| | 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 |
| The Group | | | | | | | | |
| 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 | | | | | Consolidated |
|--|-----------|----------------------------|-----------------------|---------|---------------------------|--------------|
| | Hong Kong | People's Republic of China | Other Asian Countries | Others | Inter-segment elimination | |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| The Group | | | | | | |
| 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 | | | | | Consolidated |
|--|-----------|----------------------------|-----------------------|---------|---------------------------|--------------|
| | Hong Kong | People's Republic of China | Other Asian Countries | Others | Inter-segment elimination | |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| The Group | | | | | | |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | 14,462 | 14,284 | 8,347 | 7,245 |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | % |
| The Group | | | | |
| 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 | <u>57,723</u> | 76.78 | <u>55,405</u> | 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 | <u>35,165</u> | 86.52 | <u>45,355</u> | 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* | <u>134,546</u> | 76.56 | <u>113,710</u> | 72.67 |
| Total advances to customers | <u>230,339</u> | 77.91 | <u>218,184</u> | 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 |
| | HK\$Mn | % | HK\$Mn | % |
| 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 |
| The Bank | | | | |
| 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* | <u>36,254</u> | 57.35 | <u>31,330</u> | 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.

| The Group | | | | | |
|---|--|---|---|--|--|
| 2008 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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> | | |

| The Group | | | | | |
|---|--|---|---|--|--|
| 2007 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| Total | <u>218,184</u> | <u>468</u> | <u>1,242</u> | <u>264</u> | <u>433</u> |
| % of total advances to customers | | | <u>0.57%</u> | | |
| Market value of security held against impaired advances to customers | | | <u>3,647</u> | | |

| The Bank | | | | | |
|---|--|---|---|--|--|
| 2008 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | 131,123 | 437 | 1,274 | 438 | 392 |
| % of total advances to customers | | | 0.97% | | |
| Market value of security held against impaired advances to customers | | | 2,168 | | |

| The Bank | | | | | |
|---|--|---|---|--|--|
| 2007 | | | | | |
| | Total advances to customers | Advances overdue for over three months | Impaired advances to customers | Individual impairment allowance | Collective impairment allowance |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | 134,858 | 264 | 897 | 79 | 332 |
| % of total advances to customers | | | 0.67% | | |
| Market value of security held against impaired advances to customers | | | 2,282 | | |

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 | |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| 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 |
| | <u>4,260</u> | <u>604</u> | <u>4,864</u> | <u>4,421</u> | <u>1,235</u> | <u>5,656</u> |
| Less: Individual impairment allowances | <u>(21)</u> | | | <u>(4)</u> | | |
| Net investment in finance leases | <u>4,239</u> | | | <u>4,417</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.

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 |
| | <u>9,726</u> | <u>3,573</u> | <u>2,816</u> | <u>2,379</u> |
| 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:-

| <u>Name of company</u> | <u>Place of incorporation and operation</u> | <u>Issued and paid-up capital</u> | <u>% Held by</u> | | <u>Nature of business</u> |
|---|---|---------------------------------------|------------------|------------------|---|
| | | | <u>The Bank</u> | <u>The Group</u> | |
| 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 |
| Carribbean 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 |

| Name of company | Place of incorporation and operation | Issued and paid-up capital | % Held by | | Nature of business |
|--|--------------------------------------|----------------------------|-----------|-----------|--|
| | | | The Bank | The Group | |
| 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 |
| 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 | |
| Listed | | | | |
| Affin Holdings Berhad | Malaysia | 20.507% | | Investment holding |
| Unlisted | | | | |
| 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 |
| 2008 | | | | | |
| 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> |
| 2007 | | | | | |
| 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 | <u>29</u> | <u>12</u> | <u>—</u> | <u>—</u> |
| | <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 (Note2(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>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 | — | 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>1,839</u> | <u>6,293</u> | <u>3,507</u> | <u>9,800</u> | <u>11,639</u> |

| The Bank | | | | | |
|---|--------------------------|--|------------------|----------------|--------------|
| 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 | 1,829 | 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>1,819</u> | <u>2,812</u> | <u>956</u> | <u>3,768</u> | <u>5,587</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>1,819</u> | <u>3,135</u> | <u>2,246</u> | <u>5,381</u> | <u>7,200</u> |

