THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to any aspect of this circular or as to the action to be taken, you should consult your licensed securities dealer, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in CITIC International Financial Holdings Limited, you should at once hand this circular, together with the enclosed form of proxy, to the purchaser or transferee or the bank, licensed securities dealer or other agent through whom the sale or transfer was effected for transmission to the purchaser.

中信國際金融控股有限公司

CITIC INTERNATIONAL FINANCIAL HOLDINGS LIMITED

(Incorporated in Hong Kong with limited liability under the Companies Ordinance)

(Stock Code: 183)

VERY SUBSTANTIAL ACQUISITION AND CONNECTED TRANSACTION IN RELATION TO THE PROPOSED ACQUISITION OF AN INTEREST IN CHINA CITIC BANK

Financial Advisers to CITIC International Financial Holdings Limited

JPMorgan

CITIC CAPITAL 中信資本

Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders

SOMERLEY LIMITED

A letter from the Independent Board Committee containing its recommendation to the Independent Shareholders in relation to the proposed acquisition of an interest in China CITIC Bank is set out on page 17 of this circular. A letter from Somerley Limited, the Independent Financial Adviser, containing its advice to the Independent Board Committee and the Independent Shareholders is set out on pages 18 to 54 of this circular.

A notice convening the EGM to be held on Wednesday, 19 July 2006 at 10:00 a.m. at The Atrium, 39th Floor, Island Shangri-La Hotel, Pacific Place II, 88 Queensway, Hong Kong is set out on pages 306 to 307 of this circular. If you are not able to attend the EGM, you are requested to complete and return the enclosed form of proxy in accordance with the instructions printed thereon to the Company's share registrar, Computershare Hong Kong Investor Services Limited at 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong as soon as possible but in any event not less than 48 hours before the time appointed for holding the EGM. Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or any adjournment of it should you so wish.

30 June 2006

CONTENTS

In this circular, the following expressions have the following meanings unless the context requires otherwise:

"Acquisition"	the proposed acquisition of the Sale Interest by the Company from CITIC Group pursuant to the Formal Sale and Purchase Agreement;
"Approved Valuation"	19.9% of the valuation stated in RMB of the net assets of CNCB as at 31 December 2005 required to be prepared pursuant to requirements under PRC laws and approved by the PRC Ministry of Finance;
"associate"	has the meaning ascribed thereto under the Listing Rules;
"Board"	the board of Directors;
"CIFH" or "Company"	CITIC International Financial Holdings Limited (stock code: 183), a company incorporated in Hong Kong and the Shares of which are listed on the Stock Exchange;
"Circular Exchange Rate"	the rate of HK$0.970638 to 1 RMB, being mid-rate of the HK$ to 1 RMB exchange rate quoted by the People's Bank of China on the 3rd business day immediately prior to the date of this circular, being the Latest Practicable Date;
"CITIC Group"	CITIC Group, a state-owned enterprise incorporated in the PRC;
"CNCB"	China CITIC Bank and its successors or assigns;
"CNCB Group"	CNCB and its subsidiaries;
"CKWB"	CITIC Ka Wah Bank Limited;
"Completion"	completion of the Acquisition;
"Completion Exchange Rate"	mid-rate of the HK$ to 1 RMB exchange rate quoted by the People's Bank of China on the 3rd business day immediately prior to the date of completion of the Acquisition;
"Consideration"	the higher of the Transaction Value and the HK$ amount equivalent of the Approved Valuation provided that such Approved Valuation shall not exceed 120% of the Transaction Value;

"Consideration Shares"	such number of new Shares equal to the quotient obtained by dividing the Consideration by HK$3.41, subject to the adjustments set out in the section headed "Adjustments to the Consideration Shares";
"Directors"	the directors of the Company;
"EGM"	the extraordinary general meeting of the Company to be convened on 19 July 2006 to consider and, if thought fit, approve, amongst other things, the Formal Sale and Purchase Agreement and the transactions contemplated thereunder;
"Formal Sale and Purchase Agreement"	the formal sale and purchase agreement entered into between the Company and CITIC Group on 13 April 2006 (which supersedes the Framework Agreement) in respect of the Acquisition, the major terms of which are substantially the same as those contained in the Framework Agreement;
"Framework Agreement"	the binding framework agreement dated 30 March 2006 entered into between the Company and CITIC Group in relation to, amongst other things, the Acquisition. The Framework Agreement has been superseded by the Formal Sale and Purchase Agreement;
"Group"	the Company and its subsidiaries;
"HKMA"	the Hong Kong Monetary Authority;
"HK$"	Hong Kong dollars, the lawful currency of Hong Kong;
"Hong Kong"	the Hong Kong Special Administrative Region of the People's Republic of China;
"IFRS"	International Financial Reporting Standards, including International Accounting Standards and Interpretations issued by the International Accounting Standards Board;
"Independent Board Committee"	the independent board committee of the Company comprising Mr. Rafael Gil-Tienda, Mr. Lam Kwong Siu and Mr. Tsang Yiu Keung Paul;
"Independent Financial Adviser"	Somerley Limited;

"Independent Shareholders"	Shareholders other than CITIC Group and its associates (as that term is defined under the Listing Rules);
"Latest Dealing Date"	23 March 2006 (being the last trading day before trading in the Shares was suspended pending the issue of the announcement of the Company dated 31 March 2006 in relation to the Framework Agreement);
"Latest Practicable Date"	27 June 2006, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained in this circular;
"Listing Rules"	the Rules Governing the Listing of Securities on the Stock Exchange;
"PRC"	the People's Republic of China, but for the purposes of this circular only, excludes Hong Kong, Macau and Taiwan;
"PRC GAAP"	generally accepted accounting principles in the PRC;
"RMB"	Renminbi, the lawful currency of the PRC;
"Sale Interest"	19.9% of the existing equity interest in CNCB (including rights to receive dividends declared from the profits of CNCB as may be allowed under PRC law);
"Shareholder(s)"	holder(s) of the Shares;
"Share(s)"	ordinary share(s) of HK$1.00 each in the share capital of the Company;
"Stock Exchange"	The Stock Exchange of Hong Kong Limited; and
"Transaction Value"	approximately RMB5,328.9 million (approximately HK$5,172.4 million based on the Circular Exchange Rate), representing 1.153 times of 19.9% of the audited consolidated net book value in RMB of the CNCB Group as at 31 December 2005 prepared in accordance with IFRS.

中信國際金融控股有限公司
CITIC INTERNATIONAL FINANCIAL HOLDINGS LIMITED
(Incorporated in Hong Kong with limited liability under the Companies Ordinance)
(Stock Code: 183)

Chairman:
Mr. Kong Dan

Executive Directors:
Mr. Dou Jianzhong
Mrs. Chan Hui Dor Lam Doreen
Mr. Lo Wing Yat Kelvin
Mr. Roger Clark Spyer
Mr. Zhao Shengbiao

Non-executive Directors:
Mr. Chang Zhenming
Mr. Chen Xiaoxian
Mr. Ju Weimin
Mr. Liu Jifu
Mr. Wang Dongming

Independent Non-executive Directors:
Mr. Rafael Gil-Tienda
Mr. Lam Kwong Siu
Mr. Tsang Yiu Keung Paul

Registered Office:
Suites 1801-2
Bank of America Tower
12 Harcourt Road
Central
Hong Kong

30 June 2006

To the Shareholders

Dear Sir/Madam,

**VERY SUBSTANTIAL ACQUISITION
AND CONNECTED TRANSACTION
IN RELATION TO THE PROPOSED ACQUISITION OF
AN INTEREST IN CHINA CITIC BANK**

INTRODUCTION

The Company had on 13 April 2006 entered into the Formal Sale and Purchase Agreement, pursuant to which, amongst other things, the Company conditionally agreed to acquire and CITIC Group conditionally agreed to sell to the Company the Sale Interest at the Consideration. The Consideration is to be satisfied by the issue of the Consideration Shares (subject to adjustments) at HK$3.41 per Share.

Based on the audited consolidated accounts of the CNCB Group for the year ended 31 December 2005 prepared in accordance with IFRS and assuming that the Approved Valuation is equal to or lower than the Transaction Value, the Consideration (based on the Circular Exchange Rate) is approximately HK$5,172.4 million and it is estimated that approximately 1,517 million Consideration Shares (subject to adjustments) will be issued, representing approximately 47% of the existing issued share capital of the Company as at the Latest Practicable Date and approximately 32% of the issued share capital of the Company (subject to adjustments) enlarged by the issue of such Consideration Shares (assuming no other changes in the issued share capital of the Company). The above figures are for reference purposes only and the actual number of Consideration Shares to be issued is subject to the valuation of the net assets of CNCB required to be prepared pursuant to requirements under PRC law and to be approved by the PRC Ministry of Finance and subject to the adjustments described in the section headed "Adjustments to the Consideration Shares" below. Where the Transaction Value is equal to or higher than the Approved Valuation, the Consideration shall be equivalent to the Transaction Value multiplied by the Circular Exchange Rate and where the Transaction Value is lower than the Approved Valuation, the Consideration shall be equivalent to the Approved Valuation multiplied by the Circular Exchange Rate, subject to adjustments as described below. Completion of the Acquisition is conditional upon the fulfilment of a number of conditions precedent described below.

As certain of the percentage ratios calculated under the Listing Rules in respect of the Acquisition exceed 100%, the Acquisition constitutes a very substantial acquisition by the Company and requires Independent Shareholders' approval under Rule 14.49 of the Listing Rules. In addition, as CITIC Group is the controlling shareholder of the Company, the Acquisition constitutes a connected transaction of the Company. Given the size of the Acquisition, the transaction contemplated under the Formal Sale and Purchase Agreement falls under Rule 14A.16(5) of the Listing Rules and is subject to the reporting, announcement and Independent Shareholders' approval requirements of the Listing Rules pursuant to Rule 14A.17.

The purpose of this circular is to provide you with information on, amongst other things, the Formal Sale and Purchase Agreement, the recommendation of the Independent Board Committee and the letter of advice from Somerley Limited in respect of the Formal Sale and Purchase Agreement and to give you notice of the EGM.

THE ACQUISITION

The Formal Sale and Purchase Agreement dated 13 April 2006

Parties

Purchaser: the Company

Vendor: CITIC Group, a state-owned enterprise incorporated in the PRC. CITIC Group is also the controlling shareholder of the Company and, as at the Latest Practicable Date, owns approximately 56% of the Shares in issue

Summary of the Acquisition

Subject to fulfilment of the conditions precedent described below, the Company agreed to acquire and CITIC Group agreed to sell to the Company the Sale Interest at the Consideration. The Consideration will be satisfied by the issue and allotment by the Company of the Consideration Shares to CITIC Group (subject to adjustments set out in the section headed "Adjustments to the Consideration Shares" below) at HK$3.41 per Share.

Sale Interest to be acquired

As at the Latest Practicable Date, the Sale Interest represents 19.9% of the existing equity interest in CNCB (including rights to receive dividends declared from the profits of CNCB as may be allowed under PRC law). As at the Latest Practicable Date, CNCB is wholly owned by CITIC Group.

Consideration

The Consideration is to be satisfied by the issue of the Consideration Shares (subject to adjustments set out in the section headed "Adjustments to the Consideration Shares" below). The number of Consideration Shares to be issued will be equal to the quotient obtained by dividing the Consideration by HK$3.41 which was the average closing price per Share as quoted on the Stock Exchange for the period of five consecutive trading days ended on the Latest Dealing Date, subject to the adjustments set out in the section headed "Adjustments to the Consideration Shares" below.

The Consideration Shares shall, when issued, rank pari passu in all respects with the Shares then in issue. Based on the audited accounts of CNCB for the year ended 31 December 2005 prepared in accordance with IFRS and assuming that the Approved Valuation (which may only be available after the EGM but before Completion) is equal to or lower than the Transaction Value, the estimated Consideration (based on the Circular Exchange Rate) is approximately HK$5,172.4 million and it is estimated that approximately 1,517 million Consideration Shares (subject to adjustments) will be issued upon completion of the Acquisition, representing approximately 47% of the existing issued share capital of the Company as at the Latest Practicable Date. The completion of the Acquisition is not expected to result in a change of control of the Company.

On such basis, the market value of the Consideration Shares is approximately HK$6,409 million, calculated on the basis of the average closing price of approximately HK$4.225 per Share as quoted on the Stock Exchange for the period of five consecutive trading days ended on the Latest Practicable Date. However, the above figures are for reference purposes only and the actual number of Consideration Shares to be issued is subject to the adjustments described below.

Adjustments to the Consideration Shares

If the Completion Exchange Rate is greater than the Circular Exchange Rate (i.e. more HK dollars are required to exchange one RMB), the number of Consideration Shares to be issued and allotted to CITIC Group shall be based on the Completion Exchange Rate provided that the maximum number of additional Consideration Shares shall not be more than 3% of the Consideration Shares that would be issued and allotted based on the Circular Exchange Rate. Consequently, assuming that the HK$ amount equivalent of the Approved Valuation is equal to or lower than the Transaction Value, the maximum number of Consideration Shares which may fall to be issued under the Formal Sale and Purchase Agreement is approximately 1,562 million Consideration Shares. If 1,562 million Consideration Shares were to be issued, this would represent approximately 47% of the existing issued share capital of the Company as at the Latest Practicable Date and approximately 32% of the issued share capital of the Company enlarged by the issue of the Consideration Shares, resulting in CITIC Group holding approximately 70% of the enlarged issued share capital of the Company (assuming that there are no other changes in the issued share capital of the Company).

Basis of the Consideration

The Consideration was determined after arm's length negotiations between the Company and CITIC Group after taking into account a number of factors including the average closing price of approximately HK$3.41 per Share as quoted on the Stock Exchange for the period of five consecutive trading days ended on the Latest Dealing Date, the potential advantages that would accompany the Acquisition (further details of which are described in the section headed "Reasons for and Effects/Benefits of the Acquisition") and the terms of investments by other foreign investors into Chinese banks.

The issue of the Consideration Shares at HK$3.41 per Share is at a discount of 1.87% to the closing price of HK$3.475 per Share as quoted on the Stock Exchange on the Latest Dealing Date, at a premium of 1.49% to the average closing price of HK$3.36 per Share as quoted on the Stock Exchange for the period of 10 consecutive trading days ended on the Latest Dealing Date and at a discount of 21.16% to the closing price of HK$4.325 per Share as quoted on the Stock Exchange on the Latest Practicable Date.

Conditions Precedent

Completion of the Acquisition will be subject to, amongst other things, the following conditions being satisfied or waived:

(a) completion of business, financial and legal due diligence on CNCB and the results thereof being reasonably satisfactory to the Company;

(b) delivery by CITIC Group's PRC legal counsel to the Company of a PRC legal opinion on the legal status of CNCB, necessary approval for CNCB to operate its business, the legality of the transfer of the Sale Interest, the legality in respect of the issue of the Consideration Shares by the Company to CITIC Group, all in a form and substance reasonably satisfactory to the Company under PRC law;

(c) delivery by the Company to CITIC Group of:

(i) Hong Kong legal opinions given by the Company's Hong Kong legal counsel on the legal status of the Company and its material operating subsidiaries, necessary approvals for them to operate their respective businesses, legality of the transaction in respect of the issue of Consideration Shares under Hong Kong law; and

(ii) PRC legal opinions given by the Company's PRC legal counsel on compliance with requirements of Chinese law by the Company as a foreign investor of CNCB;

(d) completion of all relevant legal documentation, in form satisfactory to both CITIC Group and the Company, for the acquisition of the Sale Interest;

(e) obtaining all necessary prior government authority consents required for the transaction including, without limitation, the approvals of the Hong Kong and PRC governmental authorities, if necessary;

(f) obtaining the approval by the Independent Shareholders of the Formal Sale and Purchase Agreement, the acquisition of the Sale Interest and the issue and allotment of the Consideration Shares;

(g) the Stock Exchange approving the listing of and permission to deal in the Consideration Shares;

(h) representations and warranties being true and correct in all material respects at time of Completion; and

(i) Approved Valuation being not more than 120% of the Transaction Value.

An application will be made to the Stock Exchange for the listing of and permission to deal in the Consideration Shares.

The latest date for the fulfillment or waiver by the Purchaser or the Vendor in writing (as the case may be) of the above conditions is 31 December 2006 (or such later date as the Company and CITIC Group may agree in writing).

Completion

Completion shall take place within ten business days after the fulfillment or (if applicable) waiver of all conditions precedent to the Formal Sale and Purchase Agreement or such other date for Completion as the Company and CITIC Group may agree.

POST COMPLETION MATTERS

(a) Subject to relevant regulatory approvals and legal requirements, CITIC Group is supportive of the Company acquiring more equity interests in CNCB (being its existing capital stock or new capital stock). It has been published by CNCB that it intends to seek an initial public offering of its shares on the Stock Exchange. To the extent permitted by legal and regulatory requirements, subject to terms to be agreed, the Company does not rule out the possibility that it may increase its stake to more than 19.9% in the future, although there are no plans for such increase at the present time. Conversely, as CNCB may undertake assets or capital reorganisation prior to its anticipated initial public offering, to the extent that the Company's equity interest in CNCB falls below 19.9%, the Company does intend to acquire or subscribe for such equity in CNCB required to maintain its percentage shareholding in CNCB of at least 15%.

(b) CITIC Group has undertaken that if CNCB deems it desirable to increase its capital prior to the investment by a strategic investor and/or the listing of CNCB, such capital injection shall be the responsibility of CITIC Group and any such capital injection shall not result in the value of the Company's equity interest in CNCB falling below the equity value accorded to the Company on the date of Completion and that the Company's equity interest in CNCB will not be less than 15%.

(c) CITIC Group will support the nomination of at least one director designated by the Company to be a director on the board of CNCB. Currently, the board of CNCB comprises 5 directors, two of whom also sit on the Board of the Company.

(d) CITIC Group is supportive of cooperation between the Company and CNCB so as to establish or strengthen ties in the areas of retail banking, corporate banking, treasury activities and wealth management businesses.

(e) Notwithstanding anything to the contrary in paragraphs (a), (c) and (d) above, the Company agrees that CITIC Group shall not be required to perform any of its obligations and undertakings in paragraphs (a), (c) and (d) above if (i) the performance thereof would cause a significant regulatory or legal impediment to the listing of its shares in CNCB (including any issues that any regulatory authority may raise relating to public shareholders' interest) and (ii) the Company and CITIC Group shall have used their respective best efforts to work together to eliminate the regulatory or legal impediment to the listing of shares in CNCB. In the event of such non-performance, CITIC Group shall not be deemed to be in breach of any of the requirements on CITIC Group as described in paragraphs (a), (c) and (d) above or be liable for any damages to the Company as a result.

INFORMATION ON CNCB AND CITIC GROUP

The establishment of CITIC Group in 1979 was approved by the PRC's State Council. CITIC Group operates a wide range of businesses in the financial, services and industrial investment sectors. One of its main focuses is the development of financial businesses, with substantial interests in two commercial banks and certain non-banking financial institutions including securities firms, an insurance company, as well as a trust company. CITIC Group, the vendor of the Sale Interest, is the controlling shareholder of the Company and, therefore, is a connected person of the Company.

CNCB is principally engaged in the business of provision of banking and financial services in the PRC.

The following table shows the audited, consolidated financial information of the CNCB Group for each of the financial years ended 31 December 2004 and 31 December 2005, prepared in accordance with IFRS:

	Audited financial information for the year ended 31 December 2004	**Audited financial information for the year ended 31 December 2005**
Net profit before taxation	RMB4,061 million (approximately HK$3,942 million)	RMB5,453 million (approximately HK$5,293 million)
Net profit after taxation	RMB2,428 million (approximately HK$2,357 million)	RMB3,084 million (approximately HK$2,993 million)

The translation of RMB into HK$ has been made at the rate of RMB1.00 to HK$0.970638 for each of the financial years ended 31 December 2004 and 31 December 2005 respectively.

The audited net book value of CNCB Group as at 31 December 2005 was RMB23,225 million (approximately HK$22,543 million).

The financial information of CNCB Group is set out in Appendix II on pages 183 to 286 of this circular.

RULE 4.10 WAIVER

Rule 4.10 of the Listing Rules requires that the information to be disclosed in respect of Rules 4.04 to 4.09 of the Listing Rules must be in accordance with best practice which is at least that required to be disclosed in respect of those specific matters in the accounts of a company under the Companies Ordinance and Hong Kong Financial Reporting Standards or IFRS and, in the case of banking companies, the Financial Disclosure by Locally Incorporated Authorised Institutions issued by the HKMA.

The Company is currently unable to provide certain disclosures in respect of the accounts of CNCB as required under Supervisory Policy Manual FD-1 "Financial Disclosure by Locally Incorporated Authorised Institutions" issued by the HKMA. The Company has applied to the Stock Exchange for a waiver from strict compliance with the requirement under Rule 4.10 of the Listing Rules to the extent that the disclosure does not fully comply with the guidelines of the HKMA.

The HKMA guidelines require a separate disclosure in relation to movements in the allowance for loan impairment losses for individually assessed loans and for collectively assessed loans. The breakdown of such movements is not available from the systems of CNCB and therefore could not be provided. However, in lieu of this information, disclosure on the movements on an aggregated basis has been disclosed in Note 16(b) to the accountants' report of CNCB in Appendix II of this circular.

In addition, the HKMA guidelines require a separate disclosure in relation to the amount of new provisions charged to the income statement and the amount of provisions released back to the income statement in the movement of allowance for loan impairment losses. Similarly, the systems of CNCB did not contain information in relation to the amount of new provisions charged to the income statement and the amount of provisions released back to the income statement in the movement of allowance for loan impairment losses. However, in lieu of that, disclosure of these two amounts on a net basis has been made in Note 16(b) to the accountant's report of CNCB in Appendix II of this circular.

POSSIBLE CAPITAL INJECTION BY CITIC GROUP IN CNCB AND DISTRIBUTION OF PROFITS

Prior to the completion of the Acquisition, CITIC Group may inject further capital into CNCB. The proposed capital injection will be made consistent with CITIC Group's undertaking to assume responsibility for any additional capital requirements by CNCB prior to the investment by a strategic investor and/or the listing of CNCB, while assuring that the Company's equity interest in CNCB will not be less than 15%. The Sale Interest represents 19.9% of the capital interest in CNCB as at 31 December 2005 and therefore does not include any enlargement of the capital interests in CNCB as a result of any such capital injection by CITIC Group. Accordingly, such capital injection will result in a decrease in the percentage equity interest of the Company in CNCB. The proposed capital injection by CITIC Group into CNCB is expected to be in cash, in an amount not exceeding RMB5 billion, and is expected to be completed before 30 June 2006.

Based on the information provided by CITIC Group and CNCB, the purpose of the proposed capital injection is to further enhance the capital base and Capital Adequacy Ratio ("CAR") of CNCB. Although CNCB's CAR ratio of 8.11% as at 31 December 2005 is sufficient for the purposes of compliance with relevant PRC regulatory guidelines and PRC law, CITIC Group and CNCB believe that an enhanced capital base and CAR will be important to support CNCB's pace of growth and future development, and that the strengthened financial position of CNCB will enhance its attractiveness to potential investors, including the Company, prior to and for its planned listing.

If the proposed capital injection proceeds as planned, the Company's percentage equity interest in CNCB on Completion will be reduced to a percentage equal to 19.9% of the net asset value of CNCB on 31 December 2005 divided by the enlarged net asset value of CNCB as a result of the capital injection. For purposes of this calculation, net asset values both before and after the capital injection will be based on the Approved Valuation. The Company intends to equity account for its Sale Interest in CNCB after Completion and the capital injection by CITIC Group.

Assuming that the Transaction Value is equivalent to the Approved Valuation and the Sale Interest translates to 19.9% of RMB23,225 million of the CNCB Group's audited consolidated net book value as at 31 December 2005 and assuming that RMB $5 billion will be injected into CNCB, the interest of the Company in CNCB upon completion of the Acquisition will be approximately 16.4%, subject to the approval by the relevant government authorities.

Separately, as the consideration for the Sale Interest is based on the net asset value of CNCB as at 31st December 2005, and the Acquisition entitles the Company to the distribution of CNCB's net profits commencing upon the completion of the transaction, it is understood between the Company and CITIC Group that, the profits of CNCB attributable to the period from 1 January 2006 to the date of Completion will be distributed only to CITIC Group.

REASONS FOR AND EFFECTS/BENEFITS OF THE ACQUISITION

The Company is an investment holding company and is the holding company of CITIC Ka Wah Bank Limited, a Hong Kong licensed bank, and CITIC International Assets Management Limited, an asset management company which specializes in distressed assets management, direct investment and financial advisory services. The Company also holds 50% of CITIC Capital Holdings Limited, which focuses on China-related merchant banking and investment management services.

The Directors, including the Independent Non-executive Directors, consider the Acquisition to be in the interests of the Company and the Shareholders as a whole and the terms of the Acquisition including the Consideration and the terms on which the Consideration Shares are to be issued to be fair and reasonable. The recommendation of the Independent Board Committee is set out in its letter on page 17 of this circular.

The Directors believe that the Acquisition is beneficial to the Company for the following reasons:

(a) the strategic stake in CNCB will improve the Company's service capabilities and its ability to provide "one-stop" solutions to Greater China and overseas customers who are active in cross-border business and trade with the PRC;

(b) the strategic investment by the Company in CNCB is expected to strengthen the co-operation between the Company and CNCB in the areas of retail banking, corporate banking, treasury activities and wealth management businesses, prompting further integration of their individual operations and increasing co-operation between the Company and CNCB to achieve further scale and synergy;

(c) where the Company is currently constrained by its scale to enter into certain product areas and information technology and personnel investments, the Acquisition is expected to create economies of scale for the Company to expand capabilities in business and product developments;

(d) the expanded platform and additional development opportunities from the strengthened ties between the Company and CNCB will enable the Company to better attract and retain top talents;

(e) the sharing of expertise and know-how with CNCB will further deepen the Company's knowledge in developing business and relationships in China;

(f) the strength of the operational performance of CNCB and the proposed transaction structure of the Acquisition is expected to improve overall shareholders' value for the Company; and

(g) given the significant equity stake of the Acquisition and the strength of CNCB's operations in the PRC, the Acquisition represents a good opportunity for the Company to capture growth opportunities in the banking business in the PRC.

EFFECT ON EARNINGS AND ASSETS AND LIABILITIES OF THE COMPANY

Upon the completion of the Acquisition, based on the unaudited pro forma combined consolidated balance sheet of the Group after Completion as set out in Appendix III, the net asset value of the Group (taking into account the Acquisition) as at 31 December 2005 would be approximately HK$14,628 million and based on the unaudited pro forma combined consolidated income statement of the Group after Completion as set out in Appendix III, the net profit after tax of the Group (taking into account the Acquisition and as if the Acquisition had been completed on 1 January 2005) for the year ended 31 December 2005 would be approximately HK$1,699 million.

The pro forma financial statements are prepared in accordance with Rule 4.26 of the Listing Rules for the purpose of providing investors information on the effect of the Acquisition. The statements are prepared for illustrative purpose only and because of their nature, they do not purport to present a picture of the actual financial performance of the Company (taking into account the Acquisition) had the Acquisition actually been completed as at the relevant dates as set out on the basis stated. The unaudited pro forma financial information of the combined group does not purport to predict the combined group's future financial position or results of operations.

GENERAL

As certain of the percentage ratios calculated under the Listing Rules in respect of the Acquisition exceeds 100%, the Acquisition constitutes a very substantial acquisition of the Company and requires Independent Shareholders' approval under Rule 14.49 of the Listing Rules. In addition, as CITIC Group is the controlling shareholder of the Company, the Acquisition constitutes a connected transaction of the Company. Given the size of the Acquisition, the transaction contemplated under the Formal Sale and Purchase Agreement falls under Rule 14A.16(5) of the Listing Rules and are subject to the reporting, announcement and Independent Shareholders' approval requirements of the Listing Rules pursuant to Rule 14A.17.

To the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, apart from CITIC Group and its associates, no other Shareholder has a material interest in the Acquisition and accordingly, only CITIC Group and its associates are required to abstain from voting on the resolution to approve the Formal Sale and Purchase Agreement and the transactions contemplated therein at the EGM. As at the Latest Practicable Date, CITIC Group and its associates are interested in 1,791,118,990 Shares, representing approximately 55.95% of the issued share capital of the Company.

EGM

A notice convening an EGM of the Company to be held on Wednesday, 19 July 2006 at 10:00 a.m. at The Atrium, 39th Floor, Island Shangri-La Hotel, Pacific Place II, 88 Queensway, Hong Kong is set out on pages 306 to 307 of this circular. Whether or not you are able to attend the meeting in person, you are requested to complete and return the accompanying form of proxy in accordance with the instructions printed thereon to the Company's share registrar, Computershare Hong Kong Investor Services Limited at 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong as soon as practicable but in any event not later than 48 hours before the time appointed for the holding of the meeting or the adjourned meeting (as the case may be). Completion and return of the form of proxy will not preclude you from attending and voting at the meeting or any adjourned meeting thereof (as the case may be) should you so desire.

PROCEDURE FOR DEMANDING A POLL AT A GENERAL MEETING OF THE COMPANY

Article 69 of the articles of association of the Company sets out the procedure by which the Shareholders may demand a poll:–

At any general meeting, a resolution put to the vote of the meeting shall be decided on a show of hands unless (before or on the declaration of the result of the show of hands or on the withdrawal of any other demand for a poll) a poll is demanded by:

(i) the Chairman of the meeting; or

(ii) at least three members present in person (or in the case of a member being a corporation, by its duly authorized representative) or by proxy and entitled to vote at the meeting; or

(iii) any member or members present in person (or in the case of a member being a corporation, by its duly authorised representative) or by proxy and representing in the aggregate not less than one-tenth of the total voting rights of all members having the right to attend and vote at the meeting; or

(iv) any member or members present in person (or in the case of a member being a corporation, by its duly authorised representative) or by proxy and holding shares conferring a right to attend and vote at the meeting on which there have been paid up sums in the aggregate equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

Unless a poll is so demanded and the demand is not withdrawn, a declaration by the Chairman that a resolution has, on a show of hands, been carried unanimously or by a particular majority or lost shall be final and conclusive, and an entry to that effect in the minute book of the Company shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded for or against such resolution.

INDEPENDENT BOARD COMMITTEE

An Independent Board Committee comprising of Mr. Rafael Gil-Tienda, Mr. Lam Kwong Siu and Mr. Tsang Yiu Keung Paul has been appointed to advise the Independent Shareholders as to whether the terms of the Formal Sale and Purchase Agreement are fair and reasonable and whether such transaction is in the interest of the Company and its shareholders as a whole and to advise the Independent Shareholders on how to vote in respect of the resolution to be proposed at the EGM to approve the transactions contemplated under the Formal Sale and Purchase Agreement. Your attention is drawn to the recommendation of the Independent Board Committee set out in its letter on page 17 of this circular.

INDEPENDENT FINANCIAL ADVISER

Somerley Limited has been appointed to make recommendations to the Independent Board Committee and the Independent Shareholders as to whether the terms of the Formal Sale and Purchase Agreement are fair and reasonable and whether the transaction contemplated under the Formal Sale and Purchase Agreement is in the interest of the Company and its shareholders as a whole and to advise the Independent Shareholders on how to vote in respect of the resolution to be proposed at the EGM to approve the Formal Sale and Purchase Agreement and the transactions contemplated therein. Your attention is drawn to its letter to the Independent Board Committee set out on pages 18 to 54 of this circular.

RECOMMENDATION

The Directors consider that the terms of the Formal Sale and Purchase Agreement are fair and reasonable and the entering into of the Formal Sale and Purchase Agreement is in the interests of the Company and the Shareholders as a whole and therefore recommend the Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the EGM to approve the Acquisition and the Formal Sale and Purchase Agreement and to issue and allot the Consideration Shares.

You are advised to read carefully the letter from the Independent Board Committee on page 17 of this circular. The Independent Board Committee, having taken into account the advice of Somerley Limited, the text of which is set out on pages 18 to 54 of this circular, considers that the terms of the Formal Sale and Purchase Agreement are fair and reasonable and the entering into of the Formal Sale and Purchase Agreement is in the interest of the Company and the Shareholders as a whole and accordingly, the Independent Board Committee recommends the Independent Shareholders to vote in favour of the ordinary resolution to approve the Formal Sale and Purchase Agreement and the transactions contemplated therein.

ADDITIONAL INFORMATION

Your attention is also drawn to the additional information set out in the appendices to this circular.

By Order of the Board
CITIC International Financial Holdings Limited
Dou Jianzhong
Director and Chief Executive Officer

中信國際金融控股有限公司
CITIC INTERNATIONAL FINANCIAL HOLDINGS LIMITED
(Incorporated in Hong Kong with limited liability under the Companies Ordinance)
(Stock Code: 183)

30 June 2006

To the Independent Shareholders

Dear Sir or Madam,

We have been appointed by the Directors to advise you in connection with the Formal Sale and Purchase Agreement and the transactions contemplated thereunder. Details of the Acquisition and the Formal Sale and Purchase Agreement are set out in the letter from the Board on pages 4 to 16 of the circular (the "Circular") dated 30 June 2006, of which this letter forms a part. Terms defined in the Circular shall have the same meanings in this letter.

We wish to draw your attention to the letter from the Board set out on pages 4 to 16 of the Circular and the letter of advice from Somerley Limited set out on pages 18 to 54 of the Circular. Having taken into account the advice and recommendation of Somerley Limited, we consider the terms of the Formal Sale and Purchase Agreement to be fair and reasonable so far as the Independent Shareholders are concerned. Accordingly, we recommend the Independent Shareholders to vote in favour of the ordinary resolution set out in the notice convening the EGM to approve the Formal Sale and Purchase Agreement, the acquisition of the Sale Interest and the issue and allotment of the Consideration Shares at the EGM.

Yours faithfully,
Independent Board Committee

Rafael Gil-Tienda	**Lam Kwong Siu**	**Tsang Yiu Keung Paul**
Independent Non-Executive Director	*Independent Non-executive Director*	*Independent Non-executive Director*

Somerley Limited
Suite 2201, 22nd Floor
Two International Finance Centre
8 Finance Street
Central
Hong Kong

30 June 2006

To: The Independent Board Committee and the Independent Shareholders

Dear Sirs,

VERY SUBSTANTIAL ACQUISITION AND CONNECTED TRANSACTION IN RELATION TO THE PROPOSED ACQUISITION OF AN INTEREST IN CHINA CITIC BANK

INTRODUCTION

We refer to our appointment to advise the Independent Board Committee and the Independent Shareholders in connection with the Group's proposed acquisition of an interest in CNCB from CITIC Group. The Formal Sale and Purchase Agreement was signed in this respect on 13 April 2006. Details of the Acquisition are contained in the circular to the Shareholders dated 30 June 2006 ("Circular"), of which this letter forms a part. Unless otherwise defined, terms used in this letter shall have the same meanings as defined in the Circular.

The Acquisition constitutes a very substantial acquisition of the Company. As CITIC Group is the controlling Shareholder, the Acquisition also constitutes a connected transaction for the Company and is subject to, among other things, the approval of the Independent Shareholders by way of poll at the EGM.

The Independent Board Committee comprising Messrs Rafael Gil-Tienda, Lam Kwong Siu and Tsang Yiu Keung Paul, the three independent non-executive Directors, has been formed to advise the Independent Shareholders in respect of the terms of the Formal Sale and Purchase Agreement. We, Somerley Limited, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

We are not connected with the Company, CITIC Group, CNCB or their respective substantial shareholders or associates and accordingly are considered suitable to give independent financial advice on the terms of the Formal Sale and Purchase Agreement. Apart from normal professional fees payable to us in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from the Company, CITIC Group, CNCB or their respective substantial shareholders or associates.

In formulating our advice and recommendation, we have relied on the information and facts supplied, and the opinions expressed, by the Directors, which we have assumed to be true, accurate and complete. We have reviewed the financial information of the Group, including its 2003-2005 annual and interim reports, the financial information of the CNCB Group for the three years ended 31 December 2005, the unaudited pro forma financial information of the Group prepared on the assumption that the Acquisition has been completed and the result of the due diligence conducted on the CNCB Group in the context of the Acquisition. We have also held discussions with the management of CNCB and of the Group. During such discussions, the possibility of the introduction of a strategic investor from outside CITIC Group and/or an initial public offering ("IPO") of the CNCB Group has been raised. Based on the terms on which recent Hong Kong IPOs of PRC commercial banks have taken place, the pricing for a strategic investor or for an IPO is likely to be considerably higher than the consideration for the Acquisition. However, the Acquisition is not conditional on the introduction of an outside strategic investor or an IPO proceeding, which may or may not take place.

We have sought and received confirmation from the Directors that all material relevant information has been supplied to us and to the best knowledge of the Directors, no material facts have been omitted from the information supplied and opinions expressed by them. We consider that the information we have received is sufficient for us to reach our advice and recommendation as set out in this letter and to justify our reliance on such information. We have no reason to doubt the truth and accuracy of the information provided to us or to believe that any material information has been omitted or withheld. We have assumed that all information and representations contained or referred to in the Circular are true at the date of the Circular and will continue to be true up to the time of the EGM. However, we have not conducted any independent investigation into the business and affairs of the Group or the CNCB Group.