| 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, 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>1,726</u> | <u>3,992</u> | <u>1,138</u> | <u>5,130</u> | <u>6,856</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>1,726</u> | <u>4,609</u> | <u>2,711</u> | <u>7,320</u> | <u>9,046</u> |

| The Bank | | | | | |
|---|----------------------------------|--------------------------|--|------------------|----------------|
| | 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, 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>1,829</u> | <u>2,888</u> | <u>690</u> | <u>3,578</u> | <u>5,407</u> |
| The gross amounts of the above assets are stated: | | | | | |
| At cost | — | 2,358 | 1,858 | 4,216 | 4,216 |
| At Directors' valuation | — | 834 | — | 834 | 834 |
| At professional valuation | — | — | — | — | — |
| - 2007 | <u>1,829</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>1,829</u> |
| | <u>1,829</u> | <u>3,192</u> | <u>1,858</u> | <u>5,050</u> | <u>6,879</u> |

The net book value of bank premises and investment properties comprises:

| | The Group | | | |
|--|----------------------------------|--------------------------|----------------------------------|--------------------------|
| | 2008 | | 2007 | |
| | Investment Properties | Bank Premises | Investment Properties | Bank Premises |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn |
| 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 |
| Deferred tax arising from: | | | | | | | |
| 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 |
| Deferred tax arising from: | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| Deferred tax arising from: | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 |
| Deferred tax arising from: | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | <u>77</u> | <u>872</u> | <u>63</u> | <u>754</u> |
| | <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 |
|--------------------------------------|------------|------------|
| | HK\$ Mn | HK\$ Mn |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | Mn |
| (a) Trading Liabilities | | | | |
| Exchange fund bills sold | 330 | 1,098 | 330 | 1,098 |
| Exchange fund notes sold | <u>—</u> | <u>33</u> | <u>—</u> | <u>33</u> |
| | 330 | 1,131 | 330 | 1,131 |
| 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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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 | 4,641 | 4,669 | 4,641 | 4,669 |
| | <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 | Number of options | Weighted average exercise price | Number of options |
| | HK\$ | Mn | HK\$ | 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 | <u>20</u> | 27.21 | <u>19</u> |
| 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 |
| | million | HK\$ Mn | million | HK\$ Mn |
| Authorised: Ordinary shares of HK\$2.50 each | 2,600 | 6,500 | 2,600 | 6,500 |
| 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 | 1,673 | 4,183 | 1,574 | 3,936 |

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

| Date of options granted | Option price | 2008 | 2007 |
|-------------------------|--------------|---------------|---------------|
| | | No. of shares | No. of shares |
| 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 | — |
| | | 19,820,000 | 19,300,000 |

37. RESERVES

| | 2008 | |
|---|-----------|----------|
| | The Group | The Bank |
| | HK\$ Mn | HK\$ Mn |
| (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 | 4,922 | 4,922 |

| | <u>The Group</u> | <u>The Bank</u> |
|---|------------------|-----------------|
| | HK\$ Mn | HK\$ Mn |
| (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> |
| (e) Capital reserve (undistributable) | | |
| At 1st January and 31st December | <u>86</u> | <u>—</u> |
| (f) Exchange revaluation reserve (undistributable) | | |
| At 1st January | 672 | 80 |
| Exchange adjustments | 334 | (32) |
| At 31st December | <u>1,006</u> | <u>48</u> |
| (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 | <u>125</u> | <u>125</u> |
| (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 | <u>(228)</u> | <u>(45)</u> |

| | | 2008 | |
|-----|--|------------------|-----------------|
| | | The Group | The Bank |
| | | HK\$ Mn | HK\$ Mn |
| (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 | <u>5,339</u> | <u>2,724</u> |
| (j) | Total Reserves | <u>27,963</u> | <u>23,042</u> |
| | | 2007 | |
| | | The Group | The Bank |
| | | HK\$ Mn | HK\$ Mn |
| (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> |

| | | 2007 | |
|-----|--|------------------|-----------------|
| | | <u>The Group</u> | <u>The Bank</u> |
| | | HK\$ Mn | HK\$ Mn |
| (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> |
| (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

| | <u>2008</u> | <u>2007</u> |
|---|-------------|-------------|
| | HK\$ Mn | HK\$ Mn |
| 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>339</u> | <u>347</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.