SUMMARY OF THE ACQUISITION

(a) Consideration

The Company has agreed to buy from CITIC Group 19.9% of the existing equity interest in CNCB. As CITIC Group proposes to inject a further RMB5 billion in cash into CNCB before Completion, this interest is likely to decrease to about 16.4% (as discussed further under the paragraph below headed "Capital injection"). However, this will not affect the dollar value of the Consideration or the number of Consideration Shares to be issued to satisfy it.

The Consideration will be expressed in HK$ and is an amount equivalent to the Transaction Value or, if higher, the Approved Valuation (both expressed in RMB), subject to a condition that the Approved Valuation is not more than 120% of the Transaction Value. If it is, the conditions to the Acquisition would not have been fulfilled.

The Transaction Value will be expressed in RMB and is equivalent to 1.153 times 19.9% of the audited consolidated net asset value of CNCB as at 31 December 2005 prepared in accordance with the IFRS ("2005 NAV"). Based on the accountants' report set out in appendix II to the Circular, the 2005 NAV was RMB23,225 million, on which basis the Transaction Value would be calculated as follows:

	RMB (million) (rounded to nearest million)
2005 NAV	23,225
Multiplied by a factor of 1.153	26,778
19.9% thereof, being the Transaction Value	5,329

The Approved Valuation is defined as 19.9% of the appraised value of the net assets of CNCB as at 31 December 2005 as approved by the PRC Ministry of Finance. The Approved Valuation is not yet available. If the Approved Valuation is higher than the Transaction Value, the Consideration will be based on the Approved Valuation, and not the Transaction Value, with a condition limiting such increase to a maximum of 20%. Consequently, it is in principle possible for the Consideration to be as high as the HK$ equivalent of RMB6,395 million (i.e. the Transaction Value of RMB5,329 million times 1.20) and the Acquisition would still proceed. Based on our understanding, it is expected that there will be no material difference between the 2005 NAV and the Approved Valuation. As a result, we present our analysis throughout our letter on the basis that the Consideration would equal the Transaction Value.

The HK$ amount of the Consideration would be approximately HK$5,172 million, based on the Transaction Value of RMB5,329 million and the Circular Exchange Rate of RMB1.00 = HK$0.970638. However, if the Completion Exchange Rate shows an appreciation of the RMB against the HK$ (i.e. if more HK$ are required to purchase RMB1 compared to the Circular Exchange Rate), the Completion Exchange Rate, and not the Circular Exchange Rate, will be used to calculate the Consideration. Any additional Consideration Shares to be issued shall not exceed 3% of the number of Consideration Shares that would have been issued if the Circular Exchange Rate had been used for this calculation.

The Consideration Shares will be issued and allotted at HK$3.41 per Share which represents the average closing price of the Share ("Average Closing Price") as quoted on the Stock Exchange for the period of five consecutive trading days ended on 23 March 2006 (being the last trading day prior to suspension of trading in the Shares pending announcement of the Acquisition ("Announcement")). Pursuant to the Formal Sale and Purchase Agreement, approximately 1,517 million Consideration Shares would be issued upon Completion.

The Consideration Shares shall, when issued, rank pari passu in all respects with the Shares then in issue. In particular, they will rank for any interim dividend paid by the Company in respect of the first six months of 2006, provided the Consideration Shares are issued before the record date for such dividend, if paid, which will be around September based on the Company's past practice.

The Directors have stated that the Consideration has been determined after arm's length negotiations between the Company and CITIC Group after taking into account a number of factors including the Average Closing Price of approximately HK$3.41 per Share, the potential advantages that would arise from the Acquisition and the terms of investments by other foreign investors into PRC banks (including their pricing).

(b) Conditions

Completion of the Acquisition will be subject to, among other things, the following conditions being satisfied or waived:

(i) completion of business, financial and legal due diligence on CNCB with satisfactory results. This process is still in progress and no significant matters have come to light;

(ii) obtaining the approval by the Independent Shareholders in relation to the Acquisition. This is the purpose of this Circular and the holding of the EGM; and

(iii) the Approved Valuation (required to be prepared under PRC laws and approved by the PRC Ministry of Finance) being not more than 120% of the Transaction Value. This puts a ceiling on the Consideration for the Acquisition.

(c) Reasons for the Acquisition

The Group is developing as CITIC Group's offshore financial services flagship. As stated in the annual report of the Company in 2005 ("2005 Annual Report"), one of the Group's priorities for 2006 is to strengthen the collaboration between CITIC Ka Wah Bank Limited ("CKWB") and CNCB and to build an integrated platform to promote their complementary competencies. The Board considers that conditions are ripe for CKWB and CNCB to deepen the collaborative efforts they have established in the past years and to break new ground in their partnership. The benefits of the Acquisition will, in the opinion of the Board, include the following:

(i) to improve the Company's service capabilities and its ability to provide "one-stop" solutions to Greater China and overseas customers;

(ii) to create economies of scale for the Company and expand its capabilities in business and product development;

(iii) to better attract and retain top talent; and

(iv) to capture growth opportunities in the banking business in the PRC.

In this connection, we note that the PRC banking industry has seen rapid growth in line with the economic development of the PRC. Banks have historically been, and continue to be, a significant source of capital for the economy and the primary choice for domestic savings. According to the Almanac of China's Finance and Banking 2005, bank loans accounted for 90.9% of total financing in 2004 with the remaining 9.1% being raised through bonds and equity issuances. The table below sets forth total RMB denominated and foreign currency-denominated loans and deposits in the PRC from 2000 to 2005:

	As of 31 December						Average annual growth rate (2000-2005)
	2000	2001	2002	2003	2004	2005	
	RMB (billion)						
Total RMB-denominated deposits	12,380.4	14,361.7	17,091.7	20,805.6	24,052.5	28,717.0	18.3%
Total RMB-denominated loans	9,937.1	11,231.5	13,129.4	15,899.6	17,736.3	19,469.0	14.5%
Total foreign currency-denominated deposits	1,061.2	1,115.7	1,247.1	1,230.8	1,266.3	1,303.9	4.3%
Total foreign currency-denominated loans	505.8	667.1	850.9	1,077.5	1,120.2	1,214.8	19.7%

Source: PBOC Quarterly Statistical Reports.

(d) Other major terms

(a) CITIC Group has undertaken that if CNCB deems it desirable to increase its capital prior to the investment by a strategic investor and/or the listing of CNCB, such capital injection shall be the responsibility of CITIC Group and any such capital injection shall not result in the value of the Company's equity interest in CNCB falling below the equity value accorded to the Company on the date of Completion and that the Company's equity interest in CNCB will not be less than 15%. Subsequent to the issue of the Announcement, CITIC Group has decided to inject a further RMB5 billion in capital primarily to improve CNCB's capital ratios prior to its planned IPO. Following the injection by CITIC, the Group's interest in CNCB would be about 16.4% (as discussed further below).

(b) CITIC Group will support the nomination of at least one director designated by the Company to be a director on the board of CNCB. Currently, the board of CNCB has five directors, two of whom also sit on the board of the Company; and

(c) CITIC Group is supportive of cooperation between the Company and CNCB so as to establish or strengthen ties in the areas of retail banking, corporate banking, treasury activities and wealth management businesses.

PRINCIPAL FACTORS AND REASONS TAKEN INTO ACCOUNT

In arriving at our opinion as regards the Acquisition, we have taken into account the following principal factors and reasons:

1. Business of the Group

(a) Businesses of the Group

The Company, an investment holding company formed in November 2002 as the result of a reorganisation of CKWB, is CITIC Group's offshore financial services flagship. The Company is the holding company of CKWB, a Hong Kong licensed bank, and of CITIC International Assets Management Limited ("CIAM"), an asset management company which specialises in distressed assets management, direct investments and financial advisory services. The Company also holds 50% of CITIC Capital Holdings Limited ("CCHL") (formerly known as CITIC Capital Markets Holdings Limited), which focuses on China-related merchant banking and investment management services. CCHL is accounted for as an associate of the Company.

For the year ended 31 December 2005, the Group reported a profit attributable to Shareholders of approximately HK$1,103 million, representing an increase of approximately 22.1% over 2004. As at 31 December 2005, the Group's total assets amounted to approximately HK$85.0 billion and its total loans and advances amounted to approximately HK$43.4 billion.

(i) CKWB

Based in Hong Kong, CKWB is wholly-owned by the Company and provides a wide range of banking services and financial solutions, focusing on retail banking, corporate banking and treasury services, serving both corporations and individuals. CKWB currently operates 32 branches in Hong Kong. It also has branches in Shanghai, Macau, New York and Los Angeles. Moody's Investors rate CKWB "Baa2" and FITCH Ratings, an international rating agency, upgraded CKWB's long-term rating from "BBB" to "BBB+" in July 2005, which is considered satisfactory.

CKWB reported profit attributable to shareholders of approximately HK$1,047 million for the year ended 31 December 2005 and had total assets and total loans amounting to approximately HK$81.8 billion and HK$43 billion respectively as at 31 December 2005.

(ii) CIAM

The core business of CIAM, a wholly-owned subsidiary of the Company, is the management and recovery of non-performing loans. CIAM also carries on fund management and China related assets management business through venture capital and direct investments.

For the year ended 31 December 2005, CIAM reported a consolidated net profit after tax of approximately HK$50 million and had total assets of approximately HK$1,400 million as at 31 December 2005.

(iii) CCHL

CCHL has previously been engaged in securities brokerage, investment banking and asset management through CITIC Capital Securities Limited and CITIC Capital Markets Limited. CITIC Capital Securities Limited provides securities brokerage and related services while CITIC Capital Markets Limited primarily targets cross-border financing activities. After the business reorganisation in early 2006, CCHL has refined its business focus and positioned itself as a leading China focused investment management and advisory firm and is now principally engaged in asset management, private equity and merchant banking.

CCHL reported a consolidated net profit after tax of approximately HK$120 million for the year ended 31 December 2005 and the Group's share of net assets of CCHL was approximately HK$1,102 million as at 31 December 2005.

(b) Operating results of the Group

Set out below is the abridged income statement of the Group for the year ended 31 December 2004 and 2005 as extracted from the 2005 Annual Report:

	For the year ended 31 December	
	2005	**2004**
	HK$ (million)	*HK$ (million)*
Net interest income	1,099	1,473
Non-interest income	871	682
Operating income	1,970	2,155
Operating expenses	(1,094)	(1,117)
	876	1,038
Impairment allowances written back/(charged)	58	(78)
Operating profit	934	960
Loss on disposal of associates	(6)	–
Net profit on disposal of fixed assets	240	12
Revaluation gain on investment properties	2	7
Share of profits less losses of associates	46	76
Profit before taxation	1,216	1,055
Tax	(113)	(151)
Profit attributable to Shareholders	1,103	904
Earnings per Share (basic)	HK$0.3451	HK$0.2832

Based on the 2005 Annual Report, the profit attributable to the Shareholders amounted to approximately HK$1,103 million, representing an overall increase of approximately 22.1% as compared to 2004. Out of the profit attributable to the Shareholders, approximately HK$876 million represents the operating profit of the Group before impairment allowances.

Mainly as a result of the improvement in asset quality and a reversal in collective assessment allowances due to changes in accounting standards, the Group recorded a HK$58 million release in impairment allowances in 2005 as compared to a charge of approximately HK$78 million in 2004. In addition, the Group recorded a net profit on disposal of fixed assets of approximately HK$240 million during 2005 which was mainly attributable to the HK$227 million gain from the sale of Ka Wah Bank Centre.

The HK$876 million operating profit of the Group (before impairment allowances) for 2005 represents a fall of approximately 15.6% compared to 2004. As stated in the 2005 Annual Report, such decline was mainly attributable to the decline in net interest income from approximately HK$1,473 million for 2004 to approximately HK$1,099 million for 2005, representing a decrease of approximately 25.4%, attributed mainly to the adverse impact of rising interest rates throughout the year. There was a sustained narrowing of the spread between the Prime Lending Rate and the Hong Kong Interbank Offer Rate, combined with a swing of core deposits to time deposits.

On the other hand, the non-interest income of the Group grew substantially from approximately HK$682 million for 2004 to approximately HK$871 million for 2005. This represents a growth of approximately 27.7% over 2004 and was derived mainly from CKWB's retail banking and fund investment businesses.

(c) Financial position and asset quality of the Group

As at 31 December 2005, the Group's total assets amounted to approximately HK$85.0 billion, representing an approximately 1.7% increase from that of 2004. Total loans were HK$43.4 billion, with an increase in residential mortgages, property investment lending and loans for funding outside Hong Kong and trade finance. Total deposits amounted to approximately HK$61.9 billion as at 31 December 2005, similar to the 2004 position. Net asset value as at 31 December 2005 was approximately HK$9,456 million, representing an approximately 13.6% increase from that of 2004. Net asset value per Share as at 31 December 2005 was approximately HK$2.96.

As illustrated in the 2005 Annual Report, there were several improvements in asset quality which include:

	As at 31 December 2005	**As at 1 January 2005** *(Note 4)*
Impaired loan ratio *(Note 1)*	2.7%	5.4%
Classified loan loss coverage *(Note 2)*	92.7%	89.6%
Loan loss coverage *(Note 3)*	48.6%	37.0%

Notes:

1. Impaired loan ratio is equal to the impaired loans over gross advances to customers. Impaired loans are loans which have been classified as substandard, doubtful and loss.

2. Classified loan loss coverage is equal to the sum of individually assessed impairment allowances and the lower of collateral value and outstanding loan balance of the classified loans over the total balance of classified loans.

3. Loan loss coverage is equal to the sum of individually assessed impairment allowances and collectively assessed impairment allowances for gross advances to customers over the balance of impaired loans.

4. The ratios are calculated on the basis of the Group's financial information prepared under the new accounting standards effective from 1 January 2005.

As at 31 December 2005, the Group's unadjusted capital adequacy ratio and loans to deposits ratio stood at 16.0% and 70.1% respectively, a slight improvement from the position as at 31 December 2004 of 15.9% and 68.8% respectively. The loans to total assets ratio decreased slightly from 51.4% as at 31 December 2004 to 51.0% as at 31 December 2005.

(d) Issue price of HK$3.41 for the Consideration Shares

The consideration for the Acquisition will be settled wholly by the issue of the Consideration Shares and not in cash. We have assessed the issue price of HK$3.41 per Consideration Share by reference to the earnings and net assets of the Group as shown in the Group's audited financial statements for the year ended 31 December 2005. In section 6 below, we also compare the issue price to the past market prices of the Shares.

(i) Issue price in relation to net asset value per Share

Audited net asset value as at 31 December 2005	**Net asset value per Share**	**Issue price to net asset value ratio**
HK$ (million)	*HK$* *(Note)*	
9,456	2.96	1.152 times

Note: Based on issued share capital as at 31 December 2005 of 3,198 million Shares.

On the above basis, the issue price of the Consideration Shares of HK$3.41 represents a price to book ("P/B") ratio of approximately 1.152 times. This, it will be noted, is broadly the same as the P/B ratio of 1.153 times used to fix the Transaction Value of CNCB in the context of the Acquisition.

(ii) Issue price in relation to earnings per Share

Audited net profit for year ended 31 December 2005 *HK$ (million)*	Earnings per Share *HK$*	Issue price to earnings ratio
1,103	0.345 *(Note)*	9.88 times

Note: Based on issued share capital as at 31 December 2005 of 3,198 million Shares.

It will be noted that based on the net profit of CNCB of RMB3,084 million for the year ended 31 December 2005 and a value of approximately RMB26.8 billion for 100% of CNCB (implied in the price of approximately RMB5,329 million for a 19.9% stake), the price to earnings ("P/E") ratio of CNCB as implied by the Acquisition is approximately 8.69 times.

Consequently, the P/E ratio represented by the issue price for the Consideration Shares is slightly above the P/E ratio represented by the Consideration at which the stake in CNCB is being purchased by the Group. In terms of net assets, the issue price for the Consideration Shares reflects closely the P/B ratio of CNCB implied by the Acquisition.

2. Business of CNCB

CNCB was established in 1987 and is currently wholly owned by CITIC Group. It is principally engaged in the business of provision of banking and financial services in the PRC. It is one of 11 commercial banks in the PRC operating with a national licence and provides services to both corporates and consumers through 418 branches, sub-branches and operating outlets located in 18 provinces and municipalities in the PRC. CNCB has three small subsidiaries, which have principal activities of money lending and property holding in Hong Kong, and property management in the PRC respectively.

As at 31 December 2005, the CNCB Group had total assets of approximately RMB595 billion with RMB358 billion in loans and approximately RMB104 billion in investments. CNCB's main source of funding is customer deposits, which amounted to approximately RMB531 billion at the end of 2005.

(a) Operating results of the CNCB Group

The following table summarises the audited consolidated financial results of CNCB for the three years ended 31 December 2005 prepared in accordance with the IFRS as set out in the appendix II to the Circular:

	For the year ended 31 December		
	2005	**2004**	**2003**
	RMB (million)	*RMB (million)*	*RMB (million)*
Interest income	22,511	17,795	12,967
Interest expense	(9,851)	(7,412)	(5,294)
Net interest income	12,660	10,383	7,673
Fee and commission income	608	449	353
Fee and commission expense	(190)	(131)	(88)
Net fee and commission income	418	318	265
Other gains, net	98	57	33
Net gain arising from foreign currency dealing	266	227	151
Other operating income	213	161	246
Operating income	13,655	11,146	8,368
General and administrative expenses	(7,104)	(5,451)	(3,940)
Impairment losses charge	(1,098)	(1,634)	(2,145)
Profit before taxation	5,453	4,061	2,283
Tax	(2,369)	(1,633)	(862)
Net profit	3,084	2,428	1,421

For the year ended 31 December 2005, the CNCB Group reported net profit of RMB3,084 million, representing an increase of approximately 27% over 2004. For the year ended 31 December 2004, the CNCB Group reported net profit of RMB2,428 million, representing an increase of approximately 71% over 2003. The increase in net profit for the two years ended 31 December 2005 was mainly attributable to (i) an increase in net interest income; and (ii) a decrease in impairment loss charge.

The net interest income of the CNCB Group accounts for by far the largest portion of the total operating income of the CNCB Group, representing 93%, 93% and 92% of the total operating income of the CNCB Group for the years ended 31 December 2005, 2004 and 2003, respectively. This is in contrast to CKWB in Hong Kong, where the split between net interest income and non-interest income for 2005 was about 58% to 42%. For the year ended 31 December 2005, net interest income increased by 22% to RMB12,660 million compared to RMB10,383 million for the year ended 31 December 2004. For the year ended 31 December 2004, the net interest income of CNCB increased by 35% to RMB10,383 million compared to RMB7,673 million for the year ended 31 December 2003. These increases reflect both increases in interest income and increases in interest expense throughout the three years. The increase in net interest income over the period from 2003 to 2005 was mainly attributable to the continued growth in loans and advances to customers of the CNCB Group. Loans and advances to customers are financed principally by deposits. The loans to deposits ratio was maintained at around 70% in 2004 and 2005.

General and administrative expenses mainly comprise staff costs, property and equipment expenses, management fee payable to CITIC Group and business tax and surcharges. The general and administrative expenses increased by 30% to RMB7,104 million for the year ended 31 December 2005 compared to RMB5,451 million for the year ended 31 December 2004. For the year ended 31 December 2004, the general and administrative expenses increased by 38% to RMB5,451 million for the year ended 31 December 2004 compared to RMB3,940 million for the year ended 31 December 2003. These increases were primarily attributable to (i) the increase in staff costs resulting from an increase in the number of staff employed by the CNCB Group for expansion of operations; and (ii) an increase in other general and administrative expenses including management fees paid to CITIC Group. The management fee paid to CITIC Group amounted to RMB500 million and RMB300 million for the years ended 31 December 2005 and 2004 respectively, representing approximately 7% and 6% of general and administrative expenses for the respective year.

The impairment loss charge mainly covers provisions for loans and advances to customers. This charge decreased sharply from RMB2,145 million in 2003 to RMB1,098 million in 2005. Such decrease was attributed by management primarily to the improvement in quality of the loan portfolio of the CNCB Group resulting from the adoption of various risk management procedures, and to continued strengthening of control over the lending process of the CNCB Group. The risk management procedures and controls include (but are not limited to) setting appropriate risk limits and controls, constant monitoring of the risks and limits by means of reliable and up-to-date management information systems, regularly modifying and enhancing risk management policies and procedures as well as carrying out regular internal audits. This is discussed further in sub-section (b) below.

(b) Financial position and assets quality of the CNCB Group

The audited consolidated balance sheets of CNCB as at 31 December 2005, 2004 and 2003 have been prepared in accordance with the IFRS. Shareholders may refer to the full set of financial statements (including the extensive notes) in appendix II to the Circular. A summary of the balance sheets set out is as follows:

	As at 31 December		
	2005	**2004**	**2003**
	RMB (million)	*RMB (million)*	*RMB (million)*
Assets			
Cash and balances with central bank	84,453	54,253	42,299
Amounts due from banks and other financial institutions	31,352	20,899	31,848
Loans and advances to customers	358,030	291,921	240,539
Investments	104,416	110,903	58,403
Property and equipment	8,614	8,090	6,826
Deferred tax assets	4,082	5,424	5,999
Other assets	3,955	3,655	3,903
Total assets	594,602	495,445	396,817
Liabilities			
Amounts due to central bank	240	300	3,921
Amounts due to banks and other financial institutions	28,021	38,190	37,600
Deposits from customers	530,573	435,020	345,356
Tax liabilities	1,203	1,052	988
Other liabilities and provisions	5,340	4,120	3,550
Subordinated debts issued	6,000	6,000	–
Total liabilities	571,377	484,682	391,415
Equity			
Share capital	26,661	17,790	14,032
Reserves	(3,441)	(7,031)	(8,633)
Minority interests	5	4	3
Total equity	23,225	10,763	5,402
Total equity and liabilities	594,602	495,445	396,817

Loans and advances to customers increased over the years from RMB241 billion in 2003 to RMB358 billion in 2005, due to an increase in demand for loans resulting from the growth in the business of the CNCB Group. As at 31 December 2005, customer loans of RMB358,030 million represented an increase of 23% from 31 December 2004. As at 31 December 2004, customer loans were RMB291,921 million, representing an increase of 21% from 31 December 2003.

The loans and advances to customers were mainly made up of corporate loans, representing approximately 76%, 84% and 76% respectively of the total loans as at 31 December 2005, 2004 and 2003. The table below sets out further information in respect of the corporate loan portfolio of the CNCB Group analysed by legal form of borrowers as at 31 December 2005, 2004 and 2003 respectively:

	As at 31 December					
	2005		**2004**		**2003**	
	RMB (million)		*RMB (million)*		*RMB (million)*	
Joint-stock enterprises	130,157	46.1%	119,369	46.6%	83,086	42.7%
State-owned enterprises	100,738	35.7%	84,252	32.9%	64,826	33.3%
Others	51,380	18.2%	52,801	20.5%	46,605	24.0%
	282,275	100.0%	256,422	100.0%	194,517	100.0%

The CNCB Group has a diversified corporate loan portfolio, without a high concentration of loans on a particular industry. Set out below is a table of loans and advances to customers analysed by economic sector concentrations as at 31 December 2005, 2004 and 2003 respectively:

	As at 31 December					
	2005		**2004**		**2003**	
	RMB (million)		*RMB (million)*		*RMB (million)*	
Manufacturing	81,537	28.9%	71,247	27.8%	51,860	26.7%
Wholesale and retail	29,902	10.6%	26,023	10.2%	23,099	11.9%
Production and supply of electric power, gas and water	26,559	9.4%	23,825	9.3%	9,857	5.1%
Others	144,125	51.1%	135,106	52.7%	109,421	56.3%
	282,123	100.0%	256,201	100.0%	194,237	100.0%

Moreover, a majority of the loan portfolio of the CNCB Group was allocated to the more developed regions of the PRC as set out below:

	As at 31 December					
	2005		2004		2003	
	RMB (million)		*RMB (million)*		*RMB (million)*	
Bohai Rim	105,803	28.6%	89,944	29.3%	81,788	31.8%
Yangtze River Delta	120,026	32.4%	91,672	29.9%	70,051	27.2%
Pearl River Delta and Cross-Straits Economic Region	52,885	14.3%	49,491	16.1%	46,780	18.2%
Others	91,546	24.7%	75,772	24.7%	58,694	22.8%
	370,260	100.0%	306,879	100.0%	257,313	100.0%

Note: "Bohai Rim" refers to the following areas where tier-1 branches of the CNCB Group are located: Beijing, Tianjin, Qingdao, Shijiazhuang and Jinan; "Yangtze River Delta" refers to the following areas where tier-1 branches of the CNCB Group are located: Shanghai, Nanjing, Suzhou, Hangzhou and Ningbo; "Pearl River Delta and Cross-Straits Economic Region" refers to the following areas where tier-1 branches of the CNCB Group are located: Guangzhou, Shenzhen, Dongguan and Fuzhou.

Although the loan portfolio of the CNCB Group has been expanding, the amount and the percentage of impaired loans and advances, which are graded substandard, doubtful or loss, decreased. Set out below is the amount of impaired loans and advances as well as their percentages to the total balance of the loan portfolio:

	As at 31 December		
	2005	2004	2003
	RMB (million)	*RMB (million)*	*RMB (million)*
Gross loans and advances to customers	370,260	306,879	257,313
Gross impaired loans and advances to customers	15,311	19,280	23,205
% of gross impaired loans and advances to customers to gross loans and advances to customers	4.1%	6.3%	9.0%

The dollar amount of impairment allowances made by the CNBC Group have also decreased as follows:

	As at 31 December		
	2005	**2004**	**2003**
	RMB (million)	*RMB (million)*	*RMB (million)*
Gross impaired loans and advances to customers	15,311	19,280	23,205
Impairment allowances against gross impaired loans	(9,847)	(12,698)	(14,929)
% of impairment allowances against gross impaired loans to gross impaired loans and advances to customers	64.3%	65.9%	64.3%

An impaired loan may not be fully written off. The management of the Company understand that CNCB's impairment policy takes into accounts factors including the existence and value of security for a particular loan.

The CNCB Group has made loans and advances to related parties. Their outstanding balances as extracted from the audited consolidated financial statements of CNCB contained in appendix II to the Circular are set out as follows:

	As at 31 December		
	2005	**2004**	**2003**
	RMB (million)	*RMB (million)*	*RMB (million)*
Gross loans and advances to related parties of the CNCB Group	5,468	6,379	6,486
Impairment allowances	(725)	(814)	(829)
% of impairment allowances to gross loans and advances to related parties of the CNCB Group	13.3%	12.8%	12.8%

The impairment allowances as a percentage to the gross amounts of related party loans is relatively high. The management of the Company understands that this is a historical issue that is being dealt with by the CNCB Group. The CNCB Group's audited accounts reflect that there is no growth in the loan portfolio to related parties over the three years ended 31 December 2005.

The CNCB Group's lending business is mainly funded by deposits from corporate customers. As at 31 December 2005, 2004 and 2003, approximately 91%, 89% and 87% of the deposits came from corporates while the remaining balance was from individuals. The split between time deposits and demand deposits is quite stable over the three years ended 31 December 2005, 2004 and 2003.

Majority of the deposits came from the more affluent areas in the PRC. Set out below is the geographical distribution of the customers placing deposits with the CNCB Group based on the value of their deposits:

	As at 31 December					
	2005		**2004**		**2003**	
	RMB (million)		*RMB (million)*		*RMB (million)*	
Bohai Rim	207,676	39.1%	167,713	38.6%	131,092	38.0%
Yangtze River Delta	155,861	29.4%	127,269	29.3%	95,109	27.5%
Pearl River Delta and Cross-Straits Economic Region	72,855	13.7%	59,003	13.5%	50,914	14.7%
Others	94,181	17.8%	81,035	18.6%	68,241	19.8%
	530,573	100.0%	435,020	100.0%	345,356	100.0%

Note: Please refer to the table above in relation to the geographical distribution of loan portfolio of the CNCB Group for detailed definitions of the geographical segments.

Similar to other banks in the industry, CNCB has to manage liquidity risk in its normal operation. This involves ensuring that the bank is able to meet deposit withdrawals either on demand or at contractual maturity, to repay borrowings in full when they mature, or to meet other obligations for payments, to comply with the statutory liquidity ratio, and to make new loans and investments as opportunities arise. Set out below is the breakdown of the assets and liabilities of the CNCB Group into relevant maturity groupings based on the periods to repayment at the respective balance sheet date:

	As at 31 December					
	2005		2004		2003	
	Repayable on demand *(Note)*	Other maturities	Repayable on demand *(Note)*	Other maturities	Repayable on demand *(Note)*	Other maturities
Total assets	53,019	541,583	48,479	446,966	55,816	341,001
Total liabilities	288,657	282,720	222,704	261,978	200,704	190,711
Long/(short) position	235,638	258,863	(174,225)	10,763	(144,888)	150,290

Note: Including overdue items

As shown in the table above, total liabilities repayable on demand exceed total assets repayable on demand as at the above balance sheet dates. This circumstance is the norm in the banking industry where liabilities (mainly comprising deposits) tend to be short-term and assets (mainly comprising loans) have a longer term. Throughout the period, CNCB has been in compliance with the liquidity and capital adequacy ratios prescribed by the relevant PRC regulators. We note that CNCB manages liquidity risk by holding sufficient liquid assets (for example, deposits at central bank, other short-term funds and securities) of appropriate quality to ensure that short-term funding requirements were covered within prudent limits. Adequate standby facilities are also maintained to provide strategic liquidity to meet unexpected demands for payments.

As a result of successful operations, the CNCB Group has been able to generate profits in each of the three years ended 31 December 2005. However, the balance of retained earnings was still in deficit as at 31 December 2005 as a result of prior year losses accumulated. As at 31 December 2003, 2004 and 2005, the deficits of the retained earnings were approximately HK$10,394 million, HK$9,215 million, HK$6,394 million, respectively, and this would hinder any payments of dividend by CNCB. However, we are informed that CNCB is in the process of being transformed into a joint-stock company in preparation for the planned IPO. It is expected that the deficit position would be eliminated upon CNCB having completed its transformation into a joint-stock company.

The Consideration is determined with reference to the audited net asset value of CNCB Group as at 31 December 2005. It is agreed between the parties to the Acquisition that the Group will be entitled to any distribution of CNCB's net profits commencing from Completion. It is understood between the Company and CITIC Group that the profits of CNCB attributable to the period from 1 January 2006 to the date of Completion will be distributed only to CITIC Group.

(c) Capital injection

We have been informed that prior to Completion, CITIC Group may inject a further RMB5 billion capital into CNCB. The proposed capital increase will be in the form of cash and is expected to be completed before 30 June 2006. CITIC Group would be entitled to such percentage of equity interest in CNCB as calculated by dividing the new equity over the Approved Valuation of CNCB Group's net assets as at 31 December 2005 as enlarged by the capital injection. The proposed capital increase is subject to PRC regulatory approval.

We are informed that the purpose of the above capital increase is to improve CNCB's capital base and capital adequacy ratio ("CAR") in anticipation of its planned IPO. Although CNCB's CAR of 8.11% as at 31 December 2005 is sufficient for the purposes of compliance with the relevant PRC regulatory guidelines and PRC laws, CITIC Group and CNCB believe that an enhanced capital base and CAR will be important to support CNCB's pace of growth and future development, and that the strengthened financial position of CNCB will enhance its attractiveness to potential investors in anticipation of its planned IPO.

The capital increase will have no effect on the amount of consideration payable by the Company for the Acquisition. However, the Company's percentage of equity interest in CNCB as enlarged by the capital increase would be diluted. The magnitude in dilution will not be known until the Approved Valuation of the CNCB Group's net assets as at 31 December 2005 is determined. Assuming the Approved Valuation equals the 2005 NAV, the Company's percentage of equity interest in CNCB would be diluted from approximately 19.9% to 16.4%. The degree of dilution would be less if the Approved Valuation is higher than the 2005 NAV, and more if it is lower, but in any case not below 15% under the terms of the Formal Sale and Purchase Agreement.

The proposed capital increase of CNCB is not expected to have material impact on the Group's share in dollar amount of the CNCB Group's net assets. This is because despite the decrease in percentage of equity interest, the Company will participate in a bigger group with increased net asset value and the injection will take place at net asset value.

As reflected in the pro forma financial information as set out in appendix III to the Circular, the Company expects that it would equity account for the acquired interest in CNCB, on the basis that it can exert significant influence over CNCB, either through board representation or other means of management participation. The Company's management believes that this position would remain unchanged despite the dilution of the Company's interest in CNCB from around 19.9% to about 16.4% upon completion of the capital injection. The position would have to be reviewed in view of the possible further dilution upon completion of the planned IPO of CNCB.

4. Due diligence

We have reviewed and discussed the due diligence work (which was limited in scope and did not constitute an audit) which has been conducted on CNCB in the context of the Acquisition. We have held a meeting with CNCB representatives at their head office in Beijing in this regard. Among the matters covered were:

(a) Loans and advances to customers and impairment provisions

The CNCB Group's ratio of non-performing loan ("NPL"), graded as substandard, doubtful or loss, as at 31 December 2005 was 4.1% and loans graded "special mention" were a further 4.1% of the loan portfolio. Both these figures are within the general range observable for PRC banks for which NPL ratios and "special mention" loans to loan portfolio ratios ranged from 1.3% to 9.3% and from 2.7% to 12.7% respectively. CNCB's total provisions as a percentage of NPLs were 80%, which is low as compared to the average of about 100% for mid-sized PRC listed banks, but its provisioning coverage ratio of 3.3% of the total loan portfolio is relatively high.

As noted above, over the years 2003 to 2005, loans and advances steadily increased from RMB241 billion in 2003 to RMB358 billion in 2005 while the bad debt charge decreased from RMB2.1 billion in 2003 (approximately 1% of the loan portfolio) to RMB1.1 billion in 2005 (approximately 0.3% of the loan portfolio). Management of CNCB attributes this improvement to a general strengthening of credit quality and control over the period. Nothing has come to our attention which would lead us to disagree with this general assessment. In the past, the level of bad debts experienced at certain major branches was higher than average, a problem which management says has been addressed, and this appears to be the case.

As noted above, the CNCB Group had made loans to CITIC Group and its subsidiaries in the past and there were such balances outstanding as at 31 December 2005. Total loans to CITIC Group and its subsidiaries have exceeded the China Banking Regulatory Commission ("CBRC") regulation guidance of 15% of the regulatory capital. We are informed that the CNCB Group is considering ways to reduce the amount to the regulatory limit.

(b) Management fee to CITIC Group

During 2004, CNCB Group paid CITIC Group a management fee of RMB300 million, which was increased to RMB500 million in 2005. We are informed that CNCB Group is discussing with CITIC Group the termination of this arrangement prior to the planned IPO.

(c) Taxation

The CNCB Group had an income tax charge for 2005 of RMB2,369 million, representing 43% of profit before taxation of RMB5,453 million. The standard tax rate for income tax in the PRC is 33%. The higher effective charge is due principally to certain staff and other costs not being tax deductible. Of the total tax charge, RMB1,325 million is a deferred tax charge. The total deferred tax assets of the CNCB Group have declined from RMB5.9 billion in 2003 to RMB4.0 billion in 2005, principally due to lower provisions for impairment loss on loan and advances. Losses against loans are in general deductible for tax purposes, but only when the loss is crystallised.

(d) Investments

After loans and advances to customers of RMB358.0 billion, the next largest category of assets as at 31 December 2005 was investments of RMB104.4 billion, primarily in government bonds. These can be analysed as follows:

	RMB (billion)	
Held to maturity	67.7	64.8%
Available for sale	31.9	30.6%
Held for trading purposes	4.8	4.6%
	104.4	100.0%

Less than 5% of investments are held for trading purposes on the CNCB Group's own book. Proprietary trading for the CNCB Group's account does not appear to be very active nor is extensive use of derivative or other structured products yet made. The majority is held to maturity and can be considered similar to loans. The portfolio appears to us to be prudently diversified.

Included in available for sale investments are some domestic equity investments. The management of the Company understands that domestic equity investments in the amount of approximately RMB10 million need to be disposed of by CNCB under the PRC law and CNCB is considering ways to deal with these assets.

(e) Acceptances and other commitments with off-balance sheet risk

At 31 December 2005, the CNCB Group had outstanding acceptances of RMB105.8 billion and guarantees and letters of credit of RMB36.9 billion. The CNCB Group provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. Acceptances comprise undertakings by the CNCB Group to pay bills of exchange drawn on customers. The CNCB Group expects most acceptances to be settled simultaneously with reimbursement from customers. Before commitments are fulfilled or expire, management assesses and makes allowances for any probable losses. As facilities may expire without being drawn upon, the total of the contractual amounts is not representative of expected future cash outflows. The credit risk weighted amount of contingent liabilities and commitments of the CNCB Group was about RMB50.0 billion as at 31 December 2005. The credit risk weighted amount is assessed by the CNCB Group in accordance with the rules set out by the CBRC of the PRC with reference to the status of the counterparty and the maturity characteristics. We consider the amount at risk not to be excessive compared to the total assets of the CNBC Group of approximately RMB594.6 billion as at 31 December 2005.

(f) Owner's capital and total equity

CNCB is not a joint-stock company and so does not yet have a share capital although it is intended that it should be incorporated in the near future. CITIC Group has followed a policy of capitalising retained earnings of CNCB and making cash injections so that owner's capital has increased as follows:

	2005	**2004**	**2003**
	RMB (million)	*RMB (million)*	*RMB (million)*
Owner's capital			
At 1 January	17,790	14,032	6,809
Retained earnings capitalised	271	1,258	1,223
Capital injection by cash	8,600	2,500	6,000
At 31 December	26,661	17,790	14,032
Reserves (including minority interests)	(3,436)	(7,027)	(8,630)
Total equity	23,225	10,763	5,402

As can be seen from the above table, total equity has increased over four times from 2003 to 2005. As noted above, we are informed that CITIC will inject a further RMB5 billion in owner's capital in cash before Completion. It is also possible that a strategic investor from outside CITIC Group may be introduced to buy existing capital or subscribe new capital in CNCB. It is likely that the planned IPO will result in a further capital increase if and when it occurs.

(g) Deposits

Apart from its equity capital, CNCB sources the great majority of its funding needs from customer deposits, as follows:

	As at 31 December		
	2005	**2004**	**2003**
	RMB (million)	*RMB (million)*	*RMB (million)*
Customer deposits	530.6	435.0	345.3
Other liabilities	40.8	49.7	46.1
Total liabilities	571.4	484.7	391.4

The deposits are divided about 50/50 between demand deposits and time deposits. Over half of the deposits come from the Bohai Rim and the Yangtze River Delta regions. Although customer deposits are potentially volatile, as discussed above, this is a problem faced by all banks. The management of CNCB place a high priority on customer service and deposit retention.

(h) Properties

As at 31 December 2005, the CNCB Group had approximately RMB1.2 billion of fixed assets for which it did not have proper title. Based on our understanding from the management of CNCB, title in respect of approximately RMB1.0 billion of these fixed assets was obtained as at the Latest Practicable Date. The management of the CNCB Group does not anticipate difficulty in obtaining proper title for the remaining RMB0.2 billion of fixed assets in due course which, in its view, is principally a procedural matter. As the CNCB Group has been using these assets as bank premises for a long period of time, we consider this issue not material in the context of the Acquisition.

5. Evaluation of the Consideration

The Consideration will be the Hong Kong $ equivalent of the Transaction Value or, if higher, the Approved Valuation (both expressed in RMB), subject to a condition that the Approved Valuation is not more than 120% of the Transaction Value. Assuming the Transaction Value is equal to or higher than the Approved Valuation, the Consideration will be approximately RMB5,329 million, which represents 1.153 times 19.9% of the 2005 NAV. It also represents a P/E ratio of approximately 8.69 times the audited consolidated financial results of CNCB for the year ended 31 December 2005 (prepared in accordance with IFRS).

(a) Comparable transactions

We have identified the following comparable transactions which involved the acquisition of a minority interest in a PRC bank by foreign investors and which are comparable in our view to the Acquisition (the "Comparable Transactions"). Their relevant percentages of interest acquired, the P/B ratio and the P/E ratio are as follows:

Name of Chinese bank	Name of foreign investor	Date	Percentage of interest acquired	P/B ratio *(Note 2)*	P/E ratio *(Note 2)*
Bank of Shanghai	HSBC	December 2001	8.00%	1.16	7.67
Shanghai Pudong Development Bank	Citibank	December 2002	5.00%	1.40	8.64
Industrial Bank	Hang Seng Bank, International Finance Corporation and Government Investment Corporation	December 2003	24.98%	1.54	10.15
Shenzhen Development Bank	Newbridge Capital	May 2004	17.89%	1.65	22.19
China Minsheng Bank	International Finance Corporation	July 2004	1.08%	1.48	8.32

Name of Chinese bank	Name of foreign investor	Date	Percentage of interest acquired	P/B ratio *(Note 2)*	P/E ratio *(Note 2)*
Bank of Beijing	ING Bank and International Finance Corporation	March to April 2005	24.90%	1.26	12.64
China Construction Bank *(Note 1)*	Bank of America	August 2005	9.00%	1.15	4.53
China Construction Bank *(Note 1)*	Temasek	July 2005	5.10%	1.19	4.69
Bank of China *(Note 1)*	Royal Bank of Scotland, Asia Financial Holdings, UBS and Asian Development Bank	August to October 2005	16.19%	1.17	9.38
Nanjing City Commercial Bank	BNP Paribas	October 2005	19.20%	1.85	16.94
Hua Xia Bank	Deutsche Bank and Sal. Oppenheim	October 2005	13.98%	1.84	18.75
Industrial and Commercial Bank	Goldman Sachs, Allianz AG and American Express	January 2006	10.00%	1.22	10.80
Ningbo Commercial Bank	OCBC Bank	January 2006	12.20%	1.88	13.41
Average				**1.45**	**11.39**
The Acquisition			**19.90%**	**1.153**	**8.69**

Source: Bloomberg, respective company announcements, prospectuses and other published financial information.

Notes:

1. The relevant ratios of China Construction Bank and Bank of China are calculated based on the respective bank's financial statements prepared in accordance with IFRS, while the other banks' financial statements are prepared based on PRC GAAP.

2. Unless announced by the bank and/or the foreign investor, the relevant ratios are calculated with reference to the latest published or announced financial information of the relevant bank immediately before the date of the agreement for acquisition of interest in the bank.

Based on the table above, the P/B ratios of the Comparable Transactions ranged from 1.15 times to 1.88 times with an average of 1.45 times. The P/B ratio for the Acquisition of 1.153 times is below the average of the Comparable Transactions.

The P/E ratios of the Comparable Transactions ranged from 4.53 times to 22.19 times with an average of 11.39 times. The P/E ratio of the Acquisition of 8.69 times falls within range and is below the average of the Comparable Transactions.

(b) *Banks listed in Hong Kong*

We have identified the following banks listed in Hong Kong which have substantial operations in the PRC and are considered comparable to CNCB (the "Listed Banks"). Their relevant P/B and P/E ratios as at Latest Practicable Date were as follows:

Name of the Listed Banks	**P/B ratio**	**P/E ratio**
Bank of China	3.26	25.19
Bank of Communications	2.75	22.70
China Construction Bank	2.72	14.48
Average	**2.91**	**20.79**
The Acquisition	**1.153**	**8.69**

Source: Bloomberg

Based on the table above, the P/B ratios of the Listed Banks ranged from 2.72 times to 3.26 times with an average of 2.91 times. The P/B ratio for the Acquisition of 1.153 times is below the low end of the range of the Listed Banks and substantially lower than the average as shown above.

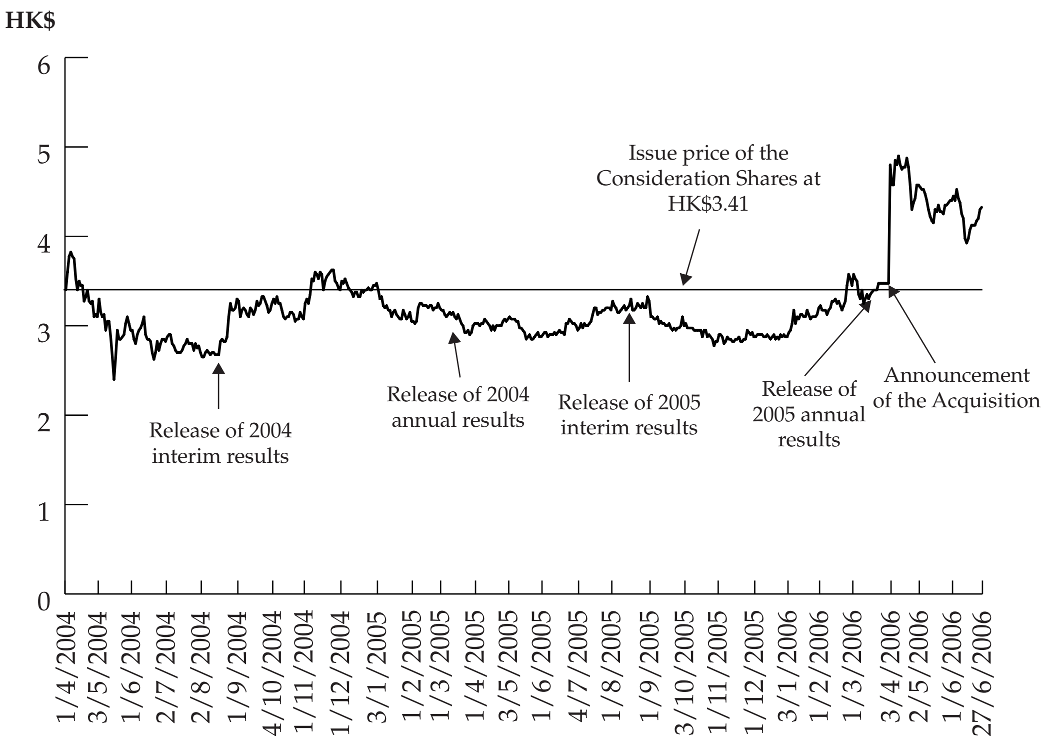
The P/E ratios of the Listed Banks ranged from 14.48 times to 25.19 times with an average of 20.79 times. The P/E ratio for the Acquisition of 8.69 times falls below the above range.

As an unlisted company, the P/B and P/E ratios of the CNCB Group might be expected to be somewhat lower than that of the Listed Banks, but not in our opinion by so great a margin.

6. Share price performance and comparison with the issue price of Consideration Shares

(a) Share price

The chart below shows the closing prices of the Shares traded on the Stock Exchange during the 24 months preceding the date of the Announcement (the "Comparison Period") up to and including the Latest Practicable Date:



Source: Bloomberg

Before the issue of the Announcement, the Share price traded in a range between HK$2.40 and HK$3.825. The issue price per Consideration Share of HK$3.41 falls within the trading range of the Share price in the Comparison Period. Upon the release of the Announcement, the market price of the Shares increased by approximately 38% from HK$3.475 as at 31 March 2006 (being the last trading day immediately before the publication of the Announcement) to HK$4.80 per Share as at 3 April 2006 (being the first trading day immediately after the publication of the Announcement). Such increase in the Share price, in our opinion, is a positive response from the market to the Acquisition and reflects the market's perception of the potential benefits to the Company upon Completion. At the Latest Practicable Date, the closing price of the Shares was HK$4.325.

(b) Comparison of the issue price for the Consideration Shares

The issue price per Consideration Share of HK$3.41 represents:

(i) a discount of approximately 1.87% to the closing price of the Shares of HK$3.475 as at the date of the Announcement;

(ii) a premium of approximately 0.29% over the closing price of the Shares of approximately HK$3.40 for the 30 trading days up to and including the date of the Announcement;

(iii) a premium of approximately 10.71% over the closing price of the Shares of approximately HK$3.08 for the 6-months period up to and including the date of the Announcement;

(iv) a premium of approximately 11.44% over the closing price of the Shares of approximately HK$3.06 for the 1-year period up to and including the date of the Announcement; and

(v) a premium of approximately 10.36% over the closing price of the Shares of approximately HK$3.09 for the 2-year period up to and including the date of the Announcement.

The issue price for the Consideration Shares is equal to the 5-day average price market price of the Share prior to signing of the agreements relating to the Acquisition. The Consideration Shares, when issued, shall rank pari passu with the existing issued Shares, and in particular will rank for any interim or final dividends that may be declared by the Company after their issue.

The issue price per Consideration Share of HK$3.41 also represents a premium of approximately 15.2% over the net asset value per Share of approximately HK$2.96 based the audited consolidated net asset value of the Company and the outstanding number of Shares in issue as at 31 December 2005. Such premium, representing a P/B ratio of approximately 1.152 times, is very close to the P/B ratio of 1.153 times on which the price for the Acquisition is based.

(c) Analysis of trading volume

The following table sets out the total number of the Shares traded on the Stock Exchange per month and the percentage of the monthly trading volume to the issued share capital of the Company for the period commencing from June 2005 to May 2006:

	Monthly trading volume *(Million shares)*	**Monthly trading volume to issued Shares** *(Note)*
2005		
June	76.1	2.38%
July	93.4	2.92%
August	134.4	4.20%
September	69.4	2.17%
October	47.5	1.48%
November	52.2	1.63%
December	61.3	1.92%
2006		
January	194.0	6.07%
February	233.3	7.30%
March	167.9	5.25%
April	903.2	28.24%
May	228.0	7.13%

Source: Bloomberg and information provided by the Company

Note: Shares in issue were: June 2005 to February 2006: 3,197,859,375; March 2006: 3,197,867,375; April 2006: 3,200,447,375; May 2006: 3,201,335,375.

Based on the above table, the Shares were in general moderately traded on the Stock Exchange during the period. The monthly trading volume in the market represented between 1.48% to 7.30% of the issued Shares as at the end of each corresponding month, except for April 2006 which represented 28.22%. The trading volume of the Shares increased significantly during April 2006, which we believe is attributable to the market reaction to the Announcement published on 3 April 2006.

Our conclusion is that trading in the Shares has been sufficiently active for the market price to reflect the fundamentals of the Company. As the volume of the trading in the Shares increased after the Announcement, we consider there are prospects for greater and more consistent liquidity in the Shares following the Acquisition.

7. Financial effects of the Acquisition on the Group

(a) Shareholding structure and dilution of the Independent Shareholders' shareholdings

The table below sets out the shareholding structure of the Company (i) prior to the Completion; and (ii) immediately after the Completion.

	Prior to Completion		Immediately after Completion		
	Number of Shares *(million)*	%	Number of Consideration Shares *(million)* *(Note)*	Number of Shares *(million)*	%
CITIC Group	1,791	55.9	1,517	3,308	70.1
Independent Shareholders	1,410	44.1	–	1,410	29.9
Total	3,201	100.0	1,517	4,718	100.0

Note: Assuming the Consideration is equal to the Transaction Value and no increase in the RMB/HK$ exchange rate (see section "(a) Consideration" under "Summary of the Acquisition" above).

The shareholdings of the Independent Shareholders are currently approximately 44.1%. Immediately after Completion, Independent Shareholders' shareholdings would be diluted to 29.9%. The degree of dilution for the Independent Shareholders under the Acquisition is significant but, in our opinion, acceptable given that their smaller attributable percentage holding will be held in an enlarged Group with improved growth prospects.

(b) Net asset value

Based on the pro forma financial information following Completion as set out in appendix III to the Circular, the pro forma combined net book value of the Combined Group (based on the audited net asset value of the Group of approximately HK$9,455 million as at 31 December 2005 and the issue of 1,517 million Consideration Shares at a price of HK$3.41 per Share) will be approximately HK$14,627 million, representing approximately HK$3.10 per Share (on the basis of the issued share capital of the Company, as enlarged by the issue of the Consideration Shares, of a total of approximately 4,718 million Shares). The pro forma net asset value per Share following Completion represents an increase of approximately 4.7% over the audited net asset value per Share of approximately HK$2.96 as at 31 December 2005. The increase in net asset value per Share arises because the Consideration Shares would be issued at a premium over the net asset value per Share.

(c) Earnings

Based on the pro forma financial information following Completion as set out in appendix III to the Circular, the pro forma net profit after taxation of the Combined Group (based on (i) the audited net profit after taxation of the Group of approximately HK$1,103 million for the year ended 31 December 2005; (ii) the sharing of 19.9% of the net profit after taxation of CNCB prepared in accordance with the IFRS of approximately RMB614 million (or equivalent to approximately HK$596 million based on the Circular Exchange Rate) for the year ended 31 December 2005 assuming the Acquisition had taken place as at 1 January 2005; and (iii) the issue of the Consideration Shares of 1,517 million Shares at a price of HK$3.41 per Share) will be approximately HK$1,699 million, representing approximately HK$0.36 per Share (on the basis of the issued share capital of the Company, as enlarged by the issue of the Consideration Shares, of a total of 4,718 million Shares). The pro forma net profit after taxation per Share following Completion of approximately HK$0.36 represents a slight increase over the audited net profit after taxation per Share of approximately HK$0.345 for the year ended 31 December 2005. The improvement in earnings per Share arises because the Consideration Shares are issued at a slightly higher P/E than that of CNCB as implied by the Consideration.

(d) Goodwill and other intangible assets

The Consideration reflects a premium over CNCB Group's audited net asset value as at 31 December 2005 (as per IFRS accounts). The entire profits of the CNCB Group attributable to the period from 1 January 2006 up to Completion is agreed to be distributed to CITIC Group. On this basis, goodwill may arise as a result of the Acquisition representing the excess of the Consideration over fair value of 19.9% of the CNCB Group's tangible and intangible assets (such as trade names or customer relationships) at Completion. In the case of tangible assets, net book values are normally taken to be their fair values. Any goodwill arising from the Acquisition would be subject to impairment test at Completion and thereafter on annual basis. If intangible assets are recognised, they would be amortised over their estimated useful life (in the case of intangible assets with a finite useful life) or subject to impairment test annually (in the case of intangible assets that do not have a finite useful life). Impairment charges and amortisation expenses, if any, will be charged to the profit and loss account of the Group.

8. Risk factors associated with CNCB

Despite the due diligence carried out, certain risks will remain associated in our opinion with an investment in CNCB. These are as follows:

(a) Risks relating to types of business operation

As compared to the "Big Four" banks, CNCB has fewer branches and concentrates on coastal and developed areas of the PRC and high-end customers. As interest income makes up over 90% of CNCB's income, a downturn in the economy could result in a decline of deposits and loans, and in turn of interest income. In addition, CNCB's interest income could be affected as the PRC Government gradually liberalises the regulation of interest rates.

CNCB may be exposed to exchange rate risks to a larger extent than certain other banks, especially after the introduction of the managed floating exchange rate system in 2005, as its non-interest income comes mostly from international transactions and treasury services.

As CNCB is expected to develop more fee and commission based services in the future, it may encounter additional risks as it changes its emphasis in this regard, especially during the initial phase.

CITIC Group may aim to provide comprehensive services in future, combining commercial banking, insurance, and securities. This may bring benefits but at the same time mean exposure to risks relating to different businesses.

(b) Risks relating to management systems

CNCB is in the process of improving and/or developing new management systems (for instance, Moody's system), but their effectiveness will not be proven until they have been fully tested and followed consistently. Moreover, their effectiveness is subject to the quality and scope of information available in the PRC.

Despite the trend in centralising management, it may be difficult for CNCB to detect and prevent fraud and misconduct in its branches and ensure consistent application of credit policies throughout the whole bank. CNCB may not be able to detect money laundering and other illegal or improper activities fully or on a timely basis.

(c) Future developments

Upon Completion, CITIC Group will remain the largest shareholder of CNCB. CITIC Group will continue to have the ability to exercise significant control over CNCB's business, including operations management and financial matters, which may give rise to conflicts of interest.

Benefits are expected from increased collaboration and closer working relationships between CKWB and CNCB after the Acquisition. However, the difference in economic and legal environments between Hong Kong and the PRC may cause difficulty in this respect.

(d) Increasing competition in the PRC banking industry

CNCB expects more competition with other commercial banks especially with foreign invested banks, as regulatory restrictions on their geographical presence, customer base and operating licenses in China are scheduled to be removed by December 2006 as part of China's commitments in its accession to the World Trade Organisation.

(e) Impact of PRC regulations or other policies and their changes in banking industry

China's banking regulatory environment is evolving, and the operation and prospects of CNCB may be adversely affected if it cannot adapt to relevant changes on a timely basis. For instance, the People's Bank of China has recently raised the required reserve ratio for commercial lenders by 0.5 percentage point to 8% in June 2006 to curb the investment boom in the PRC. This may impact all lenders, including CNCB, as they may need to put extra reserves in the central bank and reduce their loan portfolios.

Limitations imposed by the PRC authorities on the types of investments available to commercial banks may adversely affect commercial banks' ability to seek optimal investment returns and their ability to diversify their investment portfolio or fully to hedge the risks relating to their assets.

(f) Impact of PRC economic, political and social conditions and government policies

Despite the implementation of economic reform in recent years, the PRC government still exercises significant control over the economy, and some reform measures could bring about negative effects on CNCB. In addition, the government may materially and adversely affect the financial condition and business operation of CNCB through implementing macroeconomic policies in order to manage PRC's economic growth.

(g) Impact of PRC government control on currency conversion and future movements in exchange rates

Though China's existing foreign exchange regulations enable CNCB to pay dividends in foreign currencies without prior approval from State Administration of Foreign Exchange of the PRC ("SAFE"), in the future, the PRC government may take measures to restrict access to foreign currencies under certain circumstances.

CNCB is required to obtain the approval of SAFE before converting capital funds in foreign currencies into RMB, which could materially and adversely affect its financial condition, results of operations and compliance with capital adequacy ratios and operational ratios.

Following the introduction of the managed floating exchange rate system to allow the value of the RMB to fluctuate within a regulated band based on market supply and demand and by reference to a basket of currencies, the fluctuations of the RMB could have a material adverse effect on CNCB's financial condition and operational results.

(h) Impact of PRC legal system

The PRC legal system is based on written statutes. Many laws and regulations dealing with economic matters are relatively new, and are subject to different interpretations, and may be inconsistently enforced. Because of the limited volume of published cases, and their non-binding nature, interpretation and enforcement of these laws and regulations involve uncertainties.

Under PRC law, dividends may be paid only out of distributable profits as determined under the PRC GAAP or IFRS, whichever is lower, and dividend payment is also regulated by relevant PRC banking regulations. As a result, CNCB may not be able to pay dividends even if it has profits as determined under IFRS.

The above risks are common to banking investments in the PRC. Despite this, the demand for strategic and pre-IPO stakes in PRC banks remains strong, as shown by the list of the Comparable Transactions set out above. As the controlling shareholder of both CNCB and the Company is CITIC Group, there should be adequate information available to the Group to help manage such risks. In view of the growth potential of the PRC banking market, we consider that the above risks are justifiable in the context of the Group's proposed investment in CNCB.

DISCUSSION AND ANALYSIS

The Group's main business is currently commercial banking and the provision of various financial services, principally in Hong Kong. The acquisition of a strategic stake in a PRC commercial bank is, in our view, a logical extension of the Group's business into the rapidly developing PRC banking market. CNCB is a significantly larger bank than CKWB, being the seventh largest in the PRC ranked by assets. Its revenue is over 90% attributable to net interest income, leaving scope for increase in fee and commission earning services. As CNCB belongs to CITIC Group which also controls the Company, the chances of achieving the anticipated degree of a co-operation in future will be enhanced.

Financial due diligence has been carried out into CNCB. Particular attention has been paid to the quality of the loan portfolio. Impairment provisions have shown a steady decline in the period 2003 to 2005, which implies an improvement in the quality of lending.

The price for the Acquisition is 1.153 times CNCB Group's audited net asset value (per IFRS accounts), which is also equivalent to a price earnings ratio of about 8.69 times CNCB Group's audited net profits for 2005 (per IFRS accounts). This compares favourably from the Company's point of view with the average for similar transactions in the last five years of 1.45 times and 11.39 times respectively. It is also substantially below the P/B and P/E ratios on which recent flotations of PRC commercial banks in Hong Kong have taken place and at which such shares are currently traded. We are informed that CNCB intends to float its shares in Hong Kong in the future.

The payment of the Consideration is by the issue of new Shares, not by cash. This has some advantages for the Group, in that it conserves capital to support expansion of the business, but also means that the interests of the Independent Shareholders in the Group will be diluted. At present, they own 44.1%, but assuming the issue of approximately 1,517 million new Shares to satisfy the Consideration, they will be diluted to approximately 29.9%. This is a significant level of dilution in shareholding but acceptable in our opinion as Independent Shareholders will have a stake in a larger organisation with improved growth prospects. The financial effect on the assets and earnings attributable to the Independent Shareholders will be marginally favourable as the issue price of the Consideration Shares reflects P/B and P/E ratios slightly above those at which the Consideration is pitched.

The price at which the new Shares will be issued, HK$3.41 per Share, represents an approximately 10% premium over the long-term (on a six-month to 2-year basis) average closing price of the Shares. It represents a 21.2% discount to the closing price of the Shares on the Latest Practicable Date but the rise in the Share price following the Announcement represents in our opinion a favourable market reaction to the Acquisition and does not therefore disadvantage the Independent Shareholders.

There are certain risks as elaborated above in extending the Group's business from the relatively mature Hong Kong banking market to the relatively less developed PRC market, but such risks are, in our opinion, justified by the good growth prospects of the PRC market.

OPINION AND RECOMMENDATION

Based on the above principal factors and reasons and taking these factors and reasons as a whole as summarised in the section above headed "Discussion and analysis", we consider the terms of the Formal Sale and Purchase Agreement are fair and reasonable to the Independent Shareholders and the entering into of the Formal Sale and Purchase Agreement is in the interests of the Company and its Shareholders as a whole. We therefore advise the Independent Board Committee to recommend the Independent Shareholders, and we ourselves advise the Independent Shareholders, to vote in favour of the resolution to approve the Acquisition to be proposed at the EGM.

Yours faithfully,
for and on behalf of
SOMERLEY LIMITED
M.N. Sabine
Chairman

1. FINANCIAL SUMMARY

The following is a summary of the management financial information of the Group for each of the three years ended 31 December 2005 as extracted from the relevant annual reports of the Group.

Three-Year Financial Summary

	2005	**2004** (Restated)	**2003**
Profit & Loss Items for The Year *(HK$ million)*			
Net interest income	1,099	1,473	1,562
Non-interest income	871	682	459
Operating expenses	1,095	1,117	1,015
Impairment losses written back on loans and advances	(58)	N/A	N/A
Charge for bad and doubtful debts	N/A	78	514
Profit before taxation	1,216	1,055	772
Taxation	112	151	115
Profit attributable to shareholders	1,103	904	657
Per Share *(HK$)*			
Basic earnings per share	0.345	0.283	0.210
Dividends per share	0.173	0.141	0.093
Book value at year-end	2.96	2.61	2.45
Market value at year-end	2.875	3.450	4.200
Balance Sheet Items at Year-End *(HK$ million)*			
Loans and advances	43,368	42,921	40,643
Impairment allowance	569	N/A	N/A
Loan loss provision	N/A	1,059	1,237
Total assets	85,037	83,577	79,917
Average interest earnings assets	70,384	70,297	73,472
Total deposits	61,883	62,411	61,559
Shareholders' funds	9,455	8,322	7,812
Financial Ratios			
Capital adequacy	16.0%	15.9%	18.4%
Loans to deposits	70.1%	68.8%	66.0%
Loans to total assets	51.0%	51.4%	50.9%
General provision coverage	N/A	1.2%	1.3%
Collective assessment coverage	0.7%	N/A	N/A
Cost to income			
– Before goodwill amortisation in respect of 2004 and 2003	55.6%	49.1%	47.3%
– After goodwill amortisation in respect of 2004 and 2003	55.6%	51.9%	50.3%
Dividend payout	50.1%	50.0%	45.1%
Return on assets	1.3%	1.1%	0.8%
Return on shareholders' funds	12.4%	11.2%	8.7%

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards ("HKFRS") that are effective or available for early adoption for accounting periods beginning on or after 1 January 2005. Information on the changes in accounting policies resulting from initial application of these new and revised HKFRSs is provided in note 3 on the financial statements. Figures for 2004 and 2005 have been adjusted for these new and revised policies in accordance with the transitional provisions and as disclosed in note 3 on the financial statements. Figures for 2003 have not been restated.

2. SUMMARY OF AUDITED FINANCIAL STATEMENTS

The following is the audited financial statements of the Group for the year ended 31 December 2005 together with the accompanying notes prepared in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, extracted from the Group's annual report for the year ended 31 December 2005.

Consolidated Income Statement

for the year ended 31 December 2005 (Expressed in Hong Kong dollars)

	Note	**2005** *HK$'000*	**2004** (restated) *HK$'000*
Interest income	*4*	3,007,372	2,241,410
Interest expense		(1,908,115)	(767,953)
Net interest income		1,099,257	1,473,457
Fee and commission income	*5*	439,662	461,307
Fee and commission expense		(12,837)	(26,880)
Net fee and commission income		426,825	434,427
Net trading income	*6*	343,466	177,944
Net income from financial instruments designated at fair value through profit or loss	*7*	22,481	–
Net hedging expense	*8*	(679)	–
Other operating income	*9*	79,301	69,198
Operating income		1,970,651	2,155,026
Operating expenses	*10*	(1,094,688)	(1,117,485)
		875,963	1,037,541
Impairment losses written back on loans and advances	*13(a)*	57,544	–
Charge for bad and doubtful debts	*13(b)*	–	(78,065)
Impairment losses written back on held-to-maturity investments		6,306	–
Impairment losses on available-for-sale securities		(7,817)	–
Provision written back on held-to-maturity investments		–	9,682
Impairment losses written back on properties	*32*	1,517	–
Impairment losses on goodwill	*33*	–	(9,502)
Impairment losses written back/(charged)		57,550	(77,885)

	Note	2005 HK$'000	2004 (restated) HK$'000
Operating profit		933,513	959,656
Loss on disposal of associates		(6,352)	–
Net profit on disposal of fixed assets		240,222	11,862
Revaluation gain on investment properties	32	2,140	7,555
Share of profits less losses of associates		46,123	75,659
Profit before taxation		1,215,646	1,054,732
Income tax	14	(112,206)	(151,177)
Profit for the year		1,103,440	903,555
Attributable to:			
Equity shareholders of the Company	15	1,103,395	903,925
Minority interests	46	45	(370)
Profit for the year		1,103,440	903,555
Dividends payable to equity shareholders of the Company attributable to the year:	16		
Interim dividend declared and paid during the year		361,358	210,759
Final dividend proposed after the balance sheet date		191,872	239,636
		553,230	450,395
Earnings per share	17		
Basic		34.51¢	28.32¢
Diluted		32.38¢	25.77¢

Consolidated Balance Sheet
at 31 December 2005 (Expressed in Hong Kong dollars)

	Note	2005 HK$'000	2004 (restated) HK$'000
Assets			
Cash and balances with banks and other financial institutions	19	1,161,309	1,488,919
Placements with banks and other financial institutions	20	5,265,044	6,822,355
Trade bills	21	406,364	246,081
Trading assets	22	6,473,029	–
Securities designated at fair value through profit or loss	23	1,139,908	–
Other investment in securities	24	–	4,043,467
Advances to customers and other accounts	25	44,108,183	43,323,300
Available-for-sale securities	27	5,945,960	–
Held-to-maturity investments	28	17,194,283	23,930,181
Investment securities	29	–	39,841
Interest in associates	31	1,291,180	1,334,442
Fixed assets	32		
– Investment property		64,994	64,850
– Other property and equipment		936,474	1,182,610
Goodwill	33	1,007,749	1,007,749
Deferred tax assets	38	42,201	93,562
Total assets		85,036,678	83,577,357
Equity and liabilities			
Deposits and balances of banks and other financial institutions	34	4,157,446	3,555,852
Deposits from customers	35	54,415,279	55,451,727
Trading liabilities	36	661,137	–
Certificates of deposit issued	37	7,467,961	6,959,690
Debt securities issued	40	2,245,435	2,322,798
Convertible bonds issued	41	1,289,817	1,399,384
Current taxation	38	50,478	6,446
Deferred tax liabilities	38	45,466	8
Other liabilities		895,455	1,283,553
Loan capital	47	4,352,351	4,275,896
Total liabilities		75,580,825	75,255,354

	Note	2005 HK$'000	2004 (restated) HK$'000
Equity			
Share capital	44	3,197,859	3,194,153
Reserves	45	6,257,458	5,127,850
Total equity attributable to equity shareholders of the Company		9,455,317	8,322,003
Minority interests	46	536	–
Total equity		9,455,853	8,322,003
Total equity and liabilities		85,036,678	83,577,357

Balance Sheet

at 31 December 2005 (Expressed in Hong Kong dollars)

		2005		2004	
				(restated)	
	Note	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Non-current assets					
Fixed assets	*32*				
– Other property and equipment			55,565		57,823
Investments in subsidiaries	*30*		6,245,247		6,239,934
			6,300,812		6,297,757
Current assets					
Trading assets	*22*	93,707		–	
Other investment in securities	*24*	–		86,074	
Advances to customers and other accounts	*25*	18,403		23,963	
Amounts due from subsidiaries	*26*	1,025,464		1,070,478	
		1,137,574		1,180,515	
Current liabilities					
Other liabilities		6,343		6,777	
Amounts due to subsidiaries	*39*	1,396,145		1,399,608	
		1,402,488		1,406,385	
Net current liabilities			(264,914)		(225,870)
Total assets less current liabilities			6,035,898		6,071,887
Capital and reserves					
Share capital	*44*		3,197,859		3,194,153
Reserves	*45*		2,838,039		2,877,734
Total equity			6,035,898		6,071,887

Consolidated Statement of Changes in Equity
for the year ended 31 December 2005 (Expressed in Hong Kong dollars)

		2005		2004 (restated)	
	Note	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Total equity at 1 January:					
As previously reported:					
– attributable to equity shareholders of the Company		8,310,355		7,811,770	
– minority interests	46	–		191	
		8,310,355		7,811,961	
Prior period adjustments arising from changes in accounting policies	45	11,648		4,754	
As restated, before opening balance adjustments		8,322,003		7,816,715	
Opening balance adjustments arising from changes in accounting policies	45	638,816		–	
At 1 January, after prior period and opening balance adjustments			8,960,819		7,816,715
Net income recognized directly in equity:					
Exchange differences on translation of:					
– financial statements of overseas branches, subsidiaries and associates	45	3,371		283	
– related borrowings	45	(329)		–	
– on disposal of an associate	45	627		–	
			3,669		283
Surplus on revaluation of other premises upon reclassification to investment properties, net of deferred tax	45		6,785		–
Cash flow hedge					
– effective portion of changes in fair value	45	9,364		–	
– transfer to deferred tax	45	(1,639)		–	
			7,725		–
Changes in fair value					
– of available-for-sale securities	45	(59,442)		–	
– transfer to deferred tax	45	10,403		–	
			(49,039)		–
Share of associates					
– share option reserve	45	6,500		–	
– fair value reserve	45	2,894		–	
			9,394		–

		2005		2004 (restated)	
	Note	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Net profit for the year:					
As previously reported					
– attributable to equity shareholders of the Company				901,339	
– minority interests	*46*			(370)	
				900,969	
Prior year adjustments arising from changes in accounting policies	*3(a)*			2,586	
Net profit for the year (2004: as restated)			1,103,440		903,555
Total recognized income and expense for the year (2004: as restated)			1,081,974		903,838
Attributable to:					
– equity shareholders of the Company		1,081,929		904,208	
– minority interests		45		(370)	
		1,081,974		903,838	
Dividends paid during the year	*16(c)*		(601,197)		(411,897)
Minority interests attributable to subsidiaries acquired/disposed during the year			491		179
Movements in equity arising from capital transactions:					
Shares issued under share option scheme	*44(a)*	3,706		4,318	
Net share premium received	*45*	4,264		4,542	
Equity settled share-based transactions, net of tax (2004: as restated)	*45*	5,796		4,308	
			13,766		13,168
Total equity at 31 December			9,455,853		8,322,003

Consolidated Cash Flow Statement
for the year ended 31 December 2005 (Expressed in Hong Kong dollars)

	2005	2004
		(restated)
	HK$'000	*HK$'000*
OPERATING ACTIVITIES		
Profit for the year before taxation	1,215,646	1,054,732
Adjustments for non-cash items:		
Charge for bad and doubtful debts	–	78,065
Impairment losses written back on loans and advances	(57,544)	–
Share of profits less losses on associates	(46,123)	(75,659)
Revaluation gain on investment properties	(2,140)	(7,555)
Net profit on disposal of fixed assets	(240,222)	(11,862)
Impairment losses written back on held-to-maturity investments	(6,306)	–
Provision written back on held-to-maturity securities	–	(9,682)
Impairment loss written back on properties	(1,517)	–
Impairment loss on available-for-sale securities	7,817	–
Share-based payment	5,796	4,308
Amortization of deferred expenses	94,260	101,485
Amortization of discount on debt securities issued	–	(284)
Interest expenses on convertible bonds	37,731	3,495
Depreciation on tangible fixed assets	112,837	146,399
Dividend income from equity investment securities	(25,717)	(10,777)
Interest expenses on loan capital	355,262	355,877
Loss on disposal of associates	6,352	–
Profit on disposal of a subsidiary	–	(865)
Amortization of goodwill	–	60,336
Impairment loss on goodwill	–	9,502
Foreign exchange differences	(16,112)	7,937
	1,440,020	1,705,452

	2005	2004
		(restated)
	HK$'000	*HK$'000*
(Increase)/decrease in operating assets#		
Placements with banks and other financial institutions with original maturity beyond three months	(305,511)	82,153
Treasury bills with original maturity beyond three months	299,355	(398,823)
Certificates of deposit held with original maturity beyond three months	776,453	692,785
Trading assets	(2,677,493)	–
Securities designated at fair value through profit or loss	(70,110)	–
Other investments in securities	–	(1,455,248)
Advances to customers, banks and other financial institutions, trade bills and other accounts	(485,294)	(2,270,500)
Held-to-maturity investments	(494,513)	168,884
Investment securities	–	142
Available-for-sale securities	242,570	–
Increase/(decrease) in operating liabilities#		
Deposits and balances of banks and other financial institutions	601,594	69,773
Deposits from customers	(1,036,448)	(1,395,879)
Trading liabilities	661,137	–
Certificates of deposit issued	502,577	2,248,515
Debt securities issued	(65,515)	–
Other liabilities	(810,308)	(85,208)
NET CASH USED IN OPERATIONS	(1,421,486)	(637,954)
Income tax		
Hong Kong profits tax paid	(113,585)	(115,782)
Overseas profits tax paid	(1,034)	(1,568)
NET CASH USED IN OPERATING ACTIVITIES	(1,536,105)	(755,304)

The changes in these balances are quantified after taking into account the opening balance adjustments made at 1 January 2005. The opening balance adjustments result from the changes in accounting policies is described in note 3.

	Note	2005 HK$'000	2004 (restated) HK$'000
INVESTING ACTIVITIES			
Dividends received from equity investment securities		25,717	10,777
Purchase of fixed assets		(53,934)	(64,003)
Proceeds from disposal of fixed assets		439,065	241,875
Proceeds from disposal of associates		35,524	–
Increase in shareholding in an associate		–	(500,000)
Capital injection into an associate		–	(250,000)
Net cash outflow from disposal of a subsidiary	*52(b)*	–	(8,872)
Purchase of an associate		(39)	–
NET CASH GENERATED FROM/(USED IN) INVESTING ACTIVITIES		446,333	(570,223)
FINANCING ACTIVITIES			
Ordinary dividends paid		(601,197)	(411,897)
Interest paid on convertible bonds		(3,499)	(3,505)
Interest paid on loan capital		(355,733)	(355,602)
Proceeds from debt securities		–	2,323,082
Proceeds from shares issued		7,970	8,860
NET CASH (USED IN)/GENERATED FROM FINANCING ACTIVITIES		(952,459)	1,560,938
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(2,042,231)	235,411
CASH AND CASH EQUIVALENTS AT 1 JANUARY		8,054,509	7,819,098
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	*48*	6,012,278	8,054,509
Cash flows from operating activities include:			
Interest received		3,102,761	3,072,324
Interest paid		(2,027,636)	(1,549,720)

Notes on the Financial Statements

(Expressed in Hong Kong dollars unless otherwise indicated)

1. Principal Activities

The principal activities of CITIC International Financial Holdings Limited (the "Company") and its subsidiaries (the "Group"), which materially affect the results or comprise the assets and liabilities of the Group, are the provision of banking and related financial services.

2. Significant Accounting Policies

(a) Statement of compliance

These financial statements 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 financial statements 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 a number of new and revised HKFRSs that are effective or available for early adoption for accounting periods beginning on or after 1 January 2005. Information on the changes in accounting policies resulting from initial application of these new and revised HKFRSs for the current and prior accounting periods reflected in these financial statements is provided in note 3.

(b) Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements 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 (see note 2(g)(ii)); and

– investment property (see note 2(j)).

The preparation of financial statements 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 recognized 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.

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 61.

(c) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognized in the income statement as follows:

(i) Interest income

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 recognized as interest income in the income statement using the effective interest method.

The effective interest method is a method of calculating the amortized 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 (for example, prepayment, call and similar options) but does not consider future credit losses. The calculation includes all fees 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 interest income and expense and dividend income attributable to those financial instruments.

(ii) Fee and commission income

Fee and commission income is recognized 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 recognized as income in the accounting period in which the costs or risk is incurred or accounted for as interest income.

(iii) Finance income from finance lease and hire purchase contract

Finance income implicit in the finance lease and hire purchase payments is recognized as interest income over the period of the leases so as to produce an approximately constant periodic rate of return, on the outstanding net investment in the leases for each accounting period.

(iv) Rental income from operating lease

Rental income received under operating leases is recognized as other operating income 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 granted are recognized in the income statement as an integral part of the aggregate net lease payments receivable.

(v) Dividend income is recognized as follows:

– dividend income from listed investments is recognized when the share price of the investment is quoted ex-dividend; and

– dividend income from unlisted investments is recognized when the shareholder's right to receive payment is established.

(d) Subsidiaries and controlled entities

A subsidiary, in accordance with the Hong Kong Companies Ordinance, is a company in which the Group, directly or indirectly, holds more than half of the issued share capital or controls more than half of the voting power or controls the composition of the board of directors. Subsidiaries are considered to be controlled if the Company has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

An investment in a controlled subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transactions and any unrealized profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealized losses resulting from intra-group transactions are eliminated in the same way as unrealized gains but only to the extent that there is no evidence of impairment.

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and statement of changes in equity within equity, separately from equity attributable to the equity shareholders of the Company. 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 or loss for the year between minority interests and the equity shareholders of the Company.

Where losses applicable to the minority exceed the minority's interests in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (see note 2(n)).

(e) Associates

An associate is an entity over which the Group or the Company 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 financial statements 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 income statement includes 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 recognized for the year (see notes 2(f) and (n)).

When the Group's share of losses exceeds its interest in the associate, 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 accounted for under equity method is the carrying amount of the investment under equity method together with the Group's other long-term interests that in substance form part of the Group's net investment in the associate.

Unrealized profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associate, except where unrealized losses provide evidence of an impairment of the asset transferred, in which case they are recognized immediately in profit or loss.

In the Company's balance sheet, its investments in associates are stated at cost less impairment losses (see note 2(n)).

(f) *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 acquirer'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 (see note 2(n)). In respect of an associate, the carrying amount of goodwill is included in the carrying amount of the interest in the associate.

Any excess of the Group's interest in the net fair value of acquirer's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate is recognized immediately in profit or loss.

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 or loss on disposal.

(g) *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 or issue of the financial assets or financial liabilities. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

The Group recognizes 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 recognized using trade date accounting. From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities are recorded.

(ii) Categorization

Fair value through profit or loss

This category comprises financial assets and 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. Derivatives that do not qualify for hedge accounting (note 2(i)) are accounted for as trading instruments.

Financial instruments designated at fair value through profit or loss primarily consist of securities with embedded derivatives where the characteristics and risks of the embedded derivatives are not closely related to the host contracts.

Financial assets and 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 sale 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 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 loans and advances to customer and placements with banks and financial institutions.

Loans and receivables are carried at amortized cost using the effective interest method, less impairment losses, if any (see note 2(n)).

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity where the Group has the positive intention and ability to hold to maturity, other than those that the Group, upon initial recognition, designates as fair value through profit or loss or as available-for-sale.

Held-to-maturity investments are carried at amortized cost using the effective interest method less impairment losses, if any (see note 2(n)).

Available-for-sale securities

Available-for-sale securities 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.

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

Available-for-sale financial assets are carried at fair value. Unrealized gains and losses arising from changes in the fair value are recognized directly in the fair value reserve, except for foreign exchange gains and losses on monetary items such as debt securities which are recognized in the income statement.

When the available-for-sale financial assets are sold, the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments in the equity are treated as gains or losses on disposal.

Other financial liabilities

Financial liabilities, other than trading liabilities and those designated at fair value through profit or loss, are measured at amortized cost using the effective interest method.

The fair value of the liability portion of a convertible bond is determined using a market interest rate for an equivalent non-convertible bond. This amount is recorded as a liability on an amortized cost basis until extinguished on conversion or maturity of the bonds. The remainder of the proceeds is allocated to the conversion option. This is recognized and included in shareholders' equity.

(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. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices.

If a traded price or a quoted market price for exchange traded financial instrument is not available on a recognized stock exchange or a price from a broker/dealer for non-exchange-traded financial instrument is not available, or if the market for a financial instrument is not active, the fair value of the instrument is estimated using valuation techniques that provides a reasonable 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

A financial asset is derecognized 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 derecognized when the obligation specified in the contract is discharged, cancelled or expires.

(v) Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet where there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle 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 recognized in the income statement.

When the embedded derivative is separated, the host contract is accounted for in accordance with the accounting policies for financial instruments.

(h) *Repurchase and reverse repurchase transactions*

Securities sold subject to a simultaneous agreement to repurchase these securities at a certain later date at a fixed price (repurchase agreements) are retained in the financial statements and measured in accordance with their original measurement principles. The proceeds from the sale are reported as liabilities and are carried at amortized cost.

Securities purchased under agreements to resell (reverse repurchase agreements) are reported not as purchases of the securities, but as receivables and are carried in the balance sheet at amortized cost.

Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements are recognized as interest income and interest expense respectively, over the life of each agreement using the effective interest method.

(i) *Hedging*

Hedge accounting recognizes the offsetting effects on profit or loss of changes in the fair values of the hedging instrument and the hedged item. The Group assesses and documents whether the financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risks both at hedge inception and on an ongoing basis. The Group discontinues prospectively hedge accounting when (a) the hedging instrument expires or is sold, terminated or exercised; (b) the hedge no longer meets the criteria for hedge accounting; or (c) the Group revokes the designation.

(i) Fair value hedge

A fair value hedge seeks to offset risks of changes in the fair value of recognized asset or liability that will give rise to a gain or loss being recognized in the income statement.

The hedging instrument is measured at fair value, with fair value changes recognized in the income statement. The carrying amount of the hedged item is adjusted by the amount of the changes in fair value of the hedging instrument attributable to the risk being hedged. This adjustment is recognized in the income statement to offset the effect of the gain or loss on the hedging instrument.

(ii) Cash flow hedge

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognized asset or liability, or a highly probable forecast transaction, or the foreign currency risk of a committed future transaction, the effective part of any gain or loss on the derivative financial instrument in relation to the hedged risk is recognized directly in equity. The ineffective part of any gain or loss is recognized immediately in the income statement.

If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognized directly in equity are reclassified in the income statement in the same period or periods during which the asset acquired or liability assumed affects the income statement. If the hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss is removed from equity and included in the initial cost or other carrying amount of the non-financial asset or liability.

For cash flow hedges of a recognized asset or liability, the associated cumulative gain or loss is removed from equity and recognized in the income statement in the same period or periods during which the hedged cash flows affect the profit.

When a hedging instrument expires or is sold, terminated or exercised, or the Group revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognized in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealized gain or loss recognized in equity is recognized immediately in the income statement.

(iii) Hedge effectiveness testing

The Group expects the hedge to be highly effective (prospective effectiveness) at the inception of the hedge and throughout its life in order to qualify for hedge accounting. Actual effectiveness (retrospective effectiveness) also needs to be demonstrated on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method which the Group adopts for assessing hedge effectiveness will depend on its risk management strategy.

For fair value hedge relationships, the Group utilizes the cumulative dollar offset method as effectiveness testing methodologies. For cash flow hedge relationships, the Group utilizes the cumulative dollar offset method using the hypothetical derivative approach.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the changes in fair value or cash flows must offset each other in the range of 80% to 125% for the hedge to be deemed effective.

(j) Investment property

Investment properties are land and buildings which are owned and/or held under a leasehold interest (see note 2(l)) to earn rental income and/or for capital appreciation. These include land and buildings held for a currently undetermined future use.

Investment properties are stated in the balance sheet at fair value. Any gain or loss arising from a change in fair value is recognized in the income statement. Rental income from investment property is accounted for as described in accounting policy 2(c)(iv).

(k) Other property and equipment

In preparing these financial statements, 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 effect that other premises which are carried at revalued amounts in financial statements relating to periods ended before 30 September 1995 have not been revalued to fair value at the balance sheet date.

The following items of property and equipment are stated in the balance sheet at cost less accumulated depreciation and impairment losses, if any (see note 2(n)):

– held under operating leases and buildings thereon, where the fair value of the leasehold interest in the land and buildings cannot be measured separately at the inception of the lease and the building is not clearly held under an operating lease (see note 2(l)).

– items of equipment.

Depreciation is calculated to write off the cost or valuation of items of property and equipment using the straight line method over the estimated useful lives as follows:

– freehold land is not depreciated.

– buildings – over 30 years or the unexpired terms of the land leases, whichever is the shorter.

– furniture, fixtures and equipment – 3 to 10 years.

Where parts of an item of property and equipment have different useful lives, the cost or valuation of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

Gains or losses arising from the retirement or disposal of an item of property and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognized in the income statement on the date of retirement or disposal. Any related revaluation surplus is transferred from the revaluation reserve to retained profits.

(l) Leases and hire purchase contracts

(i) Classification of leased assets

Leases which transfer substantially all the risks and rewards of ownership to the lessee are classified as finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the lessee are classified as operating leases.

(ii) Assets held under finance leases

Where the Group is a lessor under finance leases, an amount representing the net investment in the lease is included in the balance sheet as loans and advances to customers. Hire purchase contracts having the characteristics of finance leases are accounted for in the same manner as finance leases. Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(n).

(iii) Assets held for use in operating leases

Where the Group leases out assets under operating leases, the 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(k). Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(n).

Revenue arising from operating leases is recognized in accordance with the Group's revenue recognition policies, as set out in note 2(c)(iv).

(iv) Operating lease charges

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to 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 recognized in income statement as an integral part of the aggregate net lease payments made.

(m) Repossessed assets

In the recovery of impaired loans and advances, the Group may take repossession of the assets held as collateral through court proceedings or voluntary delivery of possession by the borrowers. Where it is intended to achieve an orderly realisation and the Group is no longer seeking repayment from the borrower, repossessed assets are reported in "other assets".

Repossessed assets are recognized 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 amortized.

Impairment losses on initial classification and on subsequent remeasurement are recognized in the income statement.

(n) Impairment of assets

The carrying amount of the Group's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to the income statement.

(i) Loans and receivables

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. Receivables with a short duration are not discounted if the effect of discounting is immaterial.

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

The Group first assess 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 recognized 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 realizable value of any underlying collateral or guarantees in favor of the Group. Each impaired asset is assessed on its own merits.

In assessing the need for collective impairment 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 judgement, the Group believes that the impairment allowances on loans and advances to customers are reasonable and supportable.

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 be charged or credited to the income statement.

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

(ii) Held-to-maturity investments

For held-to-maturity investments, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets) on an individual basis.

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 recognized, 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 recognized in prior years.

(iii) Available-for-sale securities

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognized directly in equity is removed from equity and is recognized in the income statement. The amount of the cumulative loss that is recognized in the income statement is the difference between the acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on that asset previously recognized 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 financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Impairment losses recognized 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 recognized 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 recognized. Reversals of impairment losses in such circumstances are recognized 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 recognized no longer exists or may have decreased:

– property and equipment (other than properties carried at revalued amounts);

– investments in subsidiaries and associates; and

– goodwill.

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 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 recognized 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 recognized 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 favorable 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 recognized in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognized.

(o) Cash equivalents

Cash equivalents are short-term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(p) Employee benefits

(i) Short term employee benefits and contributions to defined contribution retirement plans

Salaries, annual bonuses, paid annual leave, contributions to defined contribution plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) Share-based payments

Employee share option scheme

The fair value of share options granted to employees is recognized as an employee cost with a corresponding increase in a capital reserve within equity. The fair value is measured at grant date using the trinomial lattice 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 recognized in prior years is charged/credited to the income statement for the year of the review unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognized 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 Company's shares.

The equity amount is recognized in equity 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).

Employee Equity Linked Deferred Award Scheme ("ELDA")

Awards are granted to employees of the Group under ELDA. The fair value of the amount payable to the employee is recognized as an employee cost with a corresponding increase in liabilities. The fair value is initially measured at grant date and spread over the period during which the employees become unconditionally entitled to payment. The fair value of the award is measured based on the maximum payment of HK$3.00 per share. The liability is remeasured at each balance sheet date and at settlement date. Any changes in the fair value of the liability are recognized in the income statement.

(iii) Staff retirement scheme

The Group operates a defined contribution provident fund and a Mandatory Provident Fund scheme. Contributions are charged to the income statement as and when the contributions fall due.

(q) 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 recognized in the income statement except to the extent that they relate to items recognized directly in equity, in which case they are recognized 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 utilized, are recognized.

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 taxable 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 recognized is measured based on the expected manner of realization 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 utilized. 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 recognized when the liability to pay the related dividends is recognized.

(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, and only if, the Group or the Company 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 Group or the Company intends either to settle on a net basis, or to realize 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 realize the current tax assets and settle the current tax liabilities on a net basis or realize and settle simultaneously.

(r) Translation of foreign currencies

Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. Exchange gains and losses are dealt with in the income statement.

Exchange differences relating to investments at fair value through profit or loss and derivative financial instruments are included in gains and losses on investments and net gain/(loss) on derivatives, respectively. All other exchange differences relating to monetary items are presented separately in the income statement.

The results of foreign operations are translated into Hong Kong dollars at the average exchange rates for the year; balance sheet items are translated at the rates of exchange ruling at the balance sheet date. The resulting exchange differences are dealt with as a movement in reserves.

On disposal of a foreign enterprise, the cumulative amount of the exchange differences recognized in reserves which relate to that foreign operation is included in the calculation of the profit or loss on disposal.

(s) Provisions and contingent liabilities

Provisions are recognized for liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, 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.

(t) *Related parties*

For the purpose of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

(u) *Segment reporting*

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or 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 for the purposes of these financial statements.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as 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 entities within a single segment.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise the bank premises and any items which cannot be reasonably allocated to specific business segments.

3. Changes in Accounting Policies

The HKICPA has issued a number of new and revised HKFRSs that are effective for accounting periods beginning on or after 1 January 2005.

The accounting policies of the Group and the Company after the adoption of these new and revised HKFRSs have been summarized in note 2. The following sets out information on the significant changes in accounting policies for the current and prior accounting periods reflected in these financial statements.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 62).

(a) Restatement of prior periods and opening balances

The following tables disclose the adjustments that have been made in accordance with the transitional provisions of the respective HKFRSs to each of the line items in the consolidated income statement and consolidated balance sheet and the Company's balance sheet and other significant related disclosure items as previously reported for the year ended 31 December 2004. The effects of the changes in accounting policies on the balances at 1 January 2004 and 2005 are disclosed in note 45.

Effect on the consolidated financial statements

Consolidated Income Statement for the year ended 31 December 2004

		Effect of new policy (increase/ (decrease) in profit for the year)		
	2004 (as previously reported)	**HKAS 28** *(note 3(d))*	**HKAS 1 & 30** *(note 3(i))*	**2004 (as restated)**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Interest income	2,241,410	–	–	2,241,410
Interest expense	(767,953)	–	–	(767,953)
Net interest income	1,473,457	–	–	1,473,457
Fee and commission income	461,307	–	–	461,307
Fee and commission expense	(26,880)	–	–	(26,880)
Net fee and commission income	434,427	–	–	434,427
Net trading income	–	–	177,944	177,944
Other operating income	248,551	(1,409)	(177,944)	69,198
Operating income	2,156,435	(1,409)	–	2,155,026
Operating expenses	(1,117,485)	–	–	(1,117,485)
	1,038,950	(1,409)	–	1,037,541
Charge for bad and doubtful debts	(78,065)	–	–	(78,065)
Provision written back on held-to-maturity investments	9,682	–	–	9,682
Impairment losses on goodwill	(9,502)	–	–	(9,502)
Impairment losses	(77,885)	–	–	(77,885)
Operating profit	961,065	(1,409)	–	959,656
Net profit on disposal of fixed assets	11,862	–	–	11,862
Revaluation gain on investment properties	7,555	–	–	7,555
Share of profits less losses of associates	75,978	4,287	(4,606)	75,659
Profit before taxation	1,056,460	2,878	(4,606)	1,054,732
Income tax	(155,491)	(292)	4,606	(151,177)
Profit for the year	900,969	2,586	–	903,555
Attributable to:				
Equity shareholders of the Company	901,339	2,586	–	903,925
Minority interests	(370)	–	–	(370)
Profit for the year	900,969	2,586	–	903,555
Earnings per share				
Basic	28.24¢	0.08¢	–	28.32¢
Diluted	25.70¢	0.07¢	–	25.77¢

Consolidated Balance Sheet as at 31 December 2004

	2004 (as previously reported)	Effect of new policy (increase/(decrease) in total assets and total liabilities) HKFRS 2 (note 3(e))	HKAS 28 (note 3(d))	HKAS 1 & 30 (note 3(i))	Sub-total	2004 (as restated)
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets						
Cash and short-term funds	8,345,790	–	–	(6,856,871)	(6,856,871)	1,488,919
Placements with banks and other financial institutions	364,307	–	–	6,458,048	6,458,048	6,822,355
Trade bills	246,081	–	–	–	–	246,081
Certificates of deposit held	1,366,315	–	–	(1,366,315)	(1,366,315)	–
Other investments in securities	3,968,263	–	(14,745)	89,949	75,204	4,043,467
Advances to customers and other accounts	43,323,300	–	–	–	–	43,323,300
Held-to-maturity investments	22,254,992	–	–	1,675,189	1,675,189	23,930,181
Investment securities	39,841	–	–	–	–	39,841
Interest in associates	1,312,357	–	22,085	–	22,085	1,334,442
Goodwill	1,007,749	–	–	–	–	1,007,749
Fixed assets	1,247,460	–	–	–	–	1,247,460
Deferred tax assets	93,562	–	–	–	–	93,562
Total assets	83,570,017	–	7,340	–	7,340	83,577,357
Equity and liabilities						
Deposits and balances of banks and other financial institutions	3,555,852	–	–	–	–	3,555,852
Deposits from customers	55,451,727	–	–	–	–	55,451,727
Certificates of deposit issued	6,959,690	–	–	–	–	6,959,690
Debt securities issued	2,322,798	–	–	–	–	2,322,798
Convertible bonds issued	1,399,384	–	–	–	–	1,399,384
Current taxation	6,446	–	–	–	–	6,446
Deferred tax liabilities	8	–	–	–	–	8
Other liabilities	1,287,861	(4,308)	–	–	(4,308)	1,283,553
Loan capital	4,275,896	–	–	–	–	4,275,896
Total liabilities	75,259,662	(4,308)	–	–	(4,308)	75,255,354
Equity						
Share capital	3,194,153	–	–	–	–	3,194,153
Reserves	5,116,202	4,308	7,340	–	11,648	5,127,850
Total equity attributable to equity shareholders of the Company	8,310,355	4,308	7,340	–	11,648	8,322,003
Minority interests	–	–	–	–	–	–
Total equity	8,310,355	4,308	7,340	–	11,648	8,322,003
Total equity and liabilities	83,570,017	–	7,340	–	7,340	83,577,357

Effect on the Company's balance sheet
Balance Sheet as at 31 December 2004

	Effect of new policy (increase/(decrease) in total assets and liabilities)		
	2004 (as previously reported)	**HKFRS 2** *(note 3(e))*	**2004 (as restated)**
	HK$'000	*HK$'000*	*HK$'000*
Non-current assets			
Fixed assets			
– Other property and equipment	57,823	–	57,823
Investments in subsidiaries	6,236,222	3,712	6,239,934
	6,294,045	3,712	6,297,757
Current assets			
Other investments in securities	86,074	–	86,074
Advances to customers and other accounts	23,963	–	23,963
Amounts due from subsidiaries	1,070,478	–	1,070,478
	1,180,515	–	1,180,515
Current liabilities			
Other liabilities	6,777	–	6,777
Amounts due to subsidiaries	1,399,608	–	1,399,608
	1,406,385	–	1,406,385
Net current liabilities	(225,870)	–	(225,870)
Total assets less current liabilities	6,068,175	3,712	6,071,887
Capital and reserves			
Share capital	3,194,153	–	3,194,153
Reserves	2,874,022	3,712	2,877,734
Total equity	6,068,175	3,712	6,071,887

(b) *Estimated effect of changes in accounting policies on the current year*

The following tables provide estimates of the extent to which each of the line items in the consolidated income statement, consolidated balance sheet and the Company's balance sheet for the year ended 31 December 2005 is higher or lower than it would have been had the previous policies still been applied in the year, where it is practicable to make such estimates.

Effect on the consolidated financial statements
Estimated effect on the Consolidated Income Statement
for the year ended 31 December 2005

	Effect of new policy (increase/ (decrease) in profit for the year)			
	HKFRS 2	**HKFRS 3**	**HKAS 32 & 39***	**Total**
	(note 3(e))	*(note 3(f))*	*(note 3(c))*	
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Interest income	–	–	(186,677)	(186,677)
Interest expense	–	–	80,564	80,564
Net interest income	–	–	(106,113)	(106,113)
Net fee and commission income	–	–	10,161	10,161
Net trading income	–	–	64,524	64,524
Net income from financial instruments designated at fair value through profit or loss	–	–	52,447	52,447
Net hedging expense	–	–	(679)	(679)
Operating income	–	–	20,340	20,340
Operating expenses	(2,699)	59,280	–	56,581
Profit before taxation	(2,699)	59,280	20,340	76,921

* *In respect of the year ended 31 December 2005, it is not practicable to estimate the extent to which the profit for the year would have been higher or lower had the previous policy on impairment of financial assets still been applied.*

The effect of HKAS 28 is not material and not estimated in the above income statement.

Estimated effect on the Consolidated Balance Sheet as at 31 December 2005

	Effect of new policy (increase/(decrease) in total assets and total liabilities)				
	HKFRS 2	**HKFRS 3 & HKAS 36**	**HKAS 32 & 39***	**HKAS 40**	**Total**
	(note 3(e))	*(note 3(f))*	*(note 3(c))*	*(note 3(g))*	
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets					
Trading assets	–	–	4,300,413	–	4,300,413
Securities designated at fair value through profit or loss	–	–	1,042,277	–	1,042,277
Other investments in securities	–	–	(3,953,518)	–	(3,953,518)
Advances to customers and other accounts	–	–	(211,560)	–	(211,560)
Available-for-sale securities	–	–	6,017,754	–	6,017,754
Held-to-maturity investments	–	–	(6,309,110)	–	(6,309,110)
Investment securities	–	–	(39,841)	–	(39,841)
Interest in associates	–	–	(4,271)	–	(4,271)
Fixed assets					
– Investment property	–	–	–	7,939	7,939
Goodwill	–	59,280	–	–	59,280
Total	–	59,280	842,144	7,939	909,363
Equity and liabilities					
Trading liabilities	–	–	845,863	–	845,863
Certificates of deposit issued	–	–	(153,530)	–	(153,530)
Debt securities issued	–	–	(73,520)	–	(73,520)
Convertible bonds issued	–	–	(106,105)	–	(106,105)
Current taxation	–	–	38,291	–	38,291
Deferred tax liabilities	–	–	67,788	1,154	68,942
Other liabilities	(7,404)	–	(230,269)	–	(237,673)
Loan capital	–	–	87,033	–	87,033
Total	(7,404)	–	475,551	1,154	469,301
Equity					
Reserves	7,404	59,280	366,593	6,785	440,062
Total equity attributable to equity shareholders of the Company	7,404	59,280	366,593	6,785	440,062
Total	–	59,280	842,144	7,939	909,363

* *In respect of the year ended 31 December 2005, it is not practicable to estimate the extent to which the net assets would have been higher or lower had the previous policy on impairment of financial assets still been applied.*

The effect of HKAS 28 is not material and not estimated in the above balance sheet.

Estimated effect on net income recognized directly in consolidated equity for the year ended 31 December 2005:

	Effect of new policy (increase/(decrease) in equity)		
	HKAS 32 & 39	**HKAS 40**	**Total**
	(note 3(c))	*(note 3(g))*	
	HK$'000	*HK$'000*	*HK$'000*
Attributable to equity shareholders of the Company	(41,314)	6,785	(34,529)
Minority interests	–	–	–
Total equity	(41,314)	6,785	(34,529)

Estimated effect on amounts recognized as capital transactions with owners of the Group for the year ended 31 December 2005:

	Effect of new policy (increase/(decrease) in equity)
	HKFRS 2
	(note 3(e))
	HK$'000
Attributable to equity shareholders of the Company	5,796
Minority interests	–
Total equity	5,796

Effect on the Company's balance sheet

Estimated effect on the Company's Balance Sheet as at 31 December 2005

	Effect of new policy (increase/(decrease) in total assets and total liabilities)	
	HKFRS 2	**Total**
	(note 3(e))	
	HK$'000	*HK$'000*
Current assets		
Investments in subsidiaries	(5,313)	(5,313)
Total	(5,313)	(5,313)
Capital and reserves		
Reserves	5,313	5,313
Total	5,313	5,313

There is no estimated effect on net income recognized directly in the Company's equity for the year ended 31 December 2005.

Estimated effect on amounts recognized as capital transactions with owners of the Company for the year ended 31 December 2005:

	Effect of new policy (increase/(decrease) in equity) HKFRS 2 *(note 3(e))* *HK$'000*
Attributable to equity shareholders of the Company	5,796

(c) Financial instruments (HKAS 32, Financial instruments: Disclosure and presentation and HKAS 39, Financial instruments: Recognition and measurement)

With effect from 1 January 2005, in order to comply with HKAS 32, the Group has provided additional disclosures of terms, conditions, accounting policies, risk and fair values of financial instruments throughout the notes to the financial statements and the specific notes 55 and 56. In order to comply with HKAS 39, the Group has changed its accounting policies relating to financial instruments to those set out in notes 2(g) to (i), (c), (n) and (q). Further details of the changes are as follows:

(i) Financial instruments (see note 2(g))

In prior years, all financial assets were carried at cost or amortized cost net of impairment provisions for diminution in value, except for other investments (under Benchmark treatment of Statement of Standard Accounting Practice ("SSAP") 24) which were held at fair value. Gains and losses from change in fair value were recognized in the income statement in respect of other investments. Provisions were recognized as an expense in the income statement and written back to income statement when circumstances and events that led to the write-down cease to exist.

In prior years, all financial liabilities except for trading securities short positions were carried at cost or amortized cost. Trading securities short positions were carried at fair value and any changes in fair value were recognized through the income statement.

With effect from 1 January 2005, and in accordance with HKAS 39, financial instruments are recognized according to the following categories: (i) fair value through profit or loss, (ii) loans and receivables, (iii) held-to-maturity investments, (iv) available-for-sale securities and (v) other financial liabilities.

(ii) Derivatives and hedge accounting (see notes 2(g) and (i))

In prior years, derivatives mainly included derivatives arising from futures, forward, swap and option transactions undertaken by the Group in the foreign exchange, interest rate and equity markets. Netting was applied where a legal right of off-set existed.

The accounting for these instruments was dependent upon whether the transactions were undertaken for trading purposes or as part of the management of asset and liability portfolios.

Derivatives used for trading purposes

Trading transactions included transactions undertaken for market making, to service customers' needs and for proprietary purposes, as well as any related hedges.

Transactions undertaken for trading purposes were marked to market and the net present value of the gain or loss arising was recognized in the income statement as dealing gains/losses.

The fair value of derivatives that were not exchange-traded was estimated at the amount that the Group 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.

Derivatives used for asset and liability management purposes

Derivatives used for this purpose were accounted for as hedges and were valued on an equivalent basis to the underlying assets, liabilities or net positions which they were hedging. Any profit or loss was recognized on the same basis as that arising from the related assets, liabilities or net positions.

Any gain or loss on termination of hedging derivatives was deferred and amortized to the income statement over the original life of the terminated contract. Where the underlying asset, liability or position was sold or terminated, the hedging derivative was immediately marked to market through the income statement.

With effect from 1 January 2005, in order to comply with HKAS 39, the Group has changed its accounting policies relating to derivative and hedge accounting set out in note 2(g) and (i) respectively.

(iii) Embedded derivatives (see note 2(g))

In prior years, embedded derivatives were not separately accounted for and they were carried accordingly to the classification of the host contracts.

With effect from 1 January 2005, embedded derivative that is not closely related to the host contract or where the hybrid (combined) instrument is not measured at fair value through profit or loss is accounted for separately from the host contract as equity, assets or liabilities.

(iv) Convertible bonds issued (see note 2(g))

In prior years, convertible bonds issued were recorded as a liability and stated at cost.

With effect from 1 January 2005, and in accordance with HKAS 32, the Group has provided additional disclosures of terms, conditions, accounting policies, risk and fair values of convertible bonds. In order to comply with HKAS 32 & 39, convertible bonds issued are split into their liability and equity components at initial recognition by recognizing the liability component at its fair value and attributing to the equity component the difference between the proceeds from the issue and the fair value of the liability component. The liability component is subsequently carried at amortized cost. The equity component is recognized in the convertible bond – equity component until the note is either converted (in which case it is transferred to share premium) or the note is redeemed (in which case it is released directly to retained profits). Further details of the new policy are set out in note 2(g).

(v) Impairment of financial assets (see note 2(n)(i), (ii) and (iii))

Loans and advances

In prior years, provisions were made against specific loans and advances as and when the directors had doubts on the ultimate recoverability of principal or interest in full.

Specific provisions represented the quantification of actual and expected losses from identified accounts and were deducted from loans and advances in the balance sheet.

Other than where provisions on smaller balance homogeneous advances were assessed on a portfolio basis, the amount of specific provision raised was assessed on a case by case basis. Specific provisions were made against the carrying amount of advances that were identified as being in doubt based on regular reviews of outstanding balances to reduce these advances, net of any collateral, to their recoverable amounts.

Where specific provisions were raised on a portfolio basis, the level of provisioning took into account management's assessment of the portfolio's structure, past and expected credit losses, business and economic conditions, and any other relevant factors. The principal portfolios evaluated on this basis were credit cards and certain unsecured personal advances.

General provisions augmented specific provisions and provided cover for loans which were impaired at the balance sheet date but would not be identified as such until some time in the future. The Group maintained a general provision which was determined taking into account the structure and risk characteristics of the Group's loan portfolio and the expected loss of the individual components of the loan portfolio based primarily on the historical loss experience. Historic levels of latent risk were regularly reviewed to determine that the level of general provisioning continues to be appropriate. General provisions were deducted from loans and advances to customers in the balance sheet.

In respect of the year ended 31 December 2005, it is not practicable to estimate the extent to which the profit for the year would have been higher or lower had the previous policy on impairment of financial assets still been applied.

With effect from 1 January 2005, in order to comply with HKAS39, the Group has changed its accounting policies relating to impairment on loans and advances to customers set out in note 2(n).

Other financial assets

For financial assets, other than loans and advances, were reviewed on each balance sheet date to determine whether there was any indication of impairment. If the recoverable amount of the asset was estimated to be less than its carrying amount, the carrying amount of the asset was reduced to its recoverable amount and the impairment loss was recognized in the income statement.

With effect from 1 January 2005, in order to comply with HKAS 39, the Group has changed its accounting policies relating to impairment of investments in debt and equity securities, and impairment of other financial assets set out in note 2(n).

(vi) Interest recognition on impaired loans

In prior years, loans were not reclassified as accruing until interest and principal payments were up-to-date and future payments were reasonably assured. Where the probability of receiving interest payments was remote, interest was no longer accrued. Where the loan had no reasonable prospect of recovery, the loan and related suspended interests were written off.

With effect from 1 January 2005, in order to comply with HKAS 39, the Group has changed its accounting policies relating to interest income recognition set out in note 2(c)(i).

(vii) Description of transitional provisions and effect of adjustments

The changes in accounting policies of the above items were adopted by way of opening balance adjustments to certain reserves and redesignation of financial instruments as at 1 January 2005 as disclosed in the respective notes. Comparative amounts have not been restated as this is prohibited by the transitional arrangements in HKAS 39.

The adjustments for each financial statement line item of the Group and of the Company affected for the year ended 31 December 2005 are set out in note 3(b).

(d) Interest in associates (HKAS 28, Investments in associates)

In prior years, investments held by the Group with 20% or more of the voting power of the investee that were acquired and held exclusively with a view to subsequent disposal in the near future were classified as other investments in securities and stated at fair value.

With effect from 1 January 2005, and in accordance with HKAS 28, such investments are reclassified as investment in associates and accounted for in the consolidated financial statements under the equity method. Further details of the new policy are set out in note 2(e).

The adjustments for each consolidated financial statement line item of the Group for the year ended 31 December 2004 are set out in note 3(a).

(e) Employee share option scheme (HKFRS 2, Share-based payment)

(i) Employee share option scheme

In prior years, no amounts were recognized when employees (which term includes directors) were granted share options over shares in the Company. If the employees chose to exercise the options, the nominal amount of share capital and share premium were credited only to the extent of the option's exercise price receivable.

With effect from 1 January 2005, in order to comply with HKFRS 2, the Group has adopted a new policy for employee share options. Under the new policy, the Group recognizes the fair value of such share options as an expense in the consolidated income statement with a corresponding increase recognized in a capital reserve within equity. Further details of the new policy are set out in note 2(p)(ii).

The new accounting policy has been applied retrospectively with comparatives restated, except that the Group has taken advantage of the transitional provisions set out in HKFRS 2, under which the new recognition and measurement policies have not been applied to the following grants of options:

(a) all options granted to employees on or before 7 November 2002; and

(b) all options granted to employees after 7 November 2002 but which had vested before 1 January 2005.

Details of the employee share option scheme are set out in note 43.

(ii) Employee Equity Linked Deferred Award Scheme ("ELDA")

In prior years, when employees (which term includes directors) were granted awards under ELDA, provision for the ELDA was made and recognized immediately as expenses in the year in which the awards were granted.

With effect from 1 January 2005, in order to comply with HKFRS 2, the fair value of the amount payable is recognized as an expense in the income statement over the relevant vesting period with a corresponding increase in liabilities. The liability is remeasured at each balance sheet date and at settlement date. Any changes in the fair value of the liability are recognized in the income statement. Further details of the new policy are set out in note 2(p)(ii).

Details of ELDA are set out in note 43.

(iii) The adjustments for each financial statement line item of the Group and of the Company affected for the years ended 31 December 2005 and 2004 are set out in notes 3(a) and (b).

(f) Amortization of positive goodwill (HKFRS 3, Business combinations and HKAS 36, Impairment of assets)

In prior years, positive goodwill which arose on or after 1 January 2001 was amortized on a straight line basis over its useful life and was subject to impairment testing when there were indications of impairment.

With effect from 1 January 2005, in order to comply with HKFRS 3 and HKAS 36, the Group has changed its accounting policy relating to goodwill. Under the new policy, the Group no longer amortizes positive goodwill but tests it at least annually for impairment. Also with effect from 1 January 2005 and in accordance with HKFRS 3, if the fair value of the net assets acquired in a business combination exceeds the consideration paid (i.e. an amount arises which would have been known as negative goodwill under the previous accounting policy), the excess is recognized immediately in profit or loss as it arises. Further details of these new policies are set out in note 2(f).

The new policy in respect of the amortization of positive goodwill has been applied prospectively in accordance with the transitional arrangements under HKFRS 3. The adjustments for each consolidated financial statement line affected for the year ended 31 December 2005 are set out in note 3(b).

(g) Investment property (HKAS 40, Investment property)

(i) Timing of recognition of movements in fair value in the income statement

In prior years, movements in the fair value of the Group's investment property were recognized directly in the investment property revaluation reserve except when, on a portfolio basis, the reserve was insufficient to cover a deficit on the portfolio, or when a deficit previously recognized in the income statement had reversed, or when an individual investment property was disposed of. In these limited circumstances, movements in the fair value were recognized in the income statement.

In addition, in prior years property (including leasehold land) which the Group held for an undetermined future purpose was accounted for under the cost model in SSAP 17, Property, plant and equipment, whereby the property was carried at cost less accumulated depreciation and impairment.

Upon adoption of HKAS 40 as from 1 January 2005, the Group has adopted a new policy for investment property. Under this new policy:

– all changes in the fair value of investment property are recognized directly in the income statement in accordance with the fair value model in HKAS 40; and

– land held for an undetermined future purpose is recognized as "investment property" if the property is freehold or, if the property is leasehold, the Group has recognized such land as investment property rather than as land held under an operating lease.

Further details of the new policy for investment property are set out in note 2(j).

(ii) Measurement of deferred tax on movements in fair value

In prior years the Group was required to apply the tax rate that would be applicable to the sale of investment property to determine whether any amounts of deferred tax should be recognised on the revaluation of investment property. Consequently, deferred tax was only provided to the extent that tax allowances already given would be clawed back if the property were disposed of at its carrying value, as there would be no additional tax payable on disposal.

As from 1 January 2005, in accordance with HK(SIC) Interpretation 21, the Group recognises deferred tax on movements in the value of an investment property using tax rates that are applicable to the property's use, if the Group has no intention to sell it and the property would have been depreciable had the Group not adopted the fair value model. Further details of the policy for deferred tax are set out in note 2(q).

(iii) Description of transitional provisions and effect of adjustments

While these changes in accounting policy have to be adopted retrospectively, no adjustment to the opening balances as at 1 January 2004 and 1 January 2005 are required because the net surplus on revaluation of investment properties for the year ended 31 December 2003 and 31 December 2004 was taken to the income statement as this related to a deficit on revaluation in respect of the portfolio of investment properties previously charged to the income statement.

The adjustments for each financial statement line items of the Group and the Company affected for the year ended 31 December 2005 are set out in note 3(b).

(h) Definition of related parties (HKAS 24, Related party disclosures)

As a result of the adoption of HKAS 24, Related party disclosures, the definition of related parties as disclosed in note 2(t) has been expanded to clarify that related parties include entities that are under the significant influence of a related party that is an individual (i.e. key management personnel, significant shareholders and/or their close family members) and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group. The clarification of the definition of related parties has not resulted in any material changes to the previously reported disclosures of related party transactions nor has it had any material effect on the disclosures made in the current period, as compared to those that would have been reported had SSAP 20, Related party disclosures, still been in effect.

(i) Changes in presentation (HKAS 1, Presentation of financial statements and HKAS 30, Disclosures in financial statements of banks and similar financial institutions)

(i) Presentation of income statement and balance sheets

In prior years, there were no specific accounting standards governing the presentation of the financial statement of banks. Management, having regard to the overall clarity and the disclosure requirements of the Hong Kong Monetary Authority, exercised its judgement in deciding on the relative prominence given to each item presented on the face of the income statement and balance sheets. As a result, certificates of deposits held were separately presented on the face of the balance sheets. Treasury bills (including Exchange Fund Bills) and money at call and short notice (representing placements with banks and other financial institutions maturing within one month) were included in cash and short-term funds with treasury bills being presented separately as held-to-maturity investments and other investments in securities according to the previous SSAP 24.

With effect from 1 January 2005, in order to comply with HKAS 30 and take into account the measurement basis that has been applied, the Group has changed its presentation of certain items on the face of the income statement and balance sheets. Treasury bills (including Exchange Fund Bills) and certificates of deposit held are included in the four categories of financial instruments under HKAS 39. Placements with banks and other financial institutions maturing within one month are included in placements with banks and other financial institutions. These changes in presentation have been applied retrospectively with comparatives reclassified.

(ii) Minority interests (HKAS 1, Presentation of financial statements and HKAS 27, Consolidated and separate financial statements)

In prior years, minority interests at the balance sheet date were presented in the consolidated balance sheet separately from liabilities and as deduction from net assets. Minority interests in the results of the Group for the year were also separately presented in the consolidated income statement as a deduction before arriving at the profit attributable to shareholders.

With effect from 1 January 2005, in order to comply with HKAS 1 and HKAS 27, the Group has changed its accounting policy relating to the presentation of minority interests. Under the new policy, minority interests are presented as part of equity, separately from interests attributable to the equity shareholders of the Company. These changes in presentation of minority interests in the consolidated balance sheet and income statement have been applied restrospectively with comparatives restated.

4. Interest Income

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Listed securities	410,103	327,940
Unlisted securities	568,930	566,284
Others	2,028,339	1,347,186
	3,007,372	2,241,410

Other interest income includes the amount of interest income accrued on impaired financial assets of HK$28.4 million (2004: Nil) and interest income on unwinding of discount on impairment loan of HK$25.2 million (2004: Nil) for the year ended 31 December 2005.

5. Fee and Commission Income

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Bills commission	40,152	42,281
Cards related income	35,064	23,722
General banking services	50,518	65,801
Insurance	77,964	61,715
Investment and structural investment products	75,888	90,451
Loans, overdrafts and facility fee	159,256	176,955
Others	820	382
	439,662	461,307

6. Net Trading Income

	The Group 2005	2004 (restated)
	HK$'000	*HK$'000*
Gains less losses from dealing in foreign currencies	98,707	54,468
Gains less losses from trading securities	137,827	100,893
Gains less losses from other dealing activities	(51,738)	22,583
Interest income on trading assets		
– Listed	26,807	–
– Unlisted	120,050	–
Interest expense on trading liabilities	(8,592)	–
Dividend income from unlisted trading securities	20,405	–
	343,466	177,944

7. Net Income from Financial Instruments Designated at Fair Value Through Profit or Loss

	The Group 2005	2004
	HK$'000	*HK$'000*
Net gains	93,941	–
Interest income		
– Listed	31,348	–
– Unlisted	3,395	–
Interest expense	(106,203)	–
	22,481	–

8. Net Hedging Expense

	The Group 2005	2004
	HK$'000	*HK$'000*
Fair value hedge	(679)	–

9. Other Operating Income

	The Group 2005	2004 (restated)
	HK$'000	*HK$'000*
Dividend income from investment securities and other investments in securities		
– Listed investments	–	488
– Unlisted investments	–	10,289
Dividend income from available-for-sale financial assets		
– Unlisted investments	5,312	–
Gross rental income from investment properties of HK$3,231,000 (2004: HK$11,491,000) less direct outgoings of HK$43,000 (2004: HK$1,598,000)	3,188	9,893
Others	70,801	48,528
	79,301	69,198

10. Operating Expenses

		The Group	
		2005	**2004**
			(restated)
		HK$'000	*HK$'000*
(a)	**Staff costs**		
	Salaries and other staff costs	555,101	548,302
	Retirement costs *(note 42)*	37,914	35,866
	Share-based payment expenses *(note 43)*:		
	– Equity-settled share-based payment expenses	5,796	4,308
	– Cash-settled share-based payment expenses	9,029	4,221
		607,840	592,697
(b)	**Depreciation and amortization**		
	Depreciation of premises and equipment *(note 32)*		
	– Assets held for use under operating leases	2,571	932
	– Other assets	110,266	145,467
	Amortization of goodwill *(note 33)*	–	60,336
		112,837	206,735
(c)	**Other operating expenses**		
	Premises and equipment expenses, excluding depreciation		
	– Rental of premises	54,054	33,369
	– Others	77,467	74,839
	Auditors' remuneration	4,325	3,358
	Advertising	63,659	66,651
	Communication, printing and stationery	57,636	52,694
	Legal and professional fee	22,876	22,247
	Others	93,994	64,895
		374,011	318,053
	Total operating expenses	1,094,688	1,117,485

Included in operating expenses are minimum lease payment under operating leases of HK$931,000 (2004: HK$1,372,000) for hire of equipment and HK$50,248,000 (2004: HK$29,619,000) for hire of other assets (including property rentals).

11. Directors' Remuneration

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

	2005					
	Directors' fee	Salaries, allowances and benefits in kind	Discretionary bonuses	Share-based payments	Retirement scheme contributions	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Mrs. Chan Hui Dor Lam Doreen	300	3,600	2,700	480	360	7,440
Mr. Chang Zhenming (resigned on 17 January 2005 and re-appointed on 27 June 2005)	170	–	–	–	–	170
Mr. Chen Xiaoxian (appointed on 17 January 2005)	290	–	–	–	–	290
Mr. Dou Jianzhong	300	2,520	945	–	252	4,017
Mr. Ju Weimin	300	–	–	–	–	300
Mr. Kong Dan	300	–	200	322	–	822
Mr. Kong Siu Chee Kenneth (resigned on 1 January 2006)	300	3,120	1,000	320	312	5,052
Mr. Lam Kwong Siu	300	–	–	–	–	300
Mr. Liu Jifu	300	–	–	–	–	300
Mr. Lo Wing Yat Kelvin	300	2,845	576	288	231	4,240
Mr. Rafael Gil-Tienda	300	–	–	–	–	300
Mr. Roger Clark Spyer (appointed on 2 December 2005)	30	242	1,200	–	–	1,472
Mr. Tsang Yiu Keung Paul	300	–	–	–	–	300
Mr. Wang Dongming	300	–	–	–	–	300
Mr. Yang Chao	300	–	–	–	–	300
Mr. Zhang Enzhao (resigned on 17 March 2005)	60	–	–	–	–	60
Mr. Zhao Shengbiao Peter	300	1,550	377	32	70	2,329
	4,450	13,877	6,998	1,442	1,225	27,992

	2004					
	Directors' fee	Salaries, allowances and benefits in kind	Discretionary bonuses	Share-based payments	Retirement scheme contributions	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Mrs. Chan Hui Dor Lam Doreen	300	3,540	3,600	293	354	8,087
Mr. Chang Zhenming (resigned on 17 January 2005)	300	2,166	903	234	205	3,808
Mr. Dou Jianzhong	300	–	–	–	–	300
Mr. Fan Sheung Tak Stephen (resigned on 19 October 2004)	240	–	–	–	–	240
Mr. Ju Weimin	300	–	–	–	–	300
Mr. Kong Dan	300	1,043	941	234	99	2,617
Mr. Kong Siu Chee Kenneth	300	3,120	1,800	196	312	5,728
Mr. Lee Wing Hung Raymond (resigned on 20 May 2004)	120	–	–	–	–	120
Mr. Lam Kwong Siu	300	–	–	–	–	300
Mr. Liu Jifu	300	–	–	–	–	300
Mr. Lo Wing Yat Kelvin	300	2,845	1,000	180	231	4,556
Mr. Rafael Gil-Tienda (appointed on 1 December 2004)	300	–	–	–	–	300
Mr. Tsang Yiu Keung Paul (appointed on 1 September 2004)	100	–	–	–	–	100
Mr. Wang Dongming	300	–	–	–	–	300
Mr. Yang Chao	300	–	–	–	–	300
Mr. Zhang Enzhao	300	–	–	–	–	300
Mr. Zhao Shengbiao Peter	300	1,605	302	23	62	2,292
	4,660	14,319	8,546	1,160	1,263	29,948

The above emoluments include the value of share options granted to certain directors under The CITIC International Financial Holdings Limited Share Option Scheme (the "New Option Scheme") and the Senior Executive Share Option Scheme (the "Old Option Scheme") of the Company. The details of these benefits in kind are disclosed under the paragraph "Share Option Schemes" in the directors' report and note 43.

12. Individuals with Highest Emoluments

Of the Group's five individuals with the highest emoluments, four of them (2004: three) are directors of the Company and the information in respect of the directors' emoluments are disclosed above.

The emoluments of the remaining one (2004: two) individuals are as follows:

	2005	**2004** (restated)
	HK$'000	*HK$'000*
Salaries and other emoluments	2,298	4,728
Discretionary bonuses	1,100	3,050
Pension contributions	220	228
Share-based payments	288	180
	3,906	8,186

The emoluments of the remaining one (2004: two) individuals with the highest emoluments are within the following bands:

	2005 Number of individuals	**2004 Number of individuals**
HK$2,500,001–HK$3,000,000	–	–
HK$3,000,001–HK$4,000,000	1	1
HK$4,000,001–HK$4,500,000	–	1
	1	2

13. Impairment Losses on Loans and Advances to Customers/Charge for Bad and Doubtful Debts

(a) Impairment losses on loans and advances

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Impairment losses (release)/charge on advances to customers and other accounts *(note 25(b)*)		
– Additions	266,960	–
– Releases	(226,391)	–
– Recoveries	(98,113)	–
	(57,544)	–

(b) Charge for bad and doubtful debts

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Charge/(release) for bad and doubtful debts *(note 25(c))*		
– Additions	–	430,152
– Releases	–	(307,715)
– Recoveries	–	(44,372)
	–	78,065

14. Income Tax in Consolidated Income Statement

(a) Income tax in the consolidated income statement

	The Group 2005	2004 (restated)
	HK$'000	*HK$'000*
Current tax – Hong Kong Profits Tax		
Provision for the year *(note 38(a))*	129,827	156,377
Over-provision in respect of prior years	(19,180)	(1,253)
	110,647	155,124
Current tax – Overseas		
Provision for the year	1,727	2,145
Deferred tax		
Reversal of temporary differences	(168)	(6,092)
Total	112,206	151,177

The provision for Hong Kong Profits Tax is calculated at 17.5% (2004: 17.5%) of the estimated assessable profits for the year. Taxation for branches and subsidiaries outside Hong Kong is charged at the appropriate current rates of taxation ruling in the relevant countries.

(b) Reconciliation between tax expense and accounting profit at applicable tax rates

	The Group 2005	2004 (restated)
	HK$'000	*HK$'000*
Profit before tax	1,215,646	1,054,732
Notional tax on profit before tax, calculated at the rates applicable to profits in the countries concerned	202,413	171,055
Tax effect of non-deductible expenses	24,375	56,294
Tax effect of non-taxable revenue	(102,583)	(51,687)
Tax effect of unused tax losses not recognized	2,799	1,593
Tax effect of previous tax losses utilized in current year	(932)	(11,636)
Tax effect of tax cost/(benefit) from tax planning arrangement	2,711	(13,247)
Tax effect of temporary allowance not recognized	1,922	58
Over-provision in prior years	(19,180)	(1,253)
Others	681	–
Actual tax expense	112,206	151,177

15. Profit Attributable to Equity Shareholders

The consolidated profit attributable to equity shareholders of the Company includes a profit of HK$551,442,000 (2004: HK$450,576,000) which has been dealt with in the financial statements of the Company.

16. Dividends

(a) Dividends payable to equity shareholders of the Company attributable to the year

	2005	**2004**
	HK$'000	*HK$'000*
Interim dividend declared and paid of HK$0.113 (2004: HK$0.066) per share	361,358	210,759
Final dividend proposed after the balance sheet date of HK$0.060 (2004: HK$0.075) per share	191,872	239,636
	553,230	450,395

The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

(b) Dividends payable to equity shareholders of the Company attributable to the previous financial year, approved and paid during the year

	2005	**2004**
	HK$'000	*HK$'000*
Final dividend in respect of the previous financial year, approved and paid during the year of HK$0.075 (2004: HK$0.063) per share	239,636	200,960
Final dividend in respect of the previous financial year on shares issued under the Old Option Scheme subsequent to the balance sheet date and before the close of the Register of Members of the Company	203	178
	239,839	201,138

(c) Dividends paid during the year

	2005	**2004**
	HK$'000	*HK$'000*
Interim dividend declared and paid of HK$0.113 (2004: HK$0.066) per share	361,358	210,759
Final dividend in respect of the previous financial year, approved and paid during the year of HK$0.075 (2004: HK$0.063) per share	239,636	200,960
Final dividend in respect of the previous financial year on shares issued under the Old Option Scheme subsequent to the balance sheet date and before the close of the Register of Members of the Company	203	178
	601,197	411,897

17. Earnings per Share

(a) Basic earnings per share

The calculation of basic earnings per share is based on profit attributable to equity shareholders of the Company of HK$1,103,395,000 (2004 (restated): HK$903,925,000) and the weighted average of 3,197,198,285 ordinary shares in issue (2004: 3,192,157,892 shares) during the year, calculated as follows:

Weighted average number of ordinary shares

	2005	**2004**
Issued ordinary shares at 1 January *(note 44(a))*	3,194,153,151	3,189,835,394
Effect of share options exercised	3,045,134	2,322,498
Weighted average number of ordinary shares at 31 December	3,197,198,285	3,192,157,892

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on adjusted profit attributable to ordinary equity shareholders of the Company of HK$1,141,126,000 (2004 (restated): HK$907,420,000) and the weighted average number of ordinary shares of 3,524,437,109 (2004: 3,521,197,208), after adjusting for the effects of all dilutive potential ordinary shares, which assuming the exercise of options under the Company's share option scheme:

Weighted average number of ordinary shares (diluted)

	2005	**2004**
Weighted average number of ordinary shares at 31 December	3,197,198,285	3,192,157,892
Effect of deemed issue of ordinary shares under the Company's share option scheme for nil consideration	337,911	2,138,403
Deemed issue of ordinary shares for Convertible Bonds	326,900,913	326,900,913
Weighted average number of ordinary shares (diluted) at 31 December	3,524,437,109	3,521,197,208

18. Segment Reporting

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format as the directors consider that this is more relevant to the Group's internal financial reporting.

(i) Business segments

The Group is principally engaged in the provision of banking and related financial services. The Group comprises the following main business segments:

Commercial banking business:	It mainly comprises banking business, which includes retail banking, corporate banking and treasury activities.
Asset management:	It mainly comprises direct investment and distressed assets management.
Investment banking:	It mainly comprises merchant banking, fund management and securities brokerage and dealing.
Unallocated:	It mainly comprises the premises and any items which cannot be reasonably allocated to specific business segments.

	2005					
	Commercial banking *HK$'000*	Asset management *HK$'000*	Investment banking *HK$'000*	Unallocated *HK$'000*	Inter-segment elimination *HK$'000*	Consolidated *HK$'000*
Net interest income	1,100,952	34,821	–	(36,516)	–	1,099,257
Other operating income	798,698	61,221	–	11,475	–	871,394
Total operating income	1,899,650	96,042	–	(25,041)	–	1,970,651
Operating expenses	(1,049,390)	(24,436)	(9)	(20,853)	–	(1,094,688)
	850,260	71,606	(9)	(45,894)	–	875,963
Impairment losses on loans and advances written back/(charged)	83,379	(25,835)	–	–	–	57,544
Impairment losses on held-to-maturity and available-for-sale securities	(2,567)	(2,818)	–	3,874	–	(1,511)
Impairment losses on properties	(354)	–	–	1,871	–	1,517
Impairment losses written back/(charged)	80,458	(28,653)	–	5,745	–	57,550
Operating profit	930,718	42,953	(9)	(40,149)	–	933,513
Net profit on disposal of fixed assets and associates	226,347	–	–	7,523	–	233,870
Revaluation gain on investment properties	2,140	–	–	–	–	2,140
Share of profit less losses of associates	(10,501)	(3,135)	59,759	–	–	46,123
Profit before taxation	1,148,704	39,818	59,750	(32,626)	–	1,215,646
Income tax	(101,661)	(7,160)	–	(3,385)	–	(112,206)
Profit for the year	1,047,043	32,658	59,750	(36,011)	–	1,103,440
Attributable to:						
Equity shareholders of the Company	1,047,043	32,613	59,750	(36,011)	–	1,103,395
Minority interests	–	45	–	–	–	45
Profit for the year	1,047,043	32,658	59,750	(36,011)	–	1,103,440
Depreciation for the year	116,800	298	–	(4,261)	–	112,837
Segment assets	81,777,136	1,295,604	–	1,035,367	(362,609)	83,745,498
Interest in associates	–	108,284	1,182,896	–	–	1,291,180
Total assets	81,777,136	1,403,888	1,182,896	1,035,367	(362,609)	85,036,678
Segment liabilities	74,660,342	12,869	–	1,396,145	(488,531)	75,580,825
Capital expenditure incurred during the year	53,237	585	–	112	–	53,934

	2004 (restated)					
	Commercial banking	Asset management	Investment banking	Unallocated	Inter-segment elimination	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Net interest income	1,456,353	12,417	–	4,687	–	1,473,457
Other operating income	600,994	58,950	–	21,625	–	681,569
Total operating income	2,057,347	71,367	–	26,312	–	2,155,026
Operating expenses	(1,011,556)	(15,306)	–	(90,623)	–	(1,117,485)
	1,045,791	56,061	–	(64,311)	–	1,037,541
Charge for bad and doubtful debts	(100,540)	22,475	–	–	–	(78,065)
Provision written back on held-to-maturity securities	9,682	–	–	–	–	9,682
Impairment loss on goodwill	(9,502)	–	–	–	–	(9,502)
Impairment losses (charged)/ written back	(100,360)	22,475	–	–	–	(77,885)
Operating profit	945,431	78,536	–	(64,311)	–	959,656
Net profit on disposal of fixed assets	19,755	–	–	(7,893)	–	11,862
Revaluation gain on investment properties	7,555	–	–	–	–	7,555
Share of profit less losses of associates	(4,139)	3,995	75,803	–	–	75,659
Profit before taxation	968,602	82,531	75,803	(72,204)	–	1,054,732
Income tax	(151,538)	(54)	–	415	–	(151,177)
Profit for the year	817,064	82,477	75,803	(71,789)	–	903,555
Attributable to:						
Equity shareholders of the Company	817,064	82,477	75,803	(71,419)	–	903,925
Minority interests	–	–	–	(370)	–	(370)
Profit for the year	817,064	82,477	75,803	(71,789)	–	903,555
Depreciation for the year	149,070	87	–	(2,758)	–	146,399
Amortization of goodwill for the year	1,056	–	6,528	52,752	–	60,336
Segment assets	80,101,502	1,320,542	–	1,038,641	(217,770)	82,242,915
Interest in associates	191,450	22,085	1,120,907	–	–	1,334,442
Total assets	80,292,952	1,342,627	1,120,907	1,038,641	(217,770)	83,577,357
Segment liabilities	74,308,120	14,064	–	1,395,300	(462,130)	75,255,354
Capital expenditure incurred during the year	62,784	719	195,866	500	–	259,869

(ii) Geographical segments

The information concerning geographical analysis has been classified by the location of the principal operations of the subsidiaries or branches of its subsidiaries.

2005

	Hong Kong	Mainland China	USA	Others	Inter-segment elimination	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Operating income from external customers	1,878,501	36,844	54,853	453	–	1,970,651
Total assets	83,788,186	2,060,081	1,776,016	612,632	(3,200,237)	85,036,678
Capital expenditure incurred during the year	45,931	2,718	460	4,825	–	53,934

2004 (restated)

	Hong Kong	Mainland China	USA	Others	Inter-segment elimination	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Operating income from external customers	2,103,648	16,684	45,380	–	(10,686)	2,155,026
Total assets	83,004,397	690,143	1,742,424	466,479	(2,326,086)	83,577,357
Capital expenditure incurred during the year	245,075	8,008	6,786	–	–	259,869

19. Cash and Balances with Banks and Other Financial Institutions

	The Group 2005	The Group 2004 (restated)
	HK$'000	*HK$'000*
Cash in hand	140,567	124,313
Balances with the central bank	3,826	233
Balances with banks and authorized institutions	1,016,916	1,364,373
	1,161,309	1,488,919

20. Placements with Banks and Other Financial Institutions

	The Group	
	2005	**2004**
		(restated)
	HK$'000	*HK$'000*
Maturing		
– within one month	4,543,004	6,458,048
– between one month and one year	722,040	364,307
	5,265,044	6,822,355

21. Trade Bills

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Gross trade bills	406,364	248,567
General provision for bad and doubtful debts *(note 25(c))*	–	(2,486)
	406,364	246,081

22. Trading Assets

	The Group		The Company	
	2005	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Debt securities	2,630,327	–	–	–
Equity securities	58,632	–	–	–
Investment funds	3,555,926	–	93,707	–
Trading securities	6,244,885	–	93,707	–
Positive fair values of derivatives *(note 55(b))*	228,144	–	–	–
	6,473,029	–	93,707	–
Issued by:				
Central governments and central banks	557,841	–	–	–
Public sector entities	16,525	–	–	–
Banks and other financial institutions	315,702	–	–	–
Corporate entities	5,354,817	–	–	–
	6,244,885	–	93,707	–
Place of listing:				
Listed in Hong Kong	154,488	–	–	–
Listed outside Hong Kong	1,245,415	–	–	–
	1,399,903	–	–	–
Unlisted	4,844,982	–	93,707	–
	6,244,885	–	93,707	–

Following the adoption of HKAS 39 in 2005, certain financial assets were re-designated as trading assets on 1 January 2005. There was no such re-designation in 2004 as retrospective application of HKAS 39 is not permitted.

The carrying amount of trading assets as at 1 January 2005 was HK$3,795,536,000 and these assets were classified as other investment securities at HK$3,795,536,000 as at 31 December 2004.

23. Securities Designated at Fair Value Through Profit or Loss

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Debt securities issued by corporate entities	1,139,908	–
Place of listing:		
Listed in Hong Kong	656,545	–
Listed outside Hong Kong	460,997	–
	1,117,542	–
Unlisted	22,366	–
Total	1,139,908	–

Following the adoption of HKAS 39 in 2005, certain financial assets were re-designated as financial assets through profit or loss on 1 January 2005. There was no such re-designation in 2004 as retrospective application of HKAS 39 is not permitted.

The carrying amount of securities assets designated at fair value through profit or loss as at 1 January 2005 was $1,069,798,000 and these assets were classified as held-to-maturity investments and other investment in securities at HK$998,550,000 and HK$36,332,000 respectively as at 31 December 2004.

24. Other Investment in Securities

	The Group		The Company	
	2005	**2004** (restated)	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Debt securities				
Listed in Hong Kong	–	1,817	–	–
Listed outside Hong Kong	–	570,004	–	
Unlisted	–	960,643	–	–
	–	1,532,464	–	–
Equity securities				
Listed in Hong Kong	–	84,692	–	–
Unlisted	–	318,137	–	–
	–	402,829	–	–
Certificates of deposits held –unlisted	–	89,949	–	–
Investment funds – unlisted	–	2,018,225	–	86,074
	–	4,043,467	–	86,074
Issued by:				
Central governments and central banks	–	1,234	–	–
Banks and other financial institutions	–	346,821	–	–
Corporate entities	–	3,688,912	–	86,074
Public sector entities	–	6,500	–	–
	–	4,043,467	–	86,074
Market value of listed securities				
Debt securities	–	571,821	–	–
Equity securities	–	84,692	–	–
	–	656,513	–	–

Following the adoption of HKAS 39 in 2005, financial assets with carrying amount of HK$4,043,467,000 at 1 January 2005 were re-designated with HK$3,795,536,000, HK$36,332,000, HK$164,750,000 and HK$46,849,000 as trading assets, securities designated at fair value through profit or loss, available-for-sale securities and other items in the balance sheet respectively.

There was no such re-designation in 2004 as restrospective application of HKAS 39 is not permitted.

25. Advances to Customers and Other Accounts

(a) Advances to customers and other accounts less impairment allowances

	The Group		The Company	
	2005	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Gross advances to customers	42,961,697	42,672,715	–	–
Less: Impairment allowances				
– Individually assessed *(note 25(b))*	(274,021)	–	–	–
– Collectively assessed *(note 25(b))*	(294,544)	–	–	–
Provisions for bad and doubtful debts				
– Specific *(note 25(c))*	–	(537,056)	–	–
– General *(note 25(c))*	–	(519,351)	–	–
	42,393,132	41,616,308	–	–
Advances to banks and other financial institutions	327,521	20,000	–	–
Accrued interest and other accounts less impairment allowances	1,387,530	1,686,992	18,403	23,963
	44,108,183	43,323,300	18,403	23,963

(b) Movement in impairment allowances on advances to customers

	2005		
	The Group		
	Individually assessed	**Collectively assessed**	**Total**
	HK$'000	*HK$'000*	*HK$'000*
At 1 January 2005 (restated)	549,325	361,177	910,502
Impairment losses released to income statement *(note 13(a))*	(10,701)	(46,843)	(57,544)
Amounts written off	(300,902)	(22,348)	(323,250)
Recoveries of advances written off in previous years	95,471	2,642	98,113
Unwind of discount on loan impairment losses *(note 4)*	(25,224)	–	(25,224)
Exchange and other adjustments	5,899	(84)	5,815
At 31 December 2005	313,868	294,544	608,412
Deducted from:			
Advances to customers *(note 25(a))*	274,021	294,544	568,565
Other accounts	39,847	–	39,847
	313,868	294,544	608,412

(c) *Movement in provision for bad and doubtful debts*

	2004 The Group			
	Specific *HK$'000*	**General** *HK$'000*	**Total** *HK$'000*	**Suspended interest** *HK$'000*
At 1 January 2004	762,063	546,474	1,308,537	389,638
Amounts written off	(297,765)	–	(297,765)	(140,617)
New provisions charged to the income statement	427,837	2,315	430,152	–
Provisions released to the income statement	(325,087)	(27,000)	(352,087)	–
Amounts recovered	44,372	–	44,372	–
Interest suspended during the year	–	–	–	154,588
Suspended interest recovered	–	–	–	(20,277)
Exchange differences	61	48	109	357
At 31 December 2004	611,481	521,837	1,133,318	383,689
Deducted from:				
Trade bills *(note 21)*	–	2,486	2,486	–
Advances to customers *(note 25(a))*	537,056	519,351	1,056,407	383,689
Other accounts	74,425	–	74,425	–
	611,481	521,837	1,133,318	383,689

(d) *Advances to customers analysed by industry sectors*

The following economic sector analysis is based on categories and definitions used by the HKMA.

	The Group	
	2005 *HK$'000*	**2004** *HK$'000*
Loans for use in Hong Kong		
Industrial, commercial and financial		
– Property development	410,595	350,668
– Property investment	5,033,111	4,313,945
– Financial concerns	2,355,699	2,702,487
– Stockbrokers	45,606	39,835
– Wholesale and retail trade	2,015,783	2,000,654
– Manufacturing	2,813,124	3,372,328
– Transport and transport equipment	4,280,529	5,404,016
– Others	3,093,252	3,690,455
Individuals		
– Loans for the purchase of flats under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	18,409	19,394
– Loans for the purchase of other residential properties	11,416,704	10,512,764
– Credit card advances	586,781	538,041
– Others	1,308,935	1,161,561
Trade finance	2,789,104	2,287,943
Loans for use outside Hong Kong	6,794,065	6,278,624
	42,961,697	42,672,715

(e) Impaired/non-performing loans and advances to customers

	The Group 2005 HK$'000	2004 HK$'000
Gross impaired loans and advances to customers	1,170,839	–
Impairment allowance-individually assessed	(274,021)	–
Gross non-performing loans and advances to customers	–	1,883,882
Specific provisions of bad and doubtful debts	–	(460,587)
	896,818	1,423,295
As a % of total loans and advances to customers		
– Gross impaired loans and advances	2.73%	–
– Gross non-performing loans and advances	–	4.41%

Impaired loans and advances are mainly individually assessed loans with objective evidence of impairment on an individual basis.

Non-performing loans and advances are loans on which interest is being suspended or on which interest accrual has ceased.

Individually assessed impairment allowance were made to write down the carrying value of the advances to the discounted value of future recoverable amounts, including the realisation of collateral.

(f) Net investment in finance leases and hire purchase contracts

Advances to customers include net investment in equipment leased to customers under finance leases and hire purchase contracts having the characteristics of finance leases. The contracts usually run for an initial period of 5 to 20 years, with an option for acquiring the leased asset at nominal value. The total minimum lease payments receivable under finance leases and hire purchase contracts and their present values are as follows:

	The Group 2005			2004		
	Present value of the minimum lease payments HK$'000	Interest income relating to future periods HK$'000	Total minimum lease payments HK$'000	Present value of the minimum lease payments HK$'000	Interest income relating to future periods HK$'000	Total minimum lease payments HK$'000
Within 1 year	559,321	198,336	757,657	592,884	101,987	694,871
After 1 year but within 5 years	778,468	614,687	1,393,155	874,284	277,119	1,151,403
After 5 years	2,590,940	1,402,639	3,993,579	2,415,956	551,367	2,967,323
	3,928,729	2,215,662	6,144,391	3,883,124	930,473	4,813,597
Impairment allowances:						
– Individually assessed	(3,718)			–		
– Collectively assessed	(1,095)			–		
– Provisions for bad and doubtful debts	–			(7,795)		
Net investment in finance leases and hire purchase contracts	3,923,916			3,875,329		

26. Amounts Due from Subsidiaries

	The Company 2005 HK$'000	2004 HK$'000
Placements with banks and other financial institutions	75,583	54,602
Advances to customers and other accounts	949,881	1,015,876
	1,025,464	1,070,478

27. Available-for-sale Securities

	The Group 2005 HK$'000	2004 HK$'000
Debt securities	5,790,022	–
Equity securities	140,455	–
Investment funds	77,551	–
	6,008,028	–
Impairment allowances	(62,068)	–
	5,945,960	–
Issued by:		
Banks and other financial institutions	873,122	–
Corporate entities	5,072,838	–
	5,945,960	–
Place of listing:		
Listed outside Hong Kong	4,731,439	–
Unlisted	1,214,521	–
Total	5,945,960	–

Following the adoption of HKAS 39 in 2005, financial assets with carrying amount of HK$6,285,790,000 at 1 January 2005 were re-designated as available-for-sale financial assets. There was no such re-designation in 2004 as retrospective application of HKAS 39 is not permitted.

These assets were classified as follows as at 31 December 2004.

	2004 HK$'000
Classified as:	
Held-to-maturity securities	5,309,764
Investment in securities	39,841
Other investment in securities	164,750
Carrying amount as at 31 December 2004	5,514,355

28. Held-to-maturity Investments

	The Group	
	2005	**2004**
		(restated)
	HK$'000	*HK$'000*
Treasury bills (including Exchange Fund Bills)	247,669	398,823
Certificates of deposit held	499,913	1,276,366
Debt securities	16,456,684	22,270,484
	17,204,266	23,945,673
Impairment allowance – individually assessed	(9,983)	–
Provision for diminution in value	–	(15,492)
	17,194,283	23,930,181
Issued by:		
Central governments and central banks	821,634	688,993
Public sector entities	1,136,047	788,265
Banks and other financial institutions	13,269,677	14,210,694
Corporate entities	1,966,925	8,242,229
	17,194,283	23,930,181
Place of listing:		
Listed in Hong Kong	1,383,224	717,949
Listed outside Hong Kong	3,478,078	7,563,978
	4,861,302	8,281,927
Unlisted	12,332,981	15,648,254
Total	17,194,283	23,930,181
Market value of listed securities:	4,826,519	9,017,797

Following the adoption of HKAS 39 in 2005, a total of HK$6,308,314,000 held-to-maturity securities at 1 January 2005 with a revalued amount of HK$1,033,466,000 and HK$6,081,200,000 were re-designated as financial assets at fair value through profit or loss and available-for-sale securities respectively. There was no such re-designation in 2004 as retrospective application of HKAS 39 is not permitted.

29. Investment Securities

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Debt securities – unlisted	–	15,782
Equity shares – unlisted	–	24,059
	–	39,841
Issued by:		
Corporate entities	–	28,059
Other entities	–	11,782
	–	39,841

Following the adoption of HKAS 39 in 2005, a total of HK$39,841,000 investment securities at 1 January 2005 with a carrying amount of HK$39,841,000 were re-designated as available-for-sale securities. There was no such re-designation in 2004 as retrospective application of HKAS 39 is not permitted.

30. Investments in Subsidiaries

	The Company	
	2005	**2004**
		(restated)
	HK$'000	*HK$'000*
Unlisted shares, at cost	6,245,247	6,239,934

The following list contains the particulars of principal subsidiaries which materially affect the results or assets of the Group.

Name of company	Place of incorporation/ operation	% of shares held	Principal activities	Issued and paid up capital
Beijing Kananten Investment Consulting Limited***	PRC	100%	Investment holding	US$500,000
California Investment LLC**¨	USA	100%	Property holding	US$5,415,000
Carford International Limited*	Hong Kong	100%	Property holding	HK$2
China International Finance Company Limited (Shenzhen)***	PRC	100%	Financial services	RMB500,000,000
CIFH (CB-I) Limited	Cayman Islands/ Hong Kong	100%	Issue of convertible bonds	US$1
CITIC International Assets Management Limited	Hong Kong	100%	Investment holding and assets management	HK$1,261,488,146
CITIC Ka Wah Bank Limited	Hong Kong	100%	Banking	HK$3,083,341,176
CKWB (Cayman Islands) Limited*	Cayman Islands/ Hong Kong	100%	Issue of subordinated notes	US$1
CKWH-UT2 Limited*	Cayman Islands/ Hong Kong	100%	Issue of subordinated notes	US$1
Dramatic Year Limited	British Virgin Islands/ Hong Kong	100%	Investment holding	US$1
HKCB Finance Limited*	Hong Kong	100%	Consumer financing	HK$300,000,000
HKCB Insurance Agency Limited*	Hong Kong	100%	Insurance agency	HK$2
Ka Wah International Merchant Finance Limited*	Hong Kong	100%	Financial services	HK$32,500,000
KS Investment and Consultancy Limited*	British Virgin Islands/ Hong Kong	100%	Investment and consultancy	US$1,200,000
KWB Investment Limited*	Hong Kong	100%	Investment holding	HK$5,000,000
The Hongkong Chinese Bank (Nominees) Limited*	Hong Kong	100%	Nominees services	HK$5,000
The Ka Wah Bank (Trustee) Limited*	Hong Kong	100%	Trustee services	HK$3,000,000
True Worth Investments Limited	British Virgin Islands/ Hong Kong	100%	Investment holding	US$1
Viewcon Hong Kong Limited*	Hong Kong	100%	Mortgage financing	HK$2

All of the above subsidiaries are held directly by the Company except for those indicated below.

* Subsidiaries held indirectly by the Company.

** 99% of the shares of this subsidiary is held directly by the Company and the remaining 1% is held indirectly through another subsidiary of the Company.

*** Subsidiaries held indirectly by the Company incorporated in the PRC and were "Foreign Investment Enterprises" under the PRC Law.

31. Interest in Associates

	The Group	
	2005	**2004** (restated)
	HK$'000	*HK$'000*
Share of net assets	1,101,843	1,145,105
Goodwill *(note 31(b))*	189,337	189,337
	1,291,180	1,334,442

Share of associates' taxation for the year amounted to HK$10,129,000 (2004 (restated): HK$4,606,000) relates to share of losses of associates.

Details of the principal associates are as follows:

Name of company	Form of business structure	Place of incorporation/ operation	Group's effective interest	Held by the subsidiaries	Held by the associates	Principal activities	Nominal value of issued shares
CITIC Capital Markets Holdings Limited	Incorporated	Hong Kong	50%	50%	–	Investment holding	HK$28,000,000
CITIC Capital Securities Limited	Incorporated	Hong Kong	50%	–	100%*	Securities brokerage and margin financing	HK$28,000,000
CITIC Capital Markets Limited	Incorporated	Hong Kong	50%	–	100% *	Investment banking	HK$10,000,000
CITIC Capital Futures Limited	Incorporated	Hong Kong	50%	–	100% *	Brokerage of exchange-traded futures and options contracts	HK$20,000,000
CITIC Frontier China Research Limited	Incorporated	Hong Kong	50%	–	100% *	Stock market research and advising on securities	HK$15,000,000

All associated companies are held indirectly by the Company.

* Interest held by a 50% associated company, CITIC Capital Markets Holdings Limited. Their results had been consolidated into the consolidated financial statements of CITIC Capital Markets Holdings Limited, which shown as below.

(a) *Summary financial information on principal associates:*

	Assets	Liabilities	Equity	Revenues	Profit/(loss)
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
CITIC Capital Markets Holdings Limited					
2005					
100%	3,987,136	1,964,148	2,022,988	554,099	114,002
The Group's effective interest	1,993,568	982,074	1,011,494	277,050	59,759
2004					
100%	3,277,865	1,409,173	1,868,692	603,633	186,573
The Group's effective interest	1,638,933	704,587	934,346	301,817	91,295

(b) *Impairment tests for cash-generating units containing goodwill*

In 2004, positive goodwill not already recognized directly in reserves was amortized on a straight-line basis over 20 years. As explained further in note 2(f), with effective from 1 January 2005 the Group no longer amortizes goodwill. In accordance with the transitional provisions set out in HKFRS 3, the accumulated amortization of goodwill as at 1 January 2005 has been eliminated against the cost of goodwill as at that date.

Goodwill is allocated to the investment banking business as cash-generating units (CGU) of the Group.

The recoverable amount of the CGU is determined based on fair value model. These calculations use cash flow projections based on financial budgets covering a five-year period. The present value of the terminal value is calculated based on the price-to-earnings (P/E) exit multiple of 10.3, which does not exceed the average P/E for the business in which the CGU operates.

Management determined the budgeted gross margin based on past performance and its expectation for market development. The discount rate used is 9.7%, which reflects specific risks relating to the relevant segments.

On 16 January 2006, CITIC Capital Holdings Limited (CCHL) has announced to realign its business with other entities within the CITIC Group, the substantial shareholder of the Company through 2 strategic moves.

Firstly, CCHL intends to form a joint venture company with CITIC Securities Co., Ltd (CITIC Securities), a fellow subsidiary of CIFH. The joint venture company, in which CITIC Securities will own a majority stake with CCHL as the minority shareholder, will take over CCHL's existing equities business. Secondly, CCHL intends to acquire 35% interest in CITIC Trust & Investment Co. Ltd (CITIC Trust), a fellow subsidiary of CIFH. Upon the completion of these strategic moves, CCHL will focus on developing its principal businesses in the areas of asset management and investment in private equity, real estate and marketable alternative investment products, and in corporate advisory, structured products and mezzanine financings.

In view of the restructuring has not yet committed up to the date of this report, the Group has not taken into consideration of the restructuring in goodwill impairment assessments.

32. Fixed Assets

(a) The Group

	The Group			
	Investment properties	**Other premises**	**Furniture, fixtures and equipment**	**Total**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Cost or valuation:				
At 1 January 2004	197,261	1,408,697	675,944	2,281,902
Additions	–	–	64,003	64,003
Disposals	(139,966)	(142,627)	(39,583)	(322,176)
Exchange adjustments	–	60	23	83
Surplus on revaluation	7,555	–	–	7,555
At 31 December 2004	64,850	1,266,130	700,387	2,031,367
The analysis of cost or valuation of the above assets is as follows:				
Cost	–	1,065,686	700,387	1,766,073
Valuation				
–1985	–	50,704	–	50,704
–1988	–	149,740	–	149,740
–2004	64,850	–	–	64,850
	64,850	1,266,130	700,387	2,031,367
At 1 January 2005	64,850	1,266,130	700,387	2,031,367
Additions	–	–	53,934	53,934
Reclassification from other premises	35,904	–	–	35,904
Reclassification to investment properties	–	(43,723)	–	(43,723)
Surplus on revaluation before reclassification	–	8,174	–	8,174
Reclassification	–	(8,174)	–	(8,174)
Disposals	(37,900)	(185,289)	(137,784)	(360,973)
Exchange adjustments	–	(101)	(6)	(107)
Surplus on revaluation	2,140	–	–	2,140
At 31 December 2005	64,994	1,037,017	616,531	1,718,542
The analysis of cost or valuation of the above assets is as follows:				
Cost	–	993,152	616,531	1,609,683
Valuation				
–1985	–	43,865	–	43,865
–2005	64,994	–	–	64,994
	64,994	1,037,017	616,531	1,718,542

	The Group			
	Investment properties	**Other premises**	**Furniture, fixtures and equipment**	**Total**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Accumulated depreciation:				
At 1 January 2004	–	366,980	361,877	728,857
Charge for the year *(note 10(b))*	–	27,235	119,164	146,399
Written back on disposals	–	(58,725)	(32,644)	(91,369)
Exchange adjustments	–	6	14	20
At 31 December 2004	–	335,496	448,411	783,907
At 1 January 2005	–	335,496	448,411	783,907
Charge for the year *(note 10(b))*	–	22,433	90,404	112,837
Written back on disposals	–	(47,317)	(114,813)	(162,130)
Write back of impairment loss on disposals	–	(1,517)	–	(1,517)
Reclassification to investment properties	–	(15,422)	–	(15,422)
Write back of impairment loss on reclassification	–	(571)	–	(571)
Exchange adjustments	–	(14)	(16)	(30)
At 31 December 2005	–	293,088	423,986	717,074
Net book value:				
At 31 December 2005	64,994	743,929	192,545	1,001,468
At 31 December 2004	64,850	930,634	251,976	1,247,460

(b) The Company

	The Company			
	Investment properties	**Other premises**	**Furniture, fixtures and equipment**	**Total**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Cost or valuation:				
At 1 January 2004	99,916	158,426	11,338	269,680
Additions	–	–	229	229
Disposals	(99,916)	(95,667)	(8,956)	(204,539)
At 31 December 2004	–	62,759	2,611	65,370
The analysis of cost or valuation of the above assets is as follows:				
Cost	–	55,389	2,710	58,099
Valuation –1985	–	7,370	–	7,370
	–	62,759	2,710	65,469
At 1 January 2005	–	62,759	2,611	65,370
Additions	–	–	99	99
At 31 December 2005	–	62,759	2,710	65,469
The analysis of cost or valuation of the above assets is as follows:				
Cost	–	55,389	2,710	58,099
Valuation – 1985	–	7,370	–	7,370
	–	62,759	2,710	65,469
Accumulated depreciation:				
At 1 January 2004	–	50,029	6,916	56,945
Charge for the year	–	2,837	856	3,693
Written back on disposals	–	(46,130)	(6,961)	(53,091)
At 31 December 2004	–	6,736	811	7,547
At 1 January 2005	–	6,736	811	7,547
Charge for the year	–	1,870	487	2,357
At 31 December 2005	–	8,606	1,298	9,904
Net book value:				
At 31 December 2005	–	54,153	1,412	55,565
At 31 December 2004	–	56,023	1,800	57,823

(c) All investment properties of the Group and the Company were revalued at 31 December 2005 by independent firms of surveyors, Vigers Appraisal & Consulting Limited on an open market value basis calculated by reference to net rental income allowing for reversionary income potential. The revaluation surplus amounted to HK$2,140,000 which has been credited to the income statement. Vigers Appraisal & Consulting Limited have among their staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of property being valued.

The gross rental income arising from investment properties is HK$3,231,000 (2004: HK$11,491,000).

During the year, profit on disposal of investment properties amounted to HK$4,641,000 (2004: HK$8,420,000).

(d) The analysis of net book value of investment properties and other premises are as follows:

	The Group		The Company	
	2005	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Freehold				
Held outside Hong Kong	37,371	38,422	2,429	2,670
Leasehold				
Held in Hong Kong				
– Long-term leases				
(over 50 years)	96,711	300,399	–	–
–Medium-term leases				
(10-50 years)	658,180	640,853	51,724	53,353
Held outside Hong Kong				
–Medium-term leases				
(10-50 years)	16,661	15,810	–	–
	808,923	995,484	54,153	56,023

Some of the other premises of the Group and the Company have been revalued in previous year. The net book value of these other premises of the Group and the Company at 31 December 2005 would have been HK$13,674,000 (2004: HK$107,359,000) and HK$2,256,000 (2004: HK$2,481,000) respectively had they been carried at cost less accumulated depreciation.

(e) The Group leases out investment properties under operating leases. The leases typically run for an initial period of two to three 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 (2004: Nil).

The gross carrying amounts of investment properties of the Group held for use in operating leases were HK$64,994,000 (2004: HK$64,850,000).

The Group's and the Company's total future minimum lease payments under non-cancellable operating leases are receivable as follows:

	The Group		The Company	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Within 1 year	2,986	2,211	–	–
After 1 year but within 5 years	3,105	3,528	–	–
	6,091	5,739	–	–

33. Goodwill

	The Group
	HK$'000
Cost:	
At 1 January 2004	1,197,158
Written off	(10,558)
At 31 December 2004	1,186,600
At 1 January 2005	1,186,600
Opening balance adjustment to eliminate accumulated amortization	(178,851)
At 31 December 2005	1,007,749
Accumulated amortization and impairment losses:	
At 1 January 2004	119,571
Amortization for the year (note 10(b))	60,336
Impairment loss	9,502
Written off	(10,558)
At 31 December 2004	178,851
At 1 January 2005	178,851
Eliminated against cost at 1 January 2005	(178,851)
At 31 December 2005	–
Carrying amount:	
At 31 December 2005	1,007,749
At 31 December 2004	1,007,749

In 2004, positive goodwill not already recognised directly in reserves was amortised on a straight-line basis over 20 years. The amortization of positive goodwill for the year ended 31 December 2004 was included in "other operating expenses (note 10(b))" in the consolidated income statement.

As explained further in note 2(f), with effect from 1 January 2005 the Group no longer amortises goodwill. In accordance with the transitional provisions set out in HKFRS 3, the accumulated amortization of goodwill as at 1 January 2005 has been eliminated against the cost of goodwill as at that date.

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:

	2005
	HK$'000
Commercial banking business	1,007,749

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 maximum of five-year period. Cash flow in subsequent years are estimated at zero growth rate which does not exceed the long-term average growth rate for the business in which the CGU operates.

Management determined the budgeted gross margin based on past performance and its expectation for market development. The discount rate used is 8.8% which reflects specific risks relating to the relevant segments.

34. Deposits and Balances of Banks and Other Financial Institutions

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Deposits and balances from banks	326,198	85,678
Deposits and balances from other financial institutions	3,831,248	3,470,174
	4,157,446	3,555,852

35. Deposits from Customers

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Demand deposits and current deposits	4,201,868	10,204,982
Savings deposits	8,058,380	11,818,370
Time, call and notice deposits	42,155,031	33,428,375
	54,415,279	55,451,727

36. Trading Liabilities

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Short positions in securities	217,904	–
Negative fair value of derivatives *(Note 55(b))*	443,233	–
	661,137	–

37. Certificates of Deposit Issued

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Designated at fair value through profit or loss	2,785,924	–
Trading	–	1,379,306
Non-trading	4,682,037	5,580,384
	7,467,961	6,959,690

At 1 January 2005, the Group designated on initial recognition HK$1,561,857,000 of financial liabilities as at fair value through profit or loss upon the adoption of HKAS 39, and these financial liabilities were classified as trading liabilities and non-trading liabilities at HK$1,379,306,000 and HK$177,744,000 respectively as at 31 December 2004.

At 31 December 2005, the difference between the carrying amount and the contractual amount payable at maturity for the Group amounted to HK$150,081,299. Such a decrease in fair value is only attributable to changes in benchmark interest rate.

38. Income Tax in the Balance Sheet

(a) Current taxation in the balance sheet represents

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Provision for Hong Kong Profits Tax for the year *(note 14(a))*	129,827	156,377
Provisional Profit Tax paid	(127,548)	(151,160)
	2,279	5,217
Balance of Profits Tax provision relating to prior years	46,335	58
	48,614	5,275
Provision for overseas taxation	1,864	1,171
	50,478	6,446

(b) Deferred tax assets and liabilities recognized

The components of deferred tax (assets)/liabilities recognized in the consolidated balance sheet and the movements during the year are as follows:

The Group

	Depreciation allowances in excess of related depreciation	Impairment allowances for loans	Provisions for loans	Fair value adjustments for properties and other assets	Fair value adjustments for available for- sale securities	Cash flow hedge	Others	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Deferred tax arising from:								
At 1 January 2004	51,047	–	(89,558)	(46,689)	–	–	(2,262)	(87,462)
Charged/(credited) to consolidated income statement	(9,749)	–	4,725	(1,068)	–	–	–	(6,092)
At 31 December 2004	41,298	–	(84,833)	(47,757)	–	–	(2,262)	(93,554)
At 1 January 2005								
– as previously reported	41,298	–	(84,833)	(47,757)	–	–	(2,262)	(93,554)
– opening balance adjustment in respect of financial instruments	–	(57,023)	84,833	–	78,191	(1,639)	–	104,362
As restated	41,298	(57,023)	–	(47,757)	78,191	(1,639)	(2,262)	10,808
Charged/(credited) to consolidated income statement	(14,689)	10,401	–	2,526	–	–	1,594	(168)
Charged/(credited) to reserves	–	–	–	1,389	(10,403)	1,639	–	(7,375)
At 31 December 2005	26,609	(46,622)	–	(43,842)	67,788	–	(668)	3,265

	The Group 2005	2004
	HK$'000	*HK$'000*
Net deferred tax asset recognized on the balance sheet	(42,201)	(93,562)
Net deferred tax liability recognized on the balance sheet	45,466	8
	3,265	(93,554)

(c) *Deferred tax assets not recognized*

The Group and the Company have not recognized deferred tax assets in respect of cumulative tax losses of HK$109,349,000 (2004: HK$106,225,000) and HK$50,581,000 (2004: HK$26,260,000) respectively, as it is not probable that future taxable profits against which the losses can be utilised 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:

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Expiring within 5 years	50,026	65,739
No expiry date	59,323	40,486
	109,349	106,225

39. Amounts Due to Subsidiaries

	The Company	
	2005	**2004**
	HK$'000	*HK$'000*
Other liabilities	223	224
Placement from a subsidiary	1,395,922	1,399,384
	1,396,145	1,399,608

40. Debt Securities Issued

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Debt securities issued	2,245,435	2,322,798

The debt securities represent 4.25% per annum notes with face value of US$300 million issued at discount on 17 November 2004. The notes were issued by CKWB and constitute direct, unconditional and unsecured obligations of CKWB. The notes will mature on 17 November 2009.

41. Convertible Bonds Issued

CIFH (CB-I) Limited, a single purpose wholly-owned subsidiary of the Company, issued 0.25% per annum Guaranteed Convertible Bonds ("Bonds") with face value of US$180 million on 8 December 2003. The Company unconditionally and irrevocably guarantees all amounts payable under the Bonds.

Each Bond, at the option of the holder, is convertible on or after 18 January 2004 upto and including 8 November 2008 into fully paid ordinary shares with a par value of HK$1.00 of the Company at an initial conversion price of HK$4.269 per share. The Bonds can be redeemed at their principal amount together with accrued interest on 8 December 2008. The net proceeds from the issue of the Bonds have been used for general corporate purposes of the Group.

The fair values of the liability component and the equity conversion component were determined at the date of waiver of the cash settlement option on 23 December 2004.

The fair values of the liability component, included in long-term borrowings, was calculated using a market interest rate for an equivalent non-convertible bond. The residual amount, representing the value of the equity conversion component, is included in shareholders' equity in Convertible Bond - equity component reserve (note 45).

The convertible bonds recognized in the balance sheet is calculated as follows:

	2005
	HK$'000
Face value of convertible bonds	1,399,384
Equity component	(133,027)
Retained earnings	(7,658)
Liability component on initial recognition at 1 January 2005	1,258,699
Interest expense	37,731
Interest paid	(3,499)
Exchange difference	(3,114)
Liability component at 31 December 2005	1,289,817

	2004
	HK$'000
Convertible bonds	1,399,384

The carrying amount of the liability component of the convertible bonds reflects its current fair value. Interest expense on the bonds is calculated using the effective interest method by applying the effective interest rate of 2.98% to the liability component and for the year end 31 December 2005 amounted to HK$37,731,000. The actual interest paid in 2005 was HK$3,499,000.

The Bonds are embedded with an early redemption option by the Group and an early redemption option by the bondholders. The values of the embedded call and put feature are interdependent and have not been accounted for separately from the host debt.

42. Staff Retirement Scheme

The Group has a defined contribution provident fund scheme (the "Retirement Scheme") under which it contributes 10% of the employees' basic salaries. The Retirement Scheme is an MPF exempted scheme and covers all permanent full-time employees of the Group. No employee contributions are required. Contributions forfeited by leavers prior to vesting fully may not be used by the Group to reduce the existing level of contribution but are transferred to a separate welfare fund which shall be applied for the welfare of the Retirement Scheme's members.

Besides the Retirement Scheme, the Group also participated in an approved MPF scheme effective on 1 December 2000 to provide scheme choice to both existing and new employees. Mandatory benefits are being provided under the MPF Scheme.

During the year, the Group contributed approximately HK$38 million (2004: HK$36 million) (note 10(a)) to these schemes.

43. Share-based Payments

Equity settled share-based transactions

On 16 May 2003, the Company adopted The CITIC International Financial Holdings Limited Share Option Scheme (the "New Option Scheme") and, at the same time, terminated the Senior Executive Share Option Scheme (the "Old Option Scheme") which was adopted by the Company on 30 March 1995. The provisions of the Old Option Scheme remained in full force and effect to the extent necessary to give effect to the exercise of all options granted prior to the termination of the Old Option Scheme on 29 March 2005.

There were no option granted under the Old Option Scheme during the year. As for the options granted under the New Option Scheme, there is a vesting period of two years starting from the date of grant and these options will then remain exercisable until the tenth anniversary day from the date of grant. Each option gives the holder the right to subscribe for one ordinary share in the Company.

(a) The terms and conditions of the options, which will be settled by physical delivery of shares, granted under the New Option Scheme are as follows:

Date of grant/number of employees entitled	Number of options	Vesting conditions	Contractual life of options
Options granted to 273 eligible persons on 17 November 2003	6,758,000	2 years from the date of grant	10 years from the date of grant
Options granted to 293 eligible persons on 6 April 2004	7,412,000	2 years from the date of grant	10 years from the date of grant
Options granted to 275 eligible persons on 13 June 2005	6,800,000	2 years from the date of grant	10 years from the date of grant

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

	Share options granted in 2005		Share options granted in 2004		Share options granted in 2003	
	Weighted average exercise price *HK$*	Number of options	Weighted average exercise price *HK$*	Number of options	Weighted average exercise price *HK$*	Number of options
Outstanding at the beginning of the year	–	–	3.775	6,544,000	3.540	5,718,000
Forfeited during the year	–	(316,000)	–	(1,220,000)	–	(1,102,000)
Exercised during the year	–	–	–	–	–	–
Granted during the year	2.925	6,800,000	–	–	–	–
Outstanding at the end of the year	2.925	6,484,000	3.775	5,324,000	3.540	4,616,000
Exercisable at the end of the year		216,000		216,000		4,616,000

The options outstanding at 31 December 2005 have the exercise prices fall within the range of HK$2.925 to HK$3.775 and a weighted average contractual life of 10 years.

(c) Fair value of share options and assumptions

The fair value of services received in return for share options granted are measured by reference to the fair value of the share options granted. The estimate of the fair value of the share options granted is measured based on a trinomial model. The 10 years contractual life of the option is used as an input into this model.

	For options granted on 13 June 2005	**For options granted on 6 April 2004**	**For options granted on 17 November 2003**
Fair value at measurement date	HK$0.653	HK$1.248	HK$0.835
Share price	HK$2.925	HK$3.775	HK$3.475
Exercise price	HK$2.925	HK$3.775	HK$3.540
Expected volatility (expressed as volatility used in the trinomial model)	24.30%	34.00%	24.00%
Option life	10 Years	10 Years	10 Years
Expected dividends (continuous Yield)	3.84%	3.71%	3.71%
Risk-free interest rate (based on HKD government bond Yield)	3.22%	4.07%	4.34%

The expected volatility is based on the implied volatilities of our own issued convertible bond on the specified dates.

Share options are granted under a service condition and, for grants to personnel, a non-market performance condition.

Cash settled share-based transactions

CITIC Ka Wah Bank Limited ("CKWB"), a wholly-owned subsidiary of the Company, has offered Equity Linked Deferred Award (the "ELDA") to the eligible employees of CKWB and certain directors of the Company (the "Eligible Persons") whereby the Eligible Persons will receive cash benefit on the specified maturity date, being the earlier of the second calendar anniversary of the offer date and the date of retirement. The amount of cash benefit to be received by the Eligible Persons on the maturity date shall be calculated by multiplying the number of ordinary shares of the Company notionally subject to ELDA by the lower of:

1. the result obtained by subtracting the ELDA price per share from the closing price of the ordinary share of the Company as stated in the daily quotations sheet of the Stock Exchange on the maturity date; and

2. HK$3.00.

The Eligible Persons are not entitled to receive any payment pursuant to the ELDA if the closing price of the ordinary share of the Company as stated in the daily quotations sheet of the Stock Exchange on the maturity date falls below the ELDA price. No ordinary shares of the Company will be allotted or transferred to the Eligible Persons upon the maturity of the ELDA.

The detailed terms of the ELDA offered to the Eligible Persons are as follows:

Offer date	**ELDA price per share** *(HK$)*	**Number of ordinary shares notionally subject to ELDA as at 31 December 2005**
16 April 2004	2.55	3,925,398
24 March 2005	2.00	6,051,530
Total:		9,976,928

The fair value of the ELDA is limited to HK$3.00, which is the maximum cash benefit to be received by the Eligible Persons on the maturity date.

Employee expenses

	2005 *HK$'000*	**2004** *HK$'000*
(a) Equity settled share-based transactions		
Share options granted in 2003	1,748	2,018
Share options granted in 2004	3,194	2,290
Share options granted in 2005	854	–
Total expense recognized as employee costs *(note 10(a))*	5,796	4,308

	2005 *HK$'000*	**2004** *HK$'000*
(b) Cash settled share-based transactions		
ELDA granted in 2004	4,236	4,221
ELDA granted in 2005	4,793	–
Total carrying amount of cash-settled transaction liabilities *(note 10(a))*	9,029	4,221

44. Share Capital

(a) Authorised and issued share capital

	2005 *HK$'000*	**2004** *HK$'000*
Authorised:		
6,000,000,000 ordinary shares of HK$1 each	6,000,000	6,000,000
Issued and fully paid:		
At 1 January: 3,194,153,151 (2004: 3,189,835,394) ordinary shares of HK$1 each	3,194,153	3,189,835
Share issued under the Old Option Scheme	3,706	4,318
At 31 December: 3,197,859,375 (2004: 3,194,153,151) ordinary shares of HK$1 each	3,197,859	3,194,153

(b) Terms of unexpired and unexercised share options at balance sheet date

Date of grant	Exercise price *(HK$)*	Number of option granted	Vesting period	Exercisable period	Number of shares acquired on exercise of options for the year ended 31 December 2005	Number of options lapsed for the year ended 31 December 2005	Number of options outstanding as at 31 December 2005	Number of options outstanding as at 31 December 2004
The Old Option Scheme								
17/08/1999	2.217	19,600,000	–	31/10/1999 – 29/03/2005	2,900,000	–	–	2,900,000
28/03/2000	1.758	1,700,000	–	31/03/2000 – 29/03/2005	500,000	–	–	500,000
10/08/2000	2.198	700,000	–	11/08/2001 – 29/03/2005	–	100,000	–	100,000
28/02/2002	1.620	44,813	–	28/02/2002 – 29/03/2005	–	203	–	203
28/02/2002	2.217	481,743	–	28/02/2002 – 29/03/2005	268,880	–	–	268,880
28/02/2002	1.758	74,688	–	28/02/2002 – 29/03/2005	37,344	–	–	37,344
28/02/2002	2.198	26,141	–	28/02/2002 – 29/03/2005	–	4,203	–	4,203
The New Option Scheme								
17/11/2003	3.540	6,758,000	17/11/2003 – 16/11/2005	17/11/2005 – 16/11/2013	–	1,102,000	4,616,000	5,718,000
06/04/2004	3.775	7,412,000	06/04/2004 – 05/04/2006	06/04/2006 – 05/04/2014	–	1,220,000	5,324,000	6,544,000
13/06/2005	2.925	6,800,000	13/06/2005 – 12/06/2007	13/06/2007 – 12/06/2015	–	316,000	6,484,000	–
		43,597,385			3,706,224	2,742,406	16,424,000	16,072,630

Each option entitles the holder to subscribe for one ordinary share in the Company. Further details of these options are set out in note 43 to the financial statements.

45. Reserves

(i) The Group

	Attributable to equity shareholders of the Company										
	Share premium	Capital reserve	General reserve	Exchange differences reserve	Other property revaluation reserve	Fair value reserve	Hedging reserve	Convertible bond-equity component	Share option reserve	Retained profits	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 1 January 2004											
– as previously reported	1,831,406	2,818	100,000	(597)	11,945	–	–	–	–	2,676,363	4,621,935
– prior period adjustments in respect of – HKAS 28	–	–	–	–	–	–	–	–	–	4,754	4,754
As restated	1,831,406	2,818	100,000	(597)	11,945	–	–	–	–	2,681,117	4,626,689
Share premium on shares issued during the year	4,542	–	–	–	–	–	–	–	–	–	4,542
Exchange difference on translation	–	–	–	283	–	–	–	–	–	–	283
Equity settled share-based transactions (restated)	–	–	–	–	–	–	–	–	4,308	–	4,308
Dividends paid in respect of the previous year *(note 16(b))*	–	–	–	–	–	–	–	–	–	(201,138)	(201,138)
Profit for the year (restated)	–	–	–	–	–	–	–	–	–	903,925	903,925
Dividends declared and paid in respect of the current year	–	–	–	–	–	–	–	–	–	(210,759)	(210,759)
At 31 December 2004 (restated)	1,835,948	2,818	100,000	(314)	11,945	–	–	–	4,308	3,173,145	5,127,850

	Attributable to equity shareholders of the Company										
	Share premium HK$'000	Capital reserve HK$'000	General reserve HK$'000	Exchange differences reserve HK$'000	Other property revaluation reserve HK$'000	Fair value reserve HK$'000	Hedging reserve HK$'000	Convertible bond-equity component HK$'000	Share option reserve HK$'000	Retained profits HK$'000	Total HK$'000
At 1 January 2005											
– as previously reported	1,835,948	2,818	100,000	(314)	11,945	–	–	–	–	3,165,805	5,116,202
– prior period adjustments in respect of											
– HKAS 28	–	–	–	–	–	–	–	–	–	4,754	4,754
– HKFRS 2	–	–	–	–	–	–	–	–	4,308	2,586	6,894
As restated, before opening balance adjustments	1,835,948	2,818	100,000	(314)	11,945	–	–	–	4,308	3,173,145	5,127,850
– HKAS 32 & 39	–	–	–	–	–	368,612	(7,725)	133,027	–	144,902	638,816
As restated, after opening balance adjustments	1,835,948	2,818	100,000	(314)	11,945	368,612	(7,725)	133,027	4,308	3,318,047	5,766,666
Share premium on shares issued during the year	4,264	–	–	–	–	–	–	–	–	–	4,264
Revaluation surplus, net of deferred tax	–	–	–	–	6,785	–	–	–	–	–	6,785
Share of share option reserve of associates	–	–	–	–	–	–	–	–	6,500	–	6,500
Share of fair value reserve of associates	–	–	–	–	–	2,894	–	–	–	–	2,894
Transfer to retained profits upon disposal	–	–	–	–	(12,180)	–	–	–	–	12,180	–
Exchange difference on translation	–	–	–	3,371	–	–	–	–	–	–	3,371
Release on disposal of an associate	–	–	–	627	–	–	–	–	–	–	627
Equity settled share-based transactions	–	–	–	–	–	–	–	–	5,796	–	5,796
Available-for-sale securities											
– change in fair value	–	–	–	–	–	(59,442)	–	–	–	–	(59,442)
– deferred tax	–	–	–	–	–	10,403	–	–	–	–	10,403
Cash flow hedge											
– effective portion of changes in fair value	–	–	–	–	–	–	9,364	–	–	–	9,364
– deferred tax	–	–	–	–	–	–	(1,639)	–	–	–	(1,639)
Exchange difference on translation of borrowings	–	–	–	–	–	–	–	(329)	–	–	(329)
Dividends paid in respect of the previous year *(note 16(b))*	–	–	–	–	–	–	–	–	–	(239,839)	(239,839)
Profit for the year	–	–	–	–	–	–	–	–	–	1,103,395	1,103,395
Dividends declared and paid in respect of the current year	–	–	–	–	–	–	–	–	–	(361,358)	(361,358)
At 31 December 2005	1,840,212	2,818	100,000	3,684	6,550	322,467	–	132,698	16,604	3,832,425	6,257,458

(ii) *The Company*

	Attributable to equity shareholders of the Company			
	Share premium	**Share option reserve**	**Retained profits**	**Total**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
At 1 January 2004	1,831,406	–	999,395	2,830,801
Share premium on shares issued during the year	4,542	–	–	4,542
Equity settled share-based transactions (restated)	–	4,308	–	4,308
Dividends paid in respect of the previous year *(note 16(b))*	–	–	(201,138)	(201,138)
Profit for the year (restated)	–	–	449,980	449,980
Dividends declared and paid in respect of the current year	–	–	(210,759)	(210,759)
At 31 December 2004 (restated)	1,835,948	4,308	1,037,478	2,877,734
At 1 January 2005				
– as previously reported	1,835,948	–	1,038,074	2,874,022
– prior period adjustments in respect of – HKFRS 2	–	4,308	(596)	3,712
As restated	1,835,948	4,308	1,037,478	2,877,734
Share premium on shares issued during the year	4,264	–	–	4,264
Equity settled share-based transactions	–	5,796	–	5,796
Dividends paid in respect of the previous year *(note 16(b))*	–	–	(239,839)	(239,839)
Profit for the year	–	–	551,442	551,442
Dividends declared and paid in respect of the current year	–	–	(361,358)	(361,358)
At 31 December 2005	1,840,212	10,104	987,723	2,838,039

(iii) *Nature and purpose of reserves*

(a) Share premium

The application of the share premium account is governed by section 48B of the Hong Kong Companies Ordinance.

(b) Exchange differences reserve

The exchange differences reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The reserve is dealt with in accordance with the accounting policies set out in notes 2(r).

(c) Other property revaluation reserve

The other property revaluation reserve is not available for distribution to shareholders because it does not constitute realised profits within the meaning of section 79B(2) of the Hong Kong Companies Ordinance.

(d) Fair value reserve

The fair value reserve comprises the cumulative net change in the fair value of available-for-sale securities held at the balance sheet date and is dealt with in accordance with the accounting policies in note 2(g).

(e) Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition of the hedged cash flow in accordance with the accounting policies adopted for cash flow hedges in note 2(i).

(f) Convertible bond-equity component

The convertible bond-equity component comprises the fair value of the equity conversion component of the convertible bond issued that were determined at the date of waiver of the cash settlement option on 23 December 2004.

(g) Share option reserve

The share option reserve comprises the fair value of the actual or estimated number of unexercised share options granted to employees of the Group recognised in accordance with the accounting policy adopted for share based payment in note 43.

Included in the share option reserve is an amount of HK$6,500,000 (2004: Nil) being the share option reserve attributable to one of the associate, CITIC Capital Markets Holdings Limited, under its own "Share Option Scheme".

(h) Retained profits

In accordance with the Hong Kong Monetary Authority (the "HKMA") guideline "Impact of the New Hong Kong Accounting Standards on Authorised Institutions' Capital Base and Regulatory Reporting", the Group has earmarked a "Regulatory Reserve" of HK$233,800,000 (2004: Nil) from retained profits as at 31 December 2005.

Included in the retained profits is an amount of HK$445,954,000 (2004 (restated): HK$465,243,000) being the retained profits attributable to associates.

(iv) Distributability of reserve

At 31 December 2005, the aggregate amount of reserves available for distribution to equity shareholders of the Company was HK$987,723,000 (2004 (restated): HK$1,037,478,000). After the balance sheet date the directors proposed a final dividend of HK$0.060 per ordinary share (2004: HK$0.075). This dividend has not been recognised as a liability at the balance sheet date.

46. Minority Interests

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
At 1 January 2005	–	191
Associates acquired during the year	78	–
Others	413	–
Profit for the year	45	(370)
Disposal of subsidiaries during the year	–	179
As 31 December 2005	536	–

47. Loan Capital

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Subordinated notes	4,352,351	4,275,896

The notes represents 7.625% per annum subordinated notes with face value of US$300 million issued on 5 July 2001 and 9.125% per annum perpetual subordinated notes with face value of US$250 million issued on 23 May 2002. The notes were issued by CKWB (Cayman Islands) Ltd and CKWH-UT2 Ltd respectively, two separate single purpose wholly-owned subsidiaries of the Group and qualify as tier 2 capital. The Group unconditionally and irrevocably guarantees all amounts payable under the notes. The 7.625% per annum subordinated notes will mature on 5 July 2011 whereas the 9.125% per annum perpetual subordinated notes will be callable by the CKWH-UT2 Ltd in 2012.

48. Cash and Cash Equivalents

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
(i) Components of cash and cash equivalents in the consolidated cash flow statement		
Cash and balances with banks and other financial institutions	1,161,309	1,488,919
Placements with banks and other financial institutions with original maturity within three months	4,702,768	6,565,590
Held-to-maturity investments		
– Treasury bills with original maturity within three months	148,201	–
	6,012,278	8,054,509
(ii) Reconciliation with the consolidated balance sheet		
Cash and balances with banks and other financial institutions	1,161,309	1,488,919
Placements with banks and other financial institutions	5,265,044	6,822,355
Held-to-maturity investments		
– Treasury bills	247,669	398,823
Amount shown in the consolidated balance sheet	6,674,022	8,710,097
Less: Amounts with an original maturity of over three months	(661,744)	(655,588)
Cash and cash equivalents in the consolidated cash flow statement	6,012,278	8,054,509

49. Assets Subject to Sale and Repurchase Transactions

The following assets and liabilities are subject to sale and repurchase transactions:

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Included in held-to-maturity investments	2,205,403	2,909,158
Included in trading assets	462,254	–
	2,667,657	2,909,158
Included in deposits and balances of banks and other financial institutions	2,665,226	3,113,297

50. Assets Pledged as Security

The following assets have been pledged as security for own liabilities:

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Assets pledge:		
Cash and balances with banks and other financial institutions	3,729	441
Held-to-maturity investments	77,528	77,714
	81,257	78,155

As at 31 December 2005, the assets pledged represented statutory deposits pledged to the Office of the Comptroller of Currency in the USA, the People's Bank of China in the PRC and the Monetary Authority of Macao.

As at 31 December 2004, the assets pledged represented statutory deposits pledged to the Office of the Comptroller of Currency in the USA and the People's Bank of China in the PRC.

51. Material Related Party Transactions

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Group entered into the following material related party transactions.

(a) Transactions with group companies

During the year, the Group entered into a number of transactions with related parties, in the ordinary course of its banking business including, inter alia, lending, the acceptance and placement of inter-bank deposits, participation in loan syndicates, correspondent banking transactions and foreign exchange transactions. The contracts were priced based on relevant market rates at the time of each transaction, and were under the same terms as those available to other counterparties and customers of the Group. In the opinion of the directors, these transactions were conducted on normal commercial terms.

The amount of related-party transactions during the year and outstanding balances at the end of the year are set out below:

	The Group					
	Ultimate holding company		Fellow subsidiaries		Associates	
	2005	2004	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Interest income	–	3	7,474	6,774	5,936	1,268
Interest expense	(5,719)	(3,411)	(37,625)	(13,207)	(11,820)	(659)
Other operating income	–	–	–	72	16,799	20,214
Operating expenses	(1,000)	(1,248)	(1)	(5)	(10,029)	(2,043)
For the year ended 31 December	(6,719)	(4,656)	(30,152)	(6,366)	886	18,780
Lending activities:						
At 1 January	–	–	299,326	612,858	134,187	19,449
At 31 December	–	–	369,418	299,326	200,000	134,187
Average for the year	–	–	391,829	365,358	171,171	31,843
Other receivables:						
At 1 January	–	–	9,189	21	10,320	1,276
At 31 December	–	–	4,805	9,189	10,810	10,320
Average for the year	–	–	3,130	2,313	45,481	10,820
Acceptance of deposits:						
At 1 January	190,667	529,348	1,114,919	1,107,519	1,383,378	580,988
At 31 December	72,392	190,667	2,219,663	1,114,919	876,868	1,383,378
Average for the year	229,389	420,469	1,536,503	1,312,932	1,089,156	855,957
Other payables:						
At 1 January	9	16	385	1,039	20	1,940
At 31 December	–	9	1,383	385	2,452	20
Average for the year	40	34	914	414	733	66

No impairment allowances was made in respect of the above loans to and placements with related parties.

	The Company Ultimate holding company	
	2005	2004
	HK$'000	*HK$'000*
Other operating income	(1,000)	(998)

(b) *Key management personnel remuneration*

Remuneration for key management personnel, including amounts paid to the Company's directors as disclosed in note 11 and certain of the highest paid employee as disclosed in note 12, are as follows:

	The Group	
	2005	2004
	HK$'000	*HK$'000*
Short-term employee benefits	47,160	49,026
Post-employment benefits	2,545	2,721
Termination benefits	–	754
Share-based payments	2,627	2,138
	52,332	54,639

Total remuneration is included in "staff costs" (note 10).

(c) *Credit facilities to key management personnel*

During the year, the Bank provided credit facilities to key management personnel of the Bank and its holding companies and their close family members and companies controlled or significantly influenced by them. The credit facilities were provided in the ordinary course of business and on substantially the same terms as for comparable transactions with persons of a similar standing or, where applicable, with other employees.

	The Group	
	2005	2004
	HK$'000	*HK$'000*
Balance at 1 January	3,604	11,301
As at 31 December	18,100	3,604
Maximum amount during the year	24,865	21,061

(d) *Loans to officers*

Loans to officers of the Group disclosed pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

	The Group	
	2005	2004
	HK$'000	*HK$'000*
Aggregate amount of relevant loans made by the Group outstanding at 31 December	1,903	2,010
Maximum aggregate amount of relevant loans made by the Group outstanding during the year	2,670	2,630

There was no interest due but unpaid nor any provision made against these loans as at 31 December 2005.

52. Disposal of a Subsidiary

(a) Net liabilities disposed

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Cash and balances with banks and other financial institutions	–	9,198
Advances to customers and other accounts less provisions	–	1,003
Tangible fixed assets	–	794
Current taxation	–	(160)
Other accounts and provisions	–	(11,553)
Minority interests	–	179
Net liabilities	–	(539)
Net profit on disposal of a subsidiary	–	865
Total sales price received, satisfied in cash	–	326

(b) Analysis of net outflow of cash and cash equivalents in respect of the disposal of a subsidiary

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Cash consideration	–	326
Cash and balances with banks and other financial institutions	–	(9,198)
	–	(8,872)

53. Financial Risk Management

This section presents information about the Group's exposure to and its management and control of risks, in particular, the primary risks associated with its use of financial instruments:

– Credit risk: loss resulting from client or counterparty default and arises on credit exposure in all forms, including settlement risk.

– Market risk: exposure to market variables such as interest rates, exchange rates and equity markets.

– Liquidity and funding risk: the Group is unable to meet its payment obligations when due, or that it is unable, on an ongoing basis, to borrow funds in the market on an unsecured, or even secured basis at an acceptable price to fund actual or proposed commitments.

– Operational risk: risk arising from matters such as non-adherence to systems and procedures or from frauds resulting in financial or reputation loss.

The Group has established policies and procedures to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and limits continually by means of reliable and up-to-date management and information systems. The Group continually modifies and enhances its risk management policies and systems to reflect changes in markets, products and best practice risk management processes. The internal auditors also perform regular audits to ensure compliance with the policies and procedures.

(a) *Credit risk management*

Credit risk is managed by a regular analysis of the current and potential risk of loss arising from a customer's or counterparty's inability to meet financial obligations. The Group is exposed to credit risk through its lending, trading and capital markets activities. The Group defines the credit exposure to a customer as the amount of maximum potential loss arising from all these activities. These exposures include both on-and off-balance sheet transactions, including unfunded lending commitments such as loan commitments, letters of credit and financial guarantees.

Credit risk management is effected by monitoring implementation of adopted credit policies that determine the borrower's creditworthiness, credit risks classification, loan application procedure and procedures for lending decisions making. The Group applies the same credit policy in respect of contingent liabilities as in respect of financial instruments recorded on the balance sheet, based on loan approval procedures, use of limits to reduce risk and monitoring. Credit risk is also minimized by obtaining collateral in the form of pledged assets and guarantees from borrowers and third parties.

The Group's credit risk management practices are designed to preserve the independence and integrity of the risk assessment process. The Group assesses credit risk based upon the risk profile of the borrower, the source of repayment and the nature of the underlying collateral after giving consideration to current events and market developments. Credit risk is also managed at portfolio levels in terms of product, industry and geography to manage concentration risk.

Analysis of geographical concentration of the Group's asset is disclosed in note 18 and credit risk concentration of respective financial assets is disclosed in note 22 to 25 and 27 to 29.

(b) *Market risk management*

The Group's major market risk exposure rested with CITIC Ka Wah Bank Limited ("the Bank"), a wholly-owned subsidiary of the Company. Both short-term trading position and long-term strategic businesses inherit market risk exposures from the movements of foreign exchange rates, interest rates, equity prices and commodity prices.

To identify and control various market risk exposures, the Bank's Credit and Risk Management Committee ("CRMC"), Asset and Liability Management Committee ("ALCO") and its delegated sub-committees set up a hierarchy of limits and a series of risk measurements. Hierarchy limits are composed of policy, business and transaction limits to ensure adequate control from different management level. Each hierarchy level has a combination of profit and loss limits, position limits and sensitivity limits for specific market risk control.

The Bank's Treasury is the centre point to take on and manage market risk exposures within the prescribed hierarchy, product and specific risk limits.

Market Risk Management as the unit under Risk Management Group is responsible for the daily monitoring and reporting functions of market risk exposures to ensure that market risk exposures are within the prescribed limits and are managed properly.

Currency risk

The Group's foreign exchange risk stems from taking foreign exchange position, commercial dealing, investment in foreign currency securities, operations of overseas branches and subsidiaries. All foreign exchange positions are subject to exposure limits approved by ALCO.

Significant foreign currency exposures at the balance sheet date were as follows:

	The Group							
	2005				2004			
Equivalent in HK$'000	US dollars	Renminbi	Other	Total	US dollars	Renminbi	Other	Total
Spot assets	28,078,183	1,327,251	5,453,586	34,859,020	28,674,000	757,264	4,981,384	34,412,648
Spot liabilities	(31,167,025)	(549,815)	(5,084,950)	(36,801,790)	(30,836,628)	(134,181)	(4,656,405)	(35,627,214)
Forward purchases	16,617,043	104,658	3,758,734	20,480,435	7,309,008	–	2,629,869	9,938,877
Forward sales	(13,674,662)	(104,573)	(4,122,558)	(17,901,793)	(5,848,312)	–	(2,943,565)	(8,791,877)
Net options position	(179)	–	179	–	693	–	(693)	–
Net (short)/long position	(146,640)	777,521	4,991	635,872	(701,239)	623,083	10,590	(67,566)

	The Company							
	2005				2004			
Equivalent in HK$'000	US dollars	Renminbi	Other	Total	US dollars	Renminbi	Other	Total
Spot assets	145,175	1,105	–	146,280	144,455	1,080	–	145,535
Spot liabilities	(1,397,518)	(2,081)	(18)	(1,399,617)	(1,400,568)	(1,994)	(21)	(1,402,583)
Net short position	(1,252,343)	(976)	(18)	(1,253,337)	(1,256,113)	(914)	(21)	(1,257,048)

The net options position is calculated using the model user approach.

Interest rate risk

The interest rate risk for the Group comes mainly from the Bank. The Bank's ALCO oversees all interest rate risk arising from the interest rate profile of the Bank's assets and liabilities. This interest rate risk comprises of maturity gaps, basis risk among different interest rate benchmarks, yield curve movements, interest rate re-pricing risk and embedded options if any. ALCO reviews interest rate risk of the banking book through gap mismatch reports, sensitivity analysis and various stress testing. To mitigate interest rate risk, the Bank has used interest rate derivatives, mainly interest rate swaps, to hedge both assets and liabilities such as available-for-sale securities (AFS) and non-trading liabilities (NTL). The Bank has adopted hedge accounting principles to further mitigate interest rate risk by offsetting the fair value changes between the AFS/NTL securities and the corresponding hedging derivative instruments.

The following table indicates the range of effective average interest rates for the year ended 31 December for monetary financial instruments:

	The Group	
	2005	**2004**
	%	%
Assets		
Cash and balances with banks and other financial institutions & placements with banks and other financial institutions	0 - 4.40	0 - 2.17
Trade bills, advances to customers and other accounts	0 - 38.40	0 - 38.40
Securities *(Note)*	0 - 7.71	0 - 6.79
Liabilities		
Deposits and balances of banks and other financial institutions	0 - 4.34	0 - 1.82
Deposits from customers	0 - 7.35	0 - 6.63
Certificates of deposit issued, debt securities issued and loan capital	0.27 - 8.08	0.15 - 6.12

Note: Securities includes:

2005: Available-for-sale securities and held-to-maturity investments.

2004: Other investment in securities, held-to-maturity investments and investment securities.

Trading assets, trading liabilities and financial instruments designated at fair value through profit and loss are not included in the above table because the net income from these financial instruments comprise all gains and losses from changes in fair value (net of accrued coupon) together with interest income and expense and dividend income.

The following tables indicate 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 2005					
	Total	**3 months or less (include overdue)**	**3 months to 1 year**	**1 year to 5 years**	**Over 5 years**	**Non-interest bearing**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets						
Cash and balances with banks and other financial institutions	1,161,309	–	–	–	–	1,161,309
Placements with banks and other financial institutions	5,265,044	5,207,844	57,200	–	–	–
	6,426,353	5,207,844	57,200	–	–	1,161,309
Trade bills	406,364	281,559	124,805	–	–	–
Trading assets	6,473,029	1,933,197	12,574	602,017	77,318	3,847,923
Securities designated at fair value through profit or loss	1,139,908	–	227,164	808,188	82,190	22,366
Advances to customers and other accounts	44,108,183	37,568,804	3,350,754	445,252	309,234	2,434,139
Available-for-sale securities	5,945,960	–	–	4,013,971	1,767,051	164,938
Held-to-maturity investments	17,194,283	1,572,192	5,711,538	8,433,382	1,471,644	5,527
Non-interest bearing assets	3,342,598	–	–	–	–	3,342,598
Total assets	85,036,678	46,563,596	9,484,035	14,302,810	3,707,437	10,978,800

	The Group 2005					
	Total	3 months or less (include overdue)	3 months to 1 year	1 year to 5 years	Over 5 years	Non-interest bearing
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Liabilities						
Deposits and balances of banks and other financial institutions	4,157,446	3,816,248	15,000	–	–	326,198
Deposits from customers	54,415,279	51,846,176	831,864	160,833	–	1,576,406
Trading liabilities	661,137	217,904	–	–	–	443,233
Certificates of deposit issued	7,467,961	5,017,915	495,660	1,954,386	–	–
Debt securities issued	2,245,435	–	–	2,245,435	–	–
Convertible bond issued	1,289,817	–	–	1,289,817	–	–
Loan capital	4,352,351	–	2,335,961	–	2,016,390	–
Non-interest bearing liabilities	991,399	–	–	–	–	991,399
Total liabilities	75,580,825	60,898,243	3,678,485	5,650,471	2,016,390	3,337,236
Asset – liability gap		(14,334,647)	5,805,550	8,652,339	1,691,047	

	The Group 2004					
	Total	**3 months or less (include overdue)**	**3 months to 1 year**	**1 year to 5 years**	**Over 5 years**	**Non-interest bearing**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets						
Cash and balances with banks and other financial institutions	1,488,919	–	–	–	–	1,488,919
Placements with banks and other financial institutions	6,822,355	6,761,821	60,534	–	–	–
	8,311,274	6,761,821	60,534	–	–	1,488,919
Trade bills	246,081	234,660	11,421	–	–	–
Other investment in securities	4,043,467	1,277,661	311,449	5,311	4,064	2,444,982
Advances to customers and other accounts	43,323,300	37,576,823	2,926,661	382,551	329,547	2,107,718
Held-to-maturity investments	23,930,181	2,722,756	5,473,374	11,277,409	4,414,604	42,038
Investment securities	39,841	–	–	–	–	39,841
Non-interest bearing assets	3,683,213	–	–	–	–	3,683,213
Total assets	83,577,357	48,573,721	8,783,439	11,665,271	4,748,215	9,806,711
Liabilities						
Deposits and balances of banks and other financial institutions	3,555,852	3,470,174	–	–	–	85,678
Deposits from customers	55,451,727	52,991,856	1,125,563	62,470	–	1,271,838
Certificates of deposit issued	6,959,690	5,302,640	1,507,050	150,000	–	–
Debt securities issued	2,322,798	–	–	2,322,798	–	–
Convertible bond issued	1,399,384	–	–	1,399,384	–	–
Loan capital	4,275,896	–	–	2,332,307	1,943,589	–
Non-interest bearing liabilities	1,290,007	–	–	–	–	1,290,007
Total liabilities	75,255,354	61,764,670	2,632,613	6,266,959	1,943,589	2,647,523
Asset – liability gap		(13,190,949)	6,150,826	5,398,312	2,804,626	

All assets and liabilities of the Company are non-interest bearing, except an amount due from a subsidiary of HK$75,180,000 and an amount due to a subsidiary of HK$1,395,922,000, which would be repriced within 3 months and between 1 year to 5 years respectively.

(c) *Liquidity Risk Management*

The Group always maintains high liquidity ratio in order to meet unexpected increase of customer demand on cash. Apart from compliance with statutory ratio requirement, stress tests are being performed regularly. The Group invests its surplus fund in a portfolio of mainly high-grade securities, which can generate liquidity if necessary either through re-purchase arrangement or out-right selling in the secondary market. The Group is also active in wholesale funding by issuing long-term certificate of deposit so as to secure stable source of funding.

Analysis of assets and liabilities by remaining maturity

The following maturity profile is based on the remaining period at the balance sheet date to the contractual maturity date.

	The Group 2005						
	Total	**Repayable on demand**	**3 months or less but not repayable on demand**	**1 year or less but over 3 months**	**5 years or less but over 1 year**	**Over 5 years**	**Undated**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets							
Cash and balances with banks and other financial institutions	1,161,309	1,161,309	–	–	–	–	–
Placements with banks and other financial institutions	5,265,044	–	5,186,132	78,912	–	–	–
Trade bills	406,364	–	275,102	131,262	–	–	–
Trading assets	6,473,029	228,144	–	12,574	2,209,584	402,947	3,619,780
Securities designated at fair value through profit or loss	1,139,908	–	–	249,531	808,187	82,190	–
Advances to customers and other accounts	44,108,183	1,459,841	4,101,392	6,135,882	15,259,293	14,700,716	2,451,059
Available-for-sale securities	5,945,960	–	–	–	4,022,971	1,767,051	155,938
Held-to-maturity investments	17,194,283	–	640,998	5,774,696	8,802,617	1,969,999	5,973
Undated assets	3,342,598	–	–	–	–	–	3,342,598
Total assets	85,036,678	2,849,294	10,203,624	12,382,857	31,102,652	18,922,903	9,575,348

	The Group 2005						
	Total	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Liabilities							
Deposits and balances of banks and other financial institutions	4,157,446	326,198	3,816,248	15,000	–	–	–
Deposits from customers	54,415,279	12,260,248	40,494,422	1,429,019	231,590	–	–
Trading liabilities	661,137	443,233	217,904	–	–	–	–
Certificates of deposit issued	7,467,961	–	368,968	1,856,231	5,242,762	–	–
Debt securities issued	2,245,435	–	–	–	2,245,435	–	–
Convertible bond issued	1,289,817	–	–	–	1,289,817	–	–
Loan capital	4,352,351	–	–	–	–	4,352,351	–
Undated liabilities	991,399	–	–	–	–	–	991,399
Total liabilities	75,580,825	13,029,679	44,897,542	3,300,250	9,009,604	4,352,351	991,399
Asset – liability gap		(10,180,385)	(34,693,918)	9,082,607	22,093,048	14,570,552	

	The Group (restated) 2004						
	Total	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets							
Cash and balances with banks and other financial institutions	1,488,919	1,488,919	–	–	–	–	–
Placements with banks and other financial institutions	6,822,355	–	6,761,821	60,534	–	–	–
Trade bills	246,081	–	231,963	14,118	–	–	–
Other investments in securities	4,043,467	–	351	50,581	1,252,649	314,904	2,424,982
Advances to customers and other accounts	43,323,300	1,531,097	3,804,515	6,327,196	16,432,807	12,940,980	2,286,705
Held-to-maturity investments	23,930,181	–	1,265,909	5,778,954	11,715,008	5,128,272	42,038
Investment securities	39,841	–	–	–	–	4,000	35,841
Undated assets	3,683,213	–	–	–	–	–	3,683,213
Total assets	83,577,357	3,020,016	12,064,559	12,231,383	29,400,464	18,388,156	8,472,779

	The Group (restated) 2004						
	Total	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Liabilities							
Deposits and balances of banks and other financial institutions	3,555,852	85,678	3,470,174	–	–	–	–
Deposits from customers	55,451,727	22,023,352	32,125,086	1,085,817	217,472	–	–
Certificates of deposit issued	6,959,690	–	674,999	1,279,926	5,004,765	–	–
Debt securities issued	2,322,798	–	–	–	2,322,798	–	–
Convertible bond issued	1,399,384	–	–	–	1,399,384	–	–
Loan capital	4,275,896	–	–	–	–	4,275,896	–
Undated liabilities	1,290,007	–	–	–	–	–	1,290,007
Total liabilities	75,255,354	22,109,030	36,270,259	2,365,743	8,944,419	4,275,896	1,290,007
Asset – liability gap		(19,089,014)	(24,205,700)	9,865,640	20,456,045	14,112,260	

All assets and liabilities of the Company are undated, except an amount due from a subsidiary of HK$75,180,000 and an amount due to a subsidiary of HK$1,395,922,000 which would be matured within 3 months and between 1 year to 5 years respectively.

(d) *Operational risk management*

The Group manages its operational risk through the Management Committee at the Group level and the Operations & Control Committee at the Bank level. The Management Committee ensures that all the subsidiaries are operating properly and managed in accordance with pre-set risk policies and procedures of the respective subsidiaries. The Operations & Control Committee comprises the Chief Operating Officer as the chairman and other senior staff from various business lines and support functions. One of its key responsibilities is to periodically review, update, and test as necessary the operational policies, procedures and contingency plans of the Bank.

Operational risk is the risk of losses which the Group may incur as a result of inadequate or failed processes, technology, infrastructure, personnel or from external events. Operational risk is not new to banks. Significant operational risk events in recent years have highlighted the need to manage operational risk more effectively by taking a broader and more comprehensive view. Technology and operational issues remain critically important, but other areas, which could lead to operational losses, must be managed as well.

The Bank currently manages operational risk through a number of ways, such as:

– Operations and technology polices and manuals are developed and reviewed annually to ensure processes are adequately considered and defined.

– Human resources policy and practices are established to define and encourage proper staff behavior, and that staff are qualified and trained for their roles.

– New products and services are evaluated to ensure that staff, processes, and technology can adequately support prior to launching.

– Disaster recovery and business continuity plans are set up and tested annually for major events such as major failure of data centre caused by fire or other events; loss of operating site and sudden and massive customer withdrawal due to market rumors or other reasons.

54. Fair Value Information

(a) Estimation of fair values

Where available, the most suitable measure for fair value is the quoted and observable market prices. In the absence of such quoted and observable market prices for most financial instruments, and in particular for loans, deposits and unlisted derivatives, the fair values are estimated based on a range of methodologies and assumptions regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors. Changes in the uncertainties and assumptions could materially affect these estimates and the resulting fair value estimates.

(b) Fair value

All financial instruments are stated at fair value or carried at amounts not materially different from their fair values as at 31 December 2005 and 2004 unless otherwise stated.

(i) Financial assets

The Group's financial assets mainly include cash, placements with banks and other financial institutions, loans and advances to customers, investments and financial derivate instruments.

The fair values of placements with banks and other financial institutions are mainly priced at market interest rates and mature within one year. Accordingly, the carrying values approximate the fair values.

The fair values of loans and advances to customers, taking into account the relevant market interest rates and being mostly priced at floating rates close to the market interest rates which are mainly repriced within 3 months, equal their carrying amounts.

Trading assets, securities designated at fair value through profit or loss and available-for-sale securities are stated at fair value in the financial statements. The fair value of held-to-maturity investments approximate their carrying amounts.

(ii) Financial liabilities

The Group's financial liabilities mainly include deposits and balances of banks and other financial institutions, deposits from customers, certificates of deposit issued, debt securities issued, convertible bonds issued and loan capital issued. The carrying values of financial liabilities approximate their fair values as at 31 December 2005, except that the fair values of loan capital issued as at the balance sheet date was HK$4,613 million, which is higher than their carrying value of HK$4,352 million.

55. Derivatives

(a) Notional amounts of 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 derivatives entered into by the Group:

	The Group					
	2005			2004		
	Trading	Hedging	Total	Trading	Hedging	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts						
Forwards	18,941,850	–	18,941,850	2,637,254	–	2,637,254
Swaps	11,521,138	–	11,521,138	7,447,460	3,504,209	10,951,669
Options purchased	91,471	–	91,471	241,068	–	241,068
Options written	84,553	–	84,553	238,249	–	238,249
Interest rate contracts						
Forwards and futures	3,032,254	–	3,032,254	427,590	–	427,590
Swaps	6,897,921	12,074,747	18,972,668	3,570,070	11,615,697	15,185,767
Options purchased	1,298,984	–	1,298,984	1,671,487	–	1,671,487
Options written	1,298,984	–	1,298,984	1,849,231	–	1,849,231
Equity contracts						
Options purchased	–	–	–	–	1,083	1,083
Options written	–	–	–	–	1,083	1,083
	43,167,155	12,074,747	55,241,902	18,082,409	15,122,072	33,204,481

The above transactions are undertaken by the Group in the foreign exchange, interest rate and equity markets. The notional amounts of these instruments indicate the volume of transactions outstanding and do not represent amounts at risk.

Derivatives use for hedging purpose as at 31 December 2005 represented hedging instruments that were qualified for hedging accounting under HKAS 39.

Derivatives use for hedging purpose as at 31 December 2004 represented all derivatives that had an assets and liability management relationship. The conditions for using hedge accounting under HKAS 39 are not allowed to be applied retrospectively.

(b) Fair values and credit risk weighted amounts of derivatives

	The Group					
	2005			2004		
	Fair value		Credit risk weighted amount	Fair value*		Credit risk weighted amount
	Assets	Liabilities		Assets	Liabilities	
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Interest rate derivatives	157,286	387,765	74,175	268,774	383,276	105,037
Currency derivatives	70,858	55,468	85,145	119,554	127,623	66,096
Other derivatives	–	–	–	90	–	46
	228,144	443,233	159,320	388,418	510,899	171,179

* *Fair values information for 2004 represented 1 January 2005 restated figures.*

Credit risk-weighted amount refers to the amount as computed in accordance with the Third Schedule to the Hong Kong Banking Ordinance on capital adequacy and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% for contingent liabilities and commitments, and from 0% to 50% for exchange rate, interest rate and other derivatives contracts.

The fair values of derivative assets and liabilities and credit risk weighted amount of the off-balance sheet exposures do not take into account the effect of bilateral netting arrangements.

(c) *Fair value of derivatives designated as hedging instruments*

The following is a summary of the fair values of derivatives held for hedging purposes by product type entered into by the Group:

	The Group 2005	
	Assets	**Liabilities**
	HK$'000	*HK$'000*
Interest rate contracts	104,174	214,693

Fair value hedges

The fair value hedges are principally consisted of interest rate swaps that are used to protect against changes in the fair value of certain fixed rate assets or liabilities due to movements in the market interest rates.

(d) *Remaining life of derivatives*

The following tables provide 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 2005 Notional amounts with remaining life of			
	Total	**1 year or less**	**Over 1 year to 5 years**	**Over 5 years**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Interest rate derivatives	24,602,890	8,169,222	12,905,087	3,528,581
Currency derivatives	30,639,012	30,561,012	–	78,000
	55,241,902	38,730,234	12,905,087	3,606,581

	The Group 2004 Notional amounts with remaining life of			
	Total	**1 year or less**	**Over 1 year to 5 years**	**Over 5 years**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Interest rate derivatives	19,134,075	1,566,462	12,008,947	5,558,666
Currency derivatives	14,068,240	13,803,903	–	264,337
Equity/index derivatives	2,166	2,166	–	–
	33,204,481	15,372,531	12,008,947	5,823,003

56. Contingent Liabilities and Commitments

(a) Contingent liabilities and commitments to extend credit

The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments:

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Direct credit substitutes	958,516	943,362
Trade-related contingencies	1,058,462	1,165,944
Other commitments:		
– with an original maturity of under 1 year or which are unconditionally cancellable	12,846,765	10,576,584
– with an original maturity of 1 year or over	350,146	588,078
	15,213,889	13,273,968
Credit risk-weighted amounts	991,061	1,072,223

Contingent liabilities and commitments are credit-related instruments which include acceptance, letters of credit, guarantees and commitments to extend credit. The risk involved is essentially the same as the credit risk involved in extending loan facilities to customers. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. As the facilities may expire without being drawn upon, the contract amounts do not represent expected future cash flows.

The risk weights used in the computation of credit risk-weighted amounts range from 0% to 100%.

(b) Capital commitments

Capital commitments for purchase of equipment outstanding at 31 December not provided for in the financial statements were as follows:

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Authorised and contracted for:		
Fixed assets	16,610	8,534
Others	63,717	15,160
Authorised but not contracted for:		
Fixed assets	1,352	–
	81,679	23,694

(c) Lease commitments

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

	The Group	
	2005	**2004**
	HK$'000	*HK$'000*
Properties, leases expiring		
Within 1 year	67,092	29,700
After 1 year but within 5 years	134,059	43,441
After 5 years	78,409	18,728
	279,560	91,869
Equipment, leases expiring		
Within 1 year	739	847
After 1 year but within 5 years	2,943	5,655
After 5 years	–	1,029
	3,682	7,531

The Group leases a number of properties and items of equipment under operating leases. The leases typically run for an initial period of two to four years, with an option to renew the lease when all terms are renegotiated. None of the leases includes contingent rentals.

(d) Contingencies

The Group and its subsidiaries are not involved in any legal actions that would be material to the financial position of the Group.

57. Non-adjusting Post Balance Sheet Events

On 30 November 2005, the Group accepted a tender to sell Unit 9A on G/F, all units on 1/F, 2/F and 3/F and 8 car parking spaces on LG/F of Eastern Central Plaza at 3 Yiu Hing Road for a total consideration of HK$128.2 million. Subsequently, the Group entered into a Memorandum of Agreement for sale and purchase with the purchaser on 2 December 2005. The sale of the Property will be completed on 9 May 2006 (the "Completion Date"). As a result of the sale, a gain of approximately of HK$46 million for the sale will be recognised in the Group's income statement for the financial year ending 31 December 2006.

58. Trust Activities

The Group commonly acts as trustees and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. These assets and income arising thereon are excluded from these financial statements, as they are not assets of the Group.

59. Comparative Figures

Certain comparative figures have been adjusted as a result of the changes in accounting policies. Further details are disclosed in note 3.

60. Ultimate Holding Company

At 31 December 2005, the directors consider the ultimate holding company to be CITIC Group, which is incorporated in the People's Republic of China.

61. Accounting Estimates and Judgements

The preparation of financial statements 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 financial statements and the reported amounts of revenues and expenses for the years presented. Changes in assumptions may have a significant impact on the financial statements 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 financial statements 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 33 and 43 contain information about the assumptions and their risk factors relating to goodwill impairment, fair value of share options granted. Other key sources of estimation uncertainty are as follows:

(i) Impairment losses

Loans and advances

Loans portfolios are reviewed periodically to access whether impairment losses exist. The Group makes judgements 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 payments status of borrowers in a group has adversely changed. It may also include observable data in local or economic conditions that correlate with defaults on the assets in the Group. If management has determined, based on their judgement, that objective evidence of impairment exists, expected future cash flows are estimated based on historical loss experience for assets with credit risk characteristics similar to those of the Group. 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 equity investments

The Group determines that available-for-sale equity 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 cost is not recoverable within a reasonable time period is judgemental by nature, so profit and loss could be affected by differences in this judgement.

(ii) Fair value of financial instruments

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, quoted market prices are used. If a quoted price is not available on a recognized stock exchange or from a broker or dealer for non-exchange traded financial instruments or from a readily available latest trading price, the fair value is estimated using present value or other valuation techniques.

All valuation models are validated before they are used as a basis for financial reporting. Wherever possible, 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 judgements made regarding risk characteristics of various financial instruments, discount rate, estimates of future cash flows, future expected loss experience 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 be realized in an immediate sale of the instruments.

(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.

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 judgment, 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.

62. Possible Impact of Amendments, New Standards and Interpretations Issued but not Yet Effective for the Annual Accounting Year Ended 31 December 2005

Up to the date of issue of these financial statements, the HKICPA has issued the following amendments, new standards and interpretations which are not yet effective for the accounting year ended 31 December 2005 and which have not been adopted in these financial statements:

	Effective for accounting periods beginning on or after
HKFRS 6, Exploration for evaluation of mineral resources	1 January 2006
HK(IFRIC) 4, Determining whether an arrangement contains a lease	1 January 2006
HK(IFRIC) 5, Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds	1 January 2006
HK(IFRIC) 6, Liabilities arising from participating in a specific market – Waste electrical and electronic equipment	1 January 2006
Amendments to HKAS 19, Employee benefits – Actuarial Gains and Losses, Group Plans and Disclosures	1 January 2006
Amendments to HKAS 39, Financial instruments : Recognition and measurement:	
– Cash flow hedge accounting of forecast intragroup transactions	1 January 2006
– The fair value option	1 January 2006
– Financial guarantee contracts	1 January 2006
Amendments, as a consequence of the Hong Kong Companies (Amendment) Ordinance 2005, to:	
– HKAS 1, Presentation of financial statements	1 January 2006
– HKAS 27, Consolidated and separate financial statements	1 January 2006
– HKFRS 3, Business combinations	1 January 2006
HKFRS 7, Financial Instruments: disclosures	1 January 2007
Amendments to HKAS 1, Presentation of financial statements: Capital disclosure	1 January 2007

In addition, the Hong Kong Companies (Amendment) Ordinance 2005 came into effect on 1 December 2005 and would be first applicable to the Group's financial statements for the period beginning 1 January 2006.

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that:

– HKFRS 7 requires more detailed qualitative and quantitative disclosures, primarily in respect of fair values and risk management. The adoption of this standard is therefore only expected to affect the level of detail of the disclosures, and is not expected to have any financial impact nor result in any changes to the Group's accounting policies.

– The adoption of HKFRS 6 and HK(IFRIC) 5 and the amendments to HKAS 1, HKAS 27 and HKFRS 3 made as a result of the Hong Kong Companies (Amendment) Ordinance 2005 are not applicable to any of the Group's operations and that the adoption of the rest of them is unlikely to have a significant impact on the Group's results of operations and financial position.

63. Approval of Financial Statements

The financial statements were approved and authorised for issue by the Board of Directors on 9 March 2006.

3. MANAGEMENT DISCUSSION AND ANALYSIS

1.0 Background

The Company is the financial flagship of CITIC Group outside Mainland China. As at the Latest Practicable Date, the Company is approximately 56%-owned by CITIC Group. As at 31 December 2005, the Company's wholly-owned subsidiary, CITIC Ka Wah Bank Limited ("CKWB"), a Hong Kong incorporated licensed bank, accounted for approximately 92.0% of its profit before tax and 97.0% of its total assets; its wholly-owned asset management subsidiary, CITIC International Assets Management Limited ("CIAM"), which specialises in distressed asset management, direct investments and financial advisory services, accounted for approximately 3.2% of its profit before tax and 1.6% of its total assets; and its 50%-owned investment banking associate, CITIC Capital Holdings Limited (formerly known as CITIC Capital Market Holdings Limited hereinafter referred to as "CCHL"), which focuses on China-related merchant banking and investment management services, accounted for approximately 4.8% of its profit before tax and 1.4% of its total assets. The Group had 1,711 staff under its employment at 2005 year-end.

2.0 Strategy

As China becomes increasingly integrated into the global economies, international trade and capital markets, immense opportunities arise from the flourishing two-way cross-border trade business, investment and capital flows between China and the rest of the world. Moreover, as China prepares to fully liberalise its banking sector by the end of 2006, enormous potential will emerge for Chinese financial institutions that have clear strategic visions and distinct competitive edges to optimise domestic and international expansion opportunities. To that end, CITIC Group has been focusing on establishing itself as China's leading international financial services powerhouse with strong global linkages. As CITIC's offshore financial flagship, the Group's vision is to be the effective platform for CITIC's offshore expansion and to establish the CITIC financial services brand internationally.

Accordingly, the Group's priority in 2006 is to successfully execute the following strategies to support this vision, namely:

- to strengthen its expanded core competencies, improve the quality and performance of its core earnings and protect its asset quality;

- to deepen the synergistic collaboration between CKWB and CNCB in order to harness the extensive competitive strengths of the two sister commercial banks, and

- to play an integral role in the realignment of CITIC's cross-border investment banking and other financial service businesses.

3.0 Business Performance

The following business performance for the years ended 31 December 2003 and 2004 was prepared based on the figures before the adoption of the new HKFRS. It may not be directly comparable with the business performance for the year ended 31 December 2005.

3.1 Earnings

Year ended 31 December 2005

For the year ended 31 December 2005, the Group reported operating profit before impairment allowances of HK$876 million, representing a fall of 15.6% over 2004. This was mainly attributed to a 25.4% decline in net interest income, but was mitigated by the Group's continued strong growth in non-interest income at 27.9% over 2004. Prudent cost management also saw operating expenses decreased by 2.0%. Meanwhile, an improvement in asset quality and a reversal in collective assessment allowances led to a HK$58 million release in impairment allowances. The disposal of tangible assets during the year realised a net profit of HK$240 million, which included the HK$227 million gain from the sale of Ka Wah Bank Centre. The Group's share of profits from associates amounted to HK$46 million. After taking into account other items, the Group's profit attributable to shareholders for the year rose 22.1% over 2004 to HK$1,103 million.

Year ended 31 December 2004

The Group's operating profit before provisions for the year ended 31 December 2004 was HK$1,039 million, representing a rise of 3.3% over 2003. The growth in profit was attributed mainly to the substantial growth in non-interest income to HK$683 million, or an increase of 48.7% over 2003. An improvement in asset quality and write-backs of provisions led to a sharp fall in charges for bad and doubtful debts by 84.8%, which resulted in a 95.5% increase in operating profit after provision to HK$961 million. Unlike 2003 when the disposal of held-to-maturity securities realised a profit of HK$125 million, no similar activity took place during 2004. Share of profits and losses of associates was amplified this year with the Group's increased stake in CCHL from 25% to 50%; however, CCHL's core contribution was offset by the underperformance of the H-share and red chip portfolio of CITIC Capital Active Partner Fund Limited, resulting in a fall in net profit arising from associates by 56.5% to HK$76 million in 2004. However, after taking into account net profits arising from the disposal of tangible fixed assets, revaluation surplus on investment properties, provision written back on held-to-maturity securities, taxation and minority interests, the Group reported a record strong performance, with net profit attributable to shareholders rising a significant 37.3% to HK$901 million for the year.

Year ended 31 December 2003

The Group's operating profit before provisions for the year ended 31 December 2003 was HK$1,005 million, representing a fall of 11.4% from 2002. Due to improvements in the property market, the Group recorded HK$24 million in revaluation surpluses on its investment properties while profit from the sale of held-to-maturity securities more than doubled to HK$125 million. During the year, CKWB increased its interest in CITIC Capital Active Partner Fund Limited (formerly 'The Ka Wah Five Arrows China Hong Kong Fund Limited'). Due to the satisfactory performance of the fund and CCHL, net profit from associates rose sharply to HK$175 million. Net profit attributable to shareholders rose 21.9% to HK$657 million.

3.2 Net Interest Income

Year ended 31 December 2005

The Group's net interest income for 2005 fell 25.4% to HK$1,099 million. Under the new accounting standards and after adjusting for funding cost on fund investments, the Group's net interest margin stood at 1.80% at 2005 year-end, compared to 2.00% restated on same basis at 2004 year-end.

The decline in net interest income and net interest margin was attributed mainly to the adverse impact stemming from rising interest rates throughout the year. The adoption of the new accounting standards generated further negative impact.

Year ended 31 December 2004

As a result of pressures on loan yields arising from intense industry competition, the Group's interest income for 2004 suffered and dropped by 11.2%. Nevertheless, helped by the persistent low level of the Hong Kong Interbank Offered Rate, the Group was able to enjoy a substantial reduction in interest expenses of 20.1%. As a result, net interest income registered only a slight decrease, down by 5.6% over 2003 to HK$1,473 million. Add to that the enhancement in the Group's asset and liability management as well as improvements in funding mix, net interest margin contracted slightly by 3 basis points to 2.1%.

Year ended 31 December 2003

The Group's net interest income for 2003 amounted to HK$1,562 million, 7.0% below that of 2002, as a result of subdued loan demand amid a weak local economy and conservative lending policies by CKWB. Outstanding loans fell 5.5% to HK$40.6 billion while net interest margin contracted 20 basis points to 2.1%.

3.3 Non-Interest Income

Year ended 31 December 2005

The Group's non-interest income grew substantially by 27.9% over 2004 to HK$871 million. The growth was derived mainly from CKWB's retail banking business and its fund investments. The proportion of non-interest income to operating income rose significantly to 44.2% in 2005, up from 31.6% in 2004.

Year ended 31 December 2004

The Group's non-interest income grew substantially by 48.7% over 2003 to HK$683 million. This was derived mainly from retail banking fees and commissions (including wealth management services), fee income from corporate loans, income from investments, profits from foreign currency dealings, and commissions from trade bills. The proportion of non-interest income to operating income rose to 31.6%, up from 22.7% in 2003.

Year ended 31 December 2003

The Group's non-interest income fell 8.8% from the 2002 level to HK$459 million. This was due to the reduction of interests in CCHL and CITIC Capital Securities Limited from 51% to 25% in May 2002, resulting in their contribution no longer being consolidated at the subsidiary level. A reduction in new loans during the year also resulted in lower loan fees, which impacted on the overall non-interest income.

3.4 Operating Expenses

Year ended 31 December 2005

The Group's prudent cost control measures, coupled with the exclusion of goodwill amortisation under the new accounting standards, led to a decline of 2.0% in operating expenses to HK$1,095 million for 2005. Nevertheless, given the pressures on operating income, the Group's cost to income ratio rose to 55.6% in 2005 from 51.8% in 2004.

Year ended 31 December 2004

Operating expenses in 2004 reached HK$1,117 million, a 10.0% increase over 2003, due mainly to a 19.4% increase in staff costs and a one-time HK$47 million accelerated depreciation charge due to a change in accounting estimates on computer software and equipment. The sharp rise in staff costs was due to newly acquired subsidiary, changes in staff mix and sales and performance incentive plans. It should be noted, however, that with rigorous cost control measures by the Group, savings were achieved in numerous expense items; premises and equipment expenses before depreciation, in particular, fell 22.0% compared to 2003. Overall, the cost to income ratio (after goodwill) stood at 51.8%.

Year ended 31 December 2003

Operating expenses in 2003 fell 3.2% to HK$1,015 million. This was attributable to a reduction in staff costs, rental expenses, advertising and legal expenses.

3.5 Impairment Allowances

Year ended 31 December 2005

With the improvements in both the Hong Kong economy and property market, strong recoveries in bad debts and the partial benefit of a reversal in collective assessment allowances after the adoption of Hong Kong Accounting Standard 39, the Group recorded a HK$58 million release in impairment allowances in 2005, as compared to a charge of HK$78 million in 2004. Net additional provisions for individually assessed loans during the year amounted to HK$85 million, while net releases in provisions for collectively assessed loans totalled HK$44 million.

Year ended 31 December 2004

The Group lent conservatively and strived to maintain its asset quality. With the rebound in both the Hong Kong economy and property market, net specific provisions for retail and corporate loans registered a sharp decline of 84.6% and 67.5%, respectively, over 2003. Total specific provisions were reduced by over HK$363 million in 2004. Coupled with a HK$25 million net release in general provisions, the charge for bad and doubtful debts saw a sharp decline of 84.8% to HK$78 million in 2004.

Year ended 31 December 2003

The Group lent conservatively and strived to maintain its asset quality amid a weak economic environment. As a result, specific provisions fell 14.9% during the year while the charge for bad and doubtful debts dropped 4.8% to HK$514 million.

4.0 Asset Quality

The following analysis for the years ended 31 December 2003 and 2004 was prepared based on the figures before the adoption of the new HKFRS. It may not be directly comparable with the analysis for the year ended 31 December 2005.

4.1 Asset, Loan, and Deposit Sizes

Year ended 31 December 2005

As at 31 December 2005, the Group's total assets were HK$85.0 billion, representing a 1.7% increase from 2004 year-end. Total loans rose 1.0 % from the end of 2004 to HK$43.4 billion, driven mainly by a rise in residential mortgages, property investment lending, loans for use outside Hong Kong and trade finance. Total deposits were HK$61.9 billion, similar to the level at 2004 year-end.

Year ended 31 December 2004

At the end of December 2004, the Group's total assets reached HK$83.6 billion, representing an increase of 4.6% from 2003 year-end. Total loans rose 5.6% from the end of 2003 to HK$42.9 billion, due mainly to a rise in loans for use outside Hong Kong, transport and transport equipment, and trade finance. Total deposits grew by 1.4% from 2003 year-end to HK$62.4 billion, of which HK$55.5 billion were customer deposits, representing a 2.5% decline from the end of 2003.

Year ended 31 December 2003

As at 31 December 2003, the Group's total assets reached HK$79.9 billion, representing an increase of 4.9% from HK$76.2 billion recorded at the end of 2002. Total loans fell by 5.5% from the 2002 level to HK$40.6 billion, mainly due to a fall in residential mortgages, property investment, as well as transport and transport equipment loans. The proportion of Mainland loans to total customer advances increased from 10.5% in 2002 to 11.1%. Total deposits amounted to HK$61.6 billion, of which HK$56.8 billion were customer deposits, representing a 2.4% increase from 2002.

4.2 Asset Quality Indicators

Set out below is a table setting out the asset quality indicators of the Group for the 3 years ended 31 December 2005 and the restated asset quality indicators as at 1 January 2005.

	31 Dec 2005	**1 Jan 2005(3)**	**31 Dec 2004**	**31 Dec 2003**
Unadjusted capital adequacy(1)	16.0%	16.2%	15.9%	18.4%
Loans to deposits	70.1%	68.8%	68.8%	66.0%
Loans to total assets	51.0%	50.7%	51.4%	50.9%
Classified exposure	2.7%	5.4%	5.4%	8.11%
Impaired loans(2)	2.7%	5.4%	N/A	N/A
Impaired loan loss and collaterals over impaired loans(2)	92.7%	89.6%	N/A	N/A
Loan loss coverage(2)	48.6%	37.0%	N/A	N/A
Collectively assessed impairment allowance over gross loans(2)	0.68%	0.84%	N/A	N/A

(1) The unadjusted capital adequacy ratio is computed on the consolidated basis covering the Company and certain of its subsidiaries as required by the Hong Kong Monetary Authority for its regulatory purposes, and is in accordance with the Third Schedule to the Hong Kong Banking Ordinance.

(2) Calculated on the basis of the new accounting standards.

(3) Asset quantity indicators as at 1 January 2005 have been adjusted after the adoption of new HKFRS.

4.3 Deposits

Set out below is a table setting out more information in respect of the Group's deposits for the 3 years ended 31 December 2005.

Deposits*

		2005	2004	2003
1.	**By type**	**2005**	**2004**	**2003**
	Current	7.7%	18.4%	21.4%
	Savings	14.8%	21.3%	15.8%
	Fixed	77.5%	60.3%	62.8%
	Total	100.0%	100.0%	100.0%
2.	**By maturity**	**2005**	**2004**	**2003**
	On demand	22.6%	39.7%	37.2%
	Less than 3 months	74.4%	57.9%	60.1%
	Over 3 months but less than 1 year	2.6%	2.0%	2.4%
	Over 1 year but less than 5 years	0.4%	0.4%	0.3%
	Total	100.0%	100.0%	100.0%
3.	**By currency**	**2005**	**2004**	**2003**
	HKD	58.0%	59.1%	64.3%
	USD	32.4%	32.4%	26.3%
	Others	9.6%	8.5%	9.4%
	Total	100.0%	100.0%	100.0%
4.	**Number of deposit accounts**	**2005**	**2004**	**2003**
		247,808	234,296	224,582

* *Based on customer deposits only*

4.4 Loan Portfolio

Set out below is a table setting out the information in respect of the loan portfolio of the Group for the 3 years ended 31 December 2005.

Loan Portfolio#

1. By industry sectors	**2005**	**2004**	**2003**
Loans for use in Hong Kong			
Industrial, commercial and financial:			
Property development	1.0%	0.8%	0.8%
Property investment	11.7%	10.1%	10.6%
Financial concerns	5.5%	6.3%	6.7%
Stockbrokers	0.1%	0.1%	1.1%
Wholesale and retail trade	4.7%	4.7%	5.8%
Manufacturing	6.5%	7.9%	8.7%
Transport and transport equipment	9.9%	12.7%	11.3%
Others	7.2%	8.6%	9.3%
Individuals:			
Mortgage (Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme)	0.1%	0.1%	0.1%
Mortgage (other residential properties)	26.6%	24.6%	27.2%
Credit card advances	1.4%	1.3%	1.1%
Others	3.0%	2.7%	3.6%
Trade finance	6.5%	5.4%	5.2%
Loans for use outside Hong Kong	15.8%	14.7%	9.5%
Total	100.0%	100.0%	100.0%

2. By geographical spread	**2005**	**2004**	**2003**
Hong Kong	80.4%	80.7%	82.0%
China	15.2%	13.8%	11.8%
USA	1.8%	1.7%	1.5%
Others	2.6%	3.8%	4.7%
Total	100.0%	100.0%	100.0%

3.	By maturity	2005	2004	2003
	Repayable on demand	3.4%	3.6%	4.9%
	Less than one year	23.1%	23.7%	22.4%
	Over 1 year but less than 5 years	35.5%	38.5%	38.2%
	Over 5 years	34.2%	30.3%	29.5%
	Undated	3.8%	3.9%	5.0%
	Total	100.0%	100.0%	100.0%

4.	By currency	2005	2004	2003
	HKD	84.9%	84.0%	83.5%
	USD	14.5%	15.3%	16.1%
	Others	0.6%	0.7%	0.4%
	Total	100.0%	100.0%	100.0%

5.	Number of loan accounts	2005	2004	2003
		194,615	188,389	180,080

Excluding trade bills and advances to banks

5.0 The Group's new products and services introduced

Set out below is a table showing the new products and services introduced for the 3 years ended 31 December 2005.

	New products and services 2005	2004	2003
January	• Five-year HKD callable certificates of deposit • Three-year USD callable step-up certificates of deposit • Credit card "Enjoy Buy-One-Get-One-Free Offer With Your Sales Draft" spending programme • Credit card on-line bill payment double reward programme • Credit card acquisition campaign	• "HOPE Educator" life insurance plan • Credit Card acquisition campaign	• "DocPrep" export document preparation system services • "Dividend Payment Services"
February	• Credit card travel insurance plan • Dollar$mart personal instalment loan express approval	• "RMB+ China Linked Services" • "CEPA Desk" • Enhanced currency-linked deposit • Credit Card – up to five times "Gen-X" bonus points programme	• "NOW Account"
March	• Three-month USD yield enhancement deposit • NOW Account "Monthly Step-Up Bonus Interest Rate Offer" • Credit card "HK$500,000 Jackpot Sharing Programme" • Credit card,"Cash-In" programme • Earn double bonus points by settling second tax payment with credit card • Credit card balance transfer programme	• Principal-protected currency-linked deposit • Credit Card acquisition campaign • Credit Card spending promotion to redeem fabulous gifts at discounted instalment price	• Credit Card "Interest Free Flexi Instalment Plan" – 2% Cash Rebate promotion • "FUTURITY Guaranteed Interest Fund"

New products and services

	2005	2004	2003
April	• Two-year HKD callable step-up certificates of deposit • Dollar$mart revolving cash card programme	• Acted as placing bank for Hong Kong Link 2004 Limited retail bond • "WARMTH" retirement plan with annuity option • Credit Card "Statement Balance IFFI" programme	• Participated in SME Loan Guarantee Scheme – "Business Installations and Equipment Loans" and "Associated Working Capital Loans" • Participated in "Film Guarantee Fund"
May	• Three-year HKD callable step-up certificates of deposit • Three-year USD callable step-up certificates of deposit • "Guaranteed Retirement Income Plan" • "Business Instalment Loan And Overdraft" services • Credit card spending programme – up to 10 times cash rebate • Credit card personal line of credit	• Dollar$mart personal instalment loan • Fixed-rate mortgage loan • Credit Card "Non-Conventional IFFI" programme • Credit Card May spending promotion • "Customer Member-Get-Member" mortgage loan referral programme	• CITIC Ka Wah SEED Credit Card • Participated in Government's HK$3.5 billion Loan Guarantee Scheme for Severe Acute Respiratory Syndrome Impacted Industries
June	• Gold margin trading • Dual option i-banking two-factor authentication • Renminbi credit card and ATM card • Credit card on-line bill payment reward programme • Credit card acquisition campaign • Dollar$mart interest-free personal instalment loan programme	• Comprehensive range of mortgage plans • Relaunch of "NOW Account" • Acted as placing bank for the Hong Kong Mortgage Corporation Limited retail bond • CIFC launched export account receivable discounting with recourse to export insurance agency	• Enhanced "140% Mortgage Refinancing Service" • "ANNUITY 100 Retirement Plan" • SME Loan Guarantee Scheme – "Accounts Receivable Loans"

	New products and services		
	2005	**2004**	**2003**
July	• On-line time deposit placement promotion • Mortgage overdraft and top-up loan programme • "PowerOne Universal Life" insurance plan • Credit card "Travel And Dine" guaranteed-to-win lucky draw • 2.8% balance transfer new card programme	• HKD callable step-up CDs • Mortgage loan promotion (super gift plan) • Acted as placing bank for the HKSAR Government retail bond • Credit Card July spending promotion	• Factoring Services
August	• Yield enhancement deposit series 1: One-year AUD-linked deposit • Yield enhancement deposit series 2: One-year NZD-linked deposit • "GROWTH Plus" insurance plan • Home contents insurance plan • Credit card on-line bill payment lucky draw programme • Dollar$mart "Free Choice Skip Payment" instalment loan programme	• 95% Mortgage insurance programme • Travel insurance plan	• Credit Card "Reward Cash Rebate"
September	• Interest rate-linked structured deposit series 1: 2.5-year HKD and USD callable deposit • Yield enhancement deposit series 3: Six-month AUD-linked deposit • Ratio par forward FX swaps • Manulife investment solutions • e-Cert "Use More Get More" reward programme • Credit card "One Off Fee Instalment" cash-in plan	• USD callable step-up CDs • Commercial property mortgage promotion • Cross-border interacting trade settlement and financing • "BRIGHT" life insurance plan • Credit Card September spending promotion	• 'GROWTH Builder' life insurance plan • 'LIFE Savings Plus' life insurance plan • 'WARMTH' retirement plan • Credit Card usage spending promotion

New products and services

	2005	**2004**	**2003**
October	• Launch of CITIC*first* mass affluent wealth management services to existing customers • Interest rate-linked structured deposit series 2: Two-year-and-nine-month HKD and USD callable deposit • Yield enhancement deposit series 4: Six-month AUD-linked deposit • eIPO services • Credit card "Low Rate Cash-In" plan • Credit card double rewards new card programme • Credit card supplementary card acquisition programme	• Step-up time deposit • "BUSINESS NOW" and Business Credit Card • Dollar$mart Cash Card revolving loan • Credit Card Macau travel programme and "Octopus" automatic add-value service enrolment reward programme	• Non-Delivery Foreign Exchange Forward Contract • New wealth management system
November	• Value-added-tax invoice financing facility • Corporate tax loan • Yield enhancement deposit series 5: Nine-month CAD-linked deposit • Yield enhancement deposit series 6: Six-month CAD-linked deposit • Credit card Christmas guaranteed-to-win lucky draw • Credit card tax instalment plan • Dollar$mart tax loan	• Dollar$mart tax loan • Credit Card tax instalment plan • Credit Card Christmas and New Year offers	• "One Stop Business Support Services" • Pre-approved profit tax loan • Credit Card "Flexi-Instalment for Tax Payment"
December	• Yield enhancement deposit series 7: Nine-month AUD-linked deposit	• Fixed price equity-linked investment offers • The "Link REIT" refund cheque deposit/investment offer • "Grand Pacifica" preferential mortgage plan • Credit Card "Double Bonus Point" tax payment offers	• 'CITIC STAR' credit card in collaboration with CITIC Industrial Bank • Credit Card "Interest Free Instalment Cash-in Scheme" and "Easy Cash-in Scheme" • Credit Card Christmas spending gift redemption plan

6.0 Segmental Information

The following table sets out the unaudited segmental information of the Group by geographical area for the three years ended 31 December 2003, 2004 and 2005. The following segmental information are not prepared in accordance to Hong Kong Accounting Standard 14: Segment Reporting ("HKAS 14"). Should the following information be prepared in accordance to HKAS 14, the presentation and figures of the segmental information would have been different.

2005	Profit	Total assets	Total liabilities	Operating income	Contingent liabilities and commitments	Advances to customers	Overdue loans and advances	Impaired loans
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Hong Kong	1,156,927	83,788,186	74,545,299	1,878,501	14,514,746	34,536,529	473,722	507,111
Mainland China	28,509	2,060,081	1,381,984	36,844	71,978	6,534,622	541,945	541,945
USA	31,759	1,776,016	1,684,051	54,853	613,328	793,891	50,495	50,495
Others	(1,549)	612,632	614,181	453	13,837	1,096,655	–	71,288
Less: Inter-segment items	–	(3,200,237)	(2,644,690)	–	–	–	–	–
Total	1,215,646	85,036,678	75,580,825	1,970,651	15,213,889	42,961,697	1,066,162	1,170,839

2004	Profit	Total assets	Total liabilities	Operating income	Contingent liabilities and commitments	Advances to customers	Overdue loans and advances	Non-performing loans
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Hong Kong	1,041,901	83,004,397	74,656,840	2,103,648	12,921,806	34,431,875	1,314,119	1,235,995
Mainland China	9,769	690,143	322,158	16,684	–	5,899,197	596,904	596,904
USA	13,620	1,742,424	1,674,194	45,380	352,162	714,454	50,620	50,620
Others	–	466,479	466,479	–	–	1,627,189	363	363
Less: Inter-segment items	(10,558)	(2,326,086)	(1,864,317)	(10,686)	–	–	–	–
Total	1,054,732	83,577,357	75,255,354	2,155,026	13,273,968	42,672,715	1,962,006	1,883,882

2003	Profit	Total assets	Total liabilities	Operating income	Contingent liabilities and commitments	Advances to customers	Overdue loans and advances	Non-performing loans
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Hong Kong	758,747	78,513,770	66,434,778	1,978,831	13,167,998	32,971,478	1,920,762	1,889,711
Mainland China	152	413,576	27,173	3,882	–	4,738,547	568,987	570,993
USA	13,185	1,911,002	1,855,577	43,689	686,159	611,329	51,754	51,754
Others	–	354,100	354,100	–	–	1,864,819	109,531	103,750
Less: Inter-segment items	–	(1,274,991)	(835,854)	(5,543)	–	–	–	–
Total	772,084	79,917,457	67,835,774	2,020,859	13,854,157	40,186,173	2,651,034	2,616,208

7.0 Remuneration Policy and Staff Development

As at the end of 2005, the Group had 1,711 staff under its employment. As at the end of 2004, the Group had 1,657 staff in its employment and as at the end of 2003, the Group employed 1,488 staff. Management firmly believes that "people" are the critical factor that distinguishes an organisation and makes it successful. In order to attract talent and retain strong performers, it has been making continuous efforts to benchmark its remuneration structure in order to ensure its competitiveness compared to industry peers. All companies under the Group offer discretionary bonus schemes aimed at cultivating common goals among employees, driving individual performance, and generating results for the Group. All bonus schemes are in direct correlation to the Group's profitability, unit performance and individual contributions.

At a shareholder meeting held on 16 May 2003, the Group received approval to implement a new share option scheme and to simultaneously terminate the Senior Executive Share Option Scheme adopted in 1995.

8.0 Core Business Development

8.1 Commercial Banking Business – CITIC Ka Wah Bank Limited ("CKWB")

8.11 Background

CKWB aspires to be the bank of choice, with the best international standards and capabilities, by providing value-creating financial solutions to define and exceed both the wealth management and international business objectives of its Greater China and overseas customers. It operates 32 branches in Hong Kong and also has an established presence in China through its branches in Shanghai and Macau, its representative office in Beijing, and its wholly-owned finance company, China International Finance Company Limited (Shenzhen). CKWB's overseas branch network covers New York and Los Angeles. CKWB is rated "Baa2" by Moody's Investors Service and "BBB+" by Fitch Ratings.

8.12 Business Performance

8.121 Earnings

For the year ended 31 December 2005, CKWB reported operating profit before impairment allowances of HK$850 million, representing a fall of 18.7% over last year. This was mainly attributed to a 24.4% decline in its net interest income, but was mitigated by its strong non-interest income growth at 32.9% over 2004. Meanwhile, an improvement in asset quality and a reversal in collective assessment allowances led to a HK$80 million release in impairment allowances. The disposal of tangible assets during the year realised a net profit of HK$233 million, which included the HK$227 million gain from the sale of Ka Wah Bank Centre. After taking into account other items, CKWB's profit attributable to shareholders for the year rose 28.2% over 2004 to HK$1,047 million.

8.122 Net Interest Income

CKWB's net interest income for 2005 fell 24.4% to HK$1,101 million. Under the new accounting standards and after adjusting for funding cost on fund investments, CKWB's net interest margin stood at 1.82% at 2005 year-end, compared to 2.00% restated on same basis at 2004 year-end. The major factors attributing to the decline in CKWB's net interest income and the narrowing of its net interest margin are discussed in section 3.2.

8.123 Non-Interest Income

During the year, CKWB recorded a strong 32.9% growth in its non-interest income to HK$799 million as compared to 2004. This lifted the share of its non-interest income in its operating income to 42.0% in 2005 from 29.2% in 2004. The main contributor of this performance came from its Retail Banking Group which registered a 16.6% increase in non-interest income to HK$319 million. The other key contributor was its Fund Investments which more than doubled its income to nearly HK$230 million.

8.124 Operating Expenses

CKWB's operating expenses for 2005 rose by 3.7% year-on-year, primarily due to incremental rental expenses and the rise in staff costs. The former arose as a result of the sale and leaseback agreement of Ka Wah Bank Centre after CKWB disposed of the property as part of its office premise rationalisation plan. Its cost to income ratio rose to 55.2% in 2005 from 49.1% in 2004.

8.125 Impairment Allowances

Consistent with the asset quality trend of the Group, CKWB recorded a HK$80 million release in impairment allowances in 2005, as compared to a charge of HK$100 million in 2004. Net additional provisions for individually assessed loans during the year amounted to HK$58 million, while net releases in provisions for collectively assessed loans totalled HK$44 million.

8.13 Asset Quality

8.131 Asset, Loan, And Deposit Sizes

Total assets of CKWB amounted to approximately HK$81.8 billion as at 31 December 2005, representing a 1.9% increase over 2004 year-end. Total loans rose 1.5% to HK$43 billion on the back of increases in a rise in residential mortgages, property investment lending, loans for use outside Hong Kong and trade finance. Despite a slight 1.5% decline in customer deposits to HK$54.8 billion, total deposits stood at HK$62.3 billion, similar to the level at 2004 year-end.

8.132 Asset Quality Indicators

	31 Dec 2005	1 Jan 2005[3]	31 Dec 2004
Unadjusted capital adequacy[1]	16.4%	16.8%	16.5%
Average liquidity	51.1%	47.9%	47.9%
Loans to deposits	69.0%	67.6%	67.6%
Loans to total assets	52.5%	52.0%	52.7%
Classified exposure	1.9%	4.3%	4.3%
Impaired loans[2]	1.9%	4.3%	N/A
Impaired loans loss and collaterals over impaired loans[2]	87.8%	86.8%	N/A
Loan loss coverage[2]	50.9%	39.3%	N/A
Collectively assessed impairment allowance over gross loans[2]	0.69%	0.85%	N/A
Mainland loans to total loans	15.1%	13.6%	13.6%
Mortgage delinquency ratio	0.14%	0.34%	0.34%
Credit card charge-off ratio	1.4%	3.0%	3.0%

(1) The unadjusted capital adequacy ratio is computed on the consolidated basis covering CKWB and certain of its subsidiaries as required by the Hong Kong Monetary Authority for its regulatory purposes, and is in accordance with the Third Schedule to the Hong Kong Banking Ordinance.

(2) Calculated on the basis of the new accounting standards.

(3) Asset quality indicators as at 1 January 2005 have been adjusted after the adoption of new HKFRS.

8.14 Business Development

8.141 Retail Banking Group

In 2005, CKWB aggressively expanded the scope of its wealth management products and services. Its broad range of structured deposit product initiatives drew in HK$2.1 billion in total funding and attracted over 800 new customers as well as generated nearly HK$30 million in non-interest income. It introduced its new mass affluent wealth management platform, CITIC*first*, in October 2005 targeting customers with minimum net worth of HK$1 million. As at the end of April 2006, about 2,900 new and existing clients of CKWB have signed up for this new service offering.

CKWB also boasts a successful bancassurance business model with Sun Life Financial (Hong Kong) Limited and Manulife (International) Limited as its strategic partners. In 2005, CKWB achieved a year-on-year growth of over 28.7% in its bancassurance-related income.

In the area of credit cards, CKWB's total new sales increased by 21.4% year-on-year in 2005. This compared favourably to the industry's average growth rate at 17.0% as released by VISA International.

Both its mortgage and small- and medium-sized enterprise ("SME") businesses also delivered strong performances last year. Its market share in newly drawn-down mortgage loans was increased by 0.8% over 2004 while its total outstanding mortgage loans rose 9.7%. Outstanding loans to SMEs also grew 43.5% over 2004.

As at the end of March 2006, CKWB's retail banking group has continued to report strong business momentum, with a healthy improvement in net interest income underpinned by the widened Prime-HIBOR spread, and non-interest income growth supported by its continuous programme of new products and services campaigns.

8.142 Wholesale Banking Group

CKWB's Wholesale Banking Group ("WBG") took a strategic decision in 2005 to reposition its business model, with a clear focus to deepen client relationships and to enhance fee income generation capability by delivering value-added services rather than relying on lending as the core product. As part of this exercise, WBG upgraded its corporate and syndication capabilities, established a commercial real estate and structured finance team and launched CITIC Insurance Brokers Limited which is wholly-owned by CKWB. At the same time, it enhanced its capability to deliver treasury solutions to corporate customers.

Meanwhile, CKWB's Macau branch was officially opened in October 2005 to offer one-stop banking services to corporate customers as well as to further reinforce CKWB's geographic reach to service customers in the Pan Pearl River Delta region.

WBG's successful repositioning has already yielded encouraging results. Deal flows have significantly strengthened in the first quarter of 2006 and have already more than doubled that in 2005. The business group is well on track to deliver its goal of double-digit loan and fee income growth in 2006.

8.143 Treasury and Markets Group

CKWB's Treasury and Markets Group ("TMG") successfully established its in-house product manufacturing capability in structured products, and focused on building its distribution during the year by cross-selling to CKWB's retail and corporate customers. TMG is continuing its efforts to improve time-to-market with the introduction of new and innovative products, and have already launched a total of eight structured products via the retail banking channel in the first quarter of this year.

Meanwhile, its fund investments delivered stable year-on-year growth in 2005. Despite the market volatility in the first few months of 2006, the portfolio is still generating healthy positive returns on the back of careful asset allocation and vigilant performance monitoring.

8.144 China Banking

CKWB's China Banking business achieved a number of strategic breakthroughs in 2005. In June 2005, China International Finance Company Limited (Shenzhen) ("CIFC") received approval from the China Banking Regulatory Commission ("CBRC") to offer Renminbi services. Leveraging on the Renminbi licence, CIFC and CKWB are able to offer Renminbi services to its corporate clients as well as to individual clients who are non-Mainland citizens. They will also be able to extend such services to all Mainland citizens when China opens up its banking sector at the end of 2006. In July 2005, CIFC was granted a property insurance agency licence by the China Insurance Regulatory Commission. Subsequently in April 2006, CIFC also received approval from CBRC to prepare for an upgrade to bank status. It is expected that this new development will strengthen CKWB's foothold in the Pearl River Delta region and give it flexibility to develop various banking services in the mainland in due course.

Its Shanghai branch continued to be profitable in 2005, achieving outstanding balances of HK$849 million at the end of 2005. The branch was granted its derivative licence in April 2006. It is expected that this will enable CKWB to strengthen its collaboration with CNCB in the treasury services area as well as to leverage new opportunities with the introduction of the QDII (Qualified Domestic Institutional Investor) programme. The branch is also planning to apply for a Renminbi licence at the end of 2006.

Additionally, CKWB has received regulatory approval to prepare for the upgrade of its Beijing representative office to branch status. The Beijing branch is expected to open in the latter half of 2006.

In the area of strategic collaboration between CKWB and CNCB, both banks have established dedicated liaison teams to identify and tap joint business opportunities, and are planning to systematically develop an integrated product and services platform for their corporate clientele, and to build complementary competencies in customer resources, professional know-how, product range, service quality and risk management.

8.2 Asset Management Business – CITIC International Assets Management Limited ("CIAM")

CIAM began to operate independently in 2002, and is primarily responsible for managing distressed loans and assets as well as for allocating resources to earmark debt and equity investments.

In 2005, CIAM reported a consolidated operating profit before impairment allowances of HK$71.6 million and an operating profit of HK$57.3 million. Its net profit after tax amounted to HK$50.2 million.

During the year, CIAM successfully resolved over HK$150 million worth of problem loans, an achievement that was over 5.4 times that in 2004. This represented a 27.1% year-on-year reduction of its NPL balances, and resulted in a decline in the aggregate value of its problem loan assets to HK$370 million.

Although CIAM added few projects to its portfolio of direct investments and structured loans in 2005 due to its focus on consolidating its overall operations, the original debt and equity investment projects have successively started to generate interest income as well as handling fee and other incomes. Coming into the first quarter of 2006, the benign stock market environment in Hong Kong has benefited the performance of CIAM.

Meanwhile, CIAM continued to make progress in establishing strategic co-investment collaborations. Its co-investment entity in China, Shenzhen Guocheng Century Venture Capital Company Limited, was fully funded in early 2005 and has begun to expand its project investments. Separately, in the second half of 2005, CIAM has joined forces with Bahrain's Shamil Bank B.S.C. to develop for the first time a China real estate investment fund. Subscription monies are expected to be deployed starting from the second quarter according to projects' requirement.

8.3 Investment Banking Business – CITIC Capital Holdings Limited ("CCHL")

8.31 Background and Business Performance

CCHL is 50%-owned by the Group and 50% owned by CITIC Pacific Limited, and is principally engaged in investment banking, asset management and securities brokerage businesses. In 2005, activities in the IPO market for CCHL's target segment of mid- to low-cap enterprises stayed relatively lackluster throughout the year. Additionally, CCHL's investment performance was impeded by a volatile trading environment. As a result, CCHL reported a declined net profit after tax of HK$120 million in 2005. This represented 6.2% return on average equity employed, compared with 11.4% achieved in 2004.

Nevertheless, strong performance in the asset management area helped to bolster CCHL's foundation for further growth. Double-digit growth in both its private equity and hedge fund assets under management was registered in 2005. These two mainstream alternative investment products accounted for around 60% and 40% respectively of its total assets under management of approximately US$800 million at the end of December 2005, which continued with a strong growth momentum during the first quarter of 2006. A total of six China-focused private equity and hedge funds were launched during 2005 to broaden CCHL's product range and to offer more choices to investors, including a fund co-managed by CCHL and Allco, a renowned Australian financial services group, focusing on mezzanine and structured financing opportunities in Greater China, in particular Mainland China.

In the area of securities brokerage, CCHL continued to enhance its capabilities to serve corporate and institutional clients as well as to grow its high net-worth client base, and maintained its market share on the Hong Kong stock market during 2005 at a level similar to the previous year.

8.32 Contemplated Group Restructuring

More significantly for CCHL were its efforts to optimize opportunities that are emerging from the gradual convergence of capital markets in China and overseas, including Hong Kong. Accordingly, CCHL came up with a series of plans to realign its business mix based on its relative strength and synergies with other entities within the CITIC Group. These strategic plannings culminated in an announcement in January 2006 of its contemplated restructuring in two related moves.

Firstly, CCHL has signed a formal sales and purchase agreement in March 2006 with CITIC Securities Co., Ltd. ("CITIC Securities") to create an integrated, cross-border equities business platform. A new Hong Kong-based joint venture company, in which CITIC Securities will own an 80% stake and CCHL a 20% stake, will take over CCHL's existing equities business, including origination, equity capital markets, institutional and retail sales, equity research and related back office and support functions.

Secondly, CCHL intends to subscribe for a 35% interest in the enlarged share capital base of CITIC Trust & Investment Co., Ltd. ("CITIC Trust"), one of the leading trust companies in China. It is envisaged that the combined forces of CITIC Trust and CCHL will enable both companies to better exploit the high growth opportunities offered by an increasing demand for trust and other alternative investment products in China.

Upon the completion of these strategic moves, CCHL will focus on developing its principal businesses in the areas of private equity, asset management, corporate advisory and mezzanine and structured finance. The completion of the contemplated restructuring is subject to the necessary regulatory approvals, which are in the course of being processed by the relevant authorities in Mainland China and in Hong Kong.

9.0 Risk Management

The Group successfully revamped its risk grading system in 2005 and rolled out an expert judgement model that can quantitatively differentiate various levels of credit risk and subsequently calibrates probability of customer default. Sections of credit risk policy, product and investment risk underwriting, exposure control, management information systems and risk infrastructure were realigned into a portfolio risk management unit to take ownership of the new risk grading system.

The Group's market risk exposures come mainly from CKWB. CKWB has set up a hierarchy of limits that comprises policy, business and transaction limits, and has adopted advanced market risk techniques for Value-at-Risk calculation, stress-testing and back-testing of the trading book. It has successfully developed an effective hedge ratio