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 | <u>1,586</u> | <u>1,242</u> | <u>1,274</u> | <u>897</u> |
| | <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 | <u>1,929</u> | <u>2,009</u> | <u>1,464</u> | <u>1,364</u> |
| | <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 |
| | 178,410 | 167,730 | 95,714 | 102,863 |

(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 |
| Assets | | | | | | | | |
| 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> |
| Liabilities | | | | | | | | |
| 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 | <u>(8,285)</u> | <u>—</u> | <u>(2,751)</u> | <u>(11,036)</u> | <u>(9,052)</u> | <u>—</u> | <u>(4,600)</u> | <u>(13,652)</u> |
| 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 |
| Assets | | | | | | | | |
| 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> |
| Liabilities | | | | | | | | |
| 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 | <u>(8,285)</u> | <u>—</u> | <u>(2,751)</u> | <u>(11,036)</u> | <u>(9,052)</u> | <u>—</u> | <u>(4,600)</u> | <u>(13,652)</u> |
| 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 December | Maximum | Minimum | Mean |
| | 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 December | Maximum | Minimum | Mean |
| | 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.

(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 | | | | | | |
|--|------------------------|---------------------|---|--|-----------------|-----------------------|----------------|
| | 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | |
| 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 | 23,548 | 134,393 | 63,985 | 97,024 | 57,035 | 39,269 | 415,254 |
| Liabilities | | | | | | | |
| 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 | 86,980 | 212,314 | 44,399 | 22,663 | 1,673 | 14,740 | 382,769 |
| Net gap | (63,432) | (77,921) | 19,586 | 74,361 | 55,362 | | |

| | 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | |
| 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 | 17,852 | 131,946 | 50,447 | 96,926 | 63,785 | 33,023 | 393,979 |
| Liabilities | | | | | | | |
| 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 | 84,950 | 197,134 | 44,684 | 18,337 | 5,317 | 13,111 | 363,533 |
| Net gap | (67,098) | (65,188) | 5,763 | 78,589 | 58,468 | | |

The Bank

| | 2008 | | | | | | |
|--|------------------------|---------------------|---|--|-----------------|-----------------------|----------------|
| | 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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | |
| 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 |
| Total assets | 8,522 | 108,369 | 35,657 | 61,583 | 32,288 | 48,800 | 295,219 |
| Liabilities | | | | | | | |
| 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 |
| Total liabilities | 54,548 | 169,134 | 19,587 | 14,121 | 2,841 | 7,763 | 267,994 |
| Net gap | (46,026) | (60,765) | 16,070 | 47,462 | 29,447 | | |

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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | | |
| 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 | 6,617 | 107,641 | 26,468 | 65,097 | 43,313 | 49,337 | 298,473 |
| Liabilities | | | | | | | |
| 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 | 56,727 | 167,617 | 19,475 | 13,108 | 7,470 | 7,895 | 272,292 |
| Net gap | (50,110) | (59,976) | 6,993 | 51,989 | 35,843 | | |

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 | | | | | | | | |
|---|---------------------------|----------------------------|-------------------------------|--|-----------------------------------|-----------------------------|----------------|---------------|
| 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\$ Mn | 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 | 384,561 | 389,518 | 87,160 | 214,034 | 46,219 | 25,334 | 2,031 | 14,740 |

| 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\$ Mn | 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 | 365,780 | 372,165 | 85,045 | 198,908 | 46,913 | 22,658 | 5,529 | 13,112 |

The Bank

2008

| | 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\$ 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 three months and one year | Between one and five years | More than five years | Undated |
|---|-----------------|--------------------|---------------------|------------------------|-----------------------------------|----------------------------|----------------------|--------------|
| | | | | | 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> |

(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 | | | | | |
|--|-----------------------------|--|---------------------------------------|-------------------------|---------------------------------|-----------------------|
| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 |
| Total Assets | <u>273,892</u> | <u>62,783</u> | <u>33,669</u> | <u>8,251</u> | <u>36,659</u> | <u>415,254</u> |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | <u>296,257</u> | <u>47,834</u> | <u>12,023</u> | <u>1,363</u> | <u>25,292</u> | <u>382,769</u> |
| Interest rate sensitivity gap | <u>(22,365)</u> | <u>14,949</u> | <u>21,646</u> | <u>6,888</u> | | |

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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 |
| Total Assets | 260,667 | 56,492 | 31,354 | 8,669 | 36,797 | 393,979 |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | 278,066 | 43,222 | 8,625 | 5,981 | 27,639 | 363,533 |
| Interest rate sensitivity gap | (17,399) | 13,270 | 22,729 | 2,688 | — | — |

The Bank

2008

| | 3 months or less | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|--|-----------------------|-------------------------------|------------------------------|---------------------|-------------------------|-----------------------|
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 |
| Total Assets | <u>179,260</u> | <u>29,015</u> | <u>29,572</u> | <u>5,655</u> | <u>51,717</u> | <u>295,219</u> |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | <u>220,086</u> | <u>19,260</u> | <u>8,466</u> | <u>3,520</u> | <u>16,662</u> | <u>267,994</u> |
| Interest rate sensitivity gap | <u>(40,826)</u> | <u>9,755</u> | <u>21,106</u> | <u>2,135</u> | | |

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\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Assets | | | | | | |
| 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 |
| Total Assets | <u>195,113</u> | <u>19,034</u> | <u>26,619</u> | <u>5,804</u> | <u>51,903</u> | <u>298,473</u> |
| Liabilities | | | | | | |
| 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 |
| Total liabilities | <u>225,098</u> | <u>16,296</u> | <u>7,238</u> | <u>8,171</u> | <u>15,489</u> | <u>272,292</u> |
| Interest rate sensitivity gap | <u>(29,985)</u> | <u>2,738</u> | <u>19,381</u> | <u>(2,367)</u> | | |

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 |
| | % | % | % | % |
| Assets | | | | |
| 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 |
| Liabilities | | | | |
| 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.

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 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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:

| | The Group | | | | | |
|-----------------------------------|------------------|--------------------|----------------|----------------|--------------------|----------------|
| | 2008 | | | 2007 | | |
| | Trading | Non-trading | Total | Trading | Non-trading | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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> |

| | The Bank | | | | | |
|-----------------------------------|-----------------|--------------------|----------------|----------------|--------------------|----------------|
| | 2008 | | | 2007 | | |
| | Trading | Non-trading | Total | Trading | Non-trading | Total |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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.

| The Group | | | | | | | | |
|--|---------------------------------------|-------------------------|----------------|----------------------------|---------------------------------------|-------------------------|----------------|--------|
| Notional amounts with remaining life of | | | | | | | | |
| 2008 | | | | 2007 | | | | |
| 1 year or less | Over 1 year to 5 years | Over 5 years | Total | 1 years or less | Over 1 year to 5 years | Over 5 years | Total | |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| 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 |
| | 64,300 | 19,708 | 4,554 | 88,562 | 62,087 | 20,477 | 5,227 | 87,791 |

| The Bank | | | | | | | | |
|--|---------------------------------------|-------------------------|----------------|----------------------------|---------------------------------------|-------------------------|----------------|--------|
| Notional amounts with remaining life of | | | | | | | | |
| 2008 | | | | 2007 | | | | |
| 1 year or less | Over 1 year to 5 years | Over 5 years | Total | 1 years or less | Over 1 year to 5 years | Over 5 years | Total | |
| HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn | |
| 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 |
| | 50,771 | 17,899 | 4,648 | 73,318 | 62,444 | 19,146 | 4,681 | 86,271 |

(c) **Capital Commitments**

Capital commitments outstanding at 31st December and not provided for in the accounts were as follows:

| | The Group | | The Bank | |
|---|------------------|----------------|-----------------|----------------|
| | 2008 | 2007 | 2008 | 2007 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| Expenditure authorised and contracted for | 1,611 | 1,880 | 608 | 647 |
| Expenditure authorised but not contracted for | 107 | 131 | 98 | 89 |
| | 1,718 | 2,011 | 706 | 736 |

(d) **Operating Lease Commitments**

At 31st December, 2008, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

| | The Group | | The Bank | |
|--|------------------|----------------|-----------------|----------------|
| | 2008 | 2007 | 2008 | 2007 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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> |
| | | | | |
| | The Group | | The Bank | |
| | 2008 | 2007 | 2008 | 2007 |
| | HK\$ Mn | HK\$ Mn | HK\$ Mn | HK\$ Mn |
| 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) |
| | <u>6</u> | <u>4</u> |
| Goodwill arising on consolidation | <u>27</u> | <u>36</u> |
| Total purchase price | 33 | 40 |
| Less: cash and cash equivalents acquired | (12) | (2) |
| Cash flow on acquisition net of cash acquired | <u>21</u> | <u>38</u> |

(b) **Disposal of Subsidiary**

| | <u>2008</u> | <u>2007</u> |
|---|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| Advances and other accounts less provisions | — | 53 |
| Taxation | — | (3) |
| Other accounts and provisions | — | (1) |
| | <u>—</u> | <u>49</u> |
| Add: gain on disposal | — | 406 |
| Cash flow on disposal of subsidiary | <u>—</u> | <u>455</u> |

(c) **Cash and Cash Equivalents**

(i) *Components of cash and cash equivalents in the consolidated cash flow statement*

| | <u>2008</u> | <u>2007</u> |
|---|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| 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 |
| | <u>94,106</u> | <u>103,718</u> |

(ii) *Reconciliation with the consolidated balance sheet*

| | <u>2008</u> | <u>2007</u> |
|---|----------------|----------------|
| | <u>HK\$ Mn</u> | <u>HK\$ Mn</u> |
| 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 | 912 | 55 | 912 | 55 |
| | <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 |
|--|--------------|--------------|
| | HK\$ Mn | HK\$ Mn |
| Aggregate amount of relevant loans outstanding at 31st December | | |
| By the Bank | 4,169 | 1,432 |
| By subsidiaries | <u>1,073</u> | <u>625</u> |
| | <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 | <u>1,492</u> | <u>625</u> |
| | <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

Number of Share Options

| Date of Grant | Outstanding at 1/1/2007 | Granted | Exercised | Lapsed | Outstanding at 31/12/2007 |
|------------------------|------------------------------------|-------------------------|-------------------------|-----------------|--|
| 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 | — | <u>2,750,000</u> | — | — | <u>2,750,000</u> |
| Total | <u><u>24,060,000</u></u> | <u><u>2,750,000</u></u> | <u><u>7,510,000</u></u> | <u><u>—</u></u> | <u><u>19,300,000</u></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 |
| April | 03/5/2006 | 500,000 | — |
| | 18/4/2002 | — | 850,000 |
| | 02/5/2003 | 30,000 | 10,000 |
| | 22/4/2004 | 165,000 | 75,000 |
| May | 03/5/2005 | 110,000 | 290,000 |
| | 02/5/2003 | 90,000 | 210,000 |
| | 22/4/2004 | 20,000 | 155,000 |
| June | 03/5/2005 | 75,000 | 390,000 |
| | 02/5/2003 | — | 150,000 |
| | 22/4/2004 | 25,000 | 65,000 |
| July | 03/5/2005 | 25,000 | 655,000 |
| | 22/4/2004 | 5,000 | 75,000 |
| | 03/5/2005 | 55,000 | 145,000 |
| August | 02/5/2003 | — | 30,000 |
| | 22/4/2004 | 30,000 | 120,000 |
| | 03/5/2005 | 45,000 | 105,000 |
| September | 22/4/2004 | 20,000 | 30,000 |
| | 03/5/2005 | — | 115,000 |
| October | 22/4/2004 | — | 180,000 |
| | 03/5/2005 | — | 100,000 |
| November | 02/5/2003 | — | 15,000 |
| | 22/4/2004 | — | 310,000 |
| | 03/5/2005 | — | 160,000 |
| | 03/5/2006 | — | 50,000 |
| December | 02/5/2003 | — | 40,000 |
| | 22/4/2004 | — | 100,000 |
| | 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.

(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.

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:

Effective for accounting periods beginning on or after

| | |
|--|------------------|
| 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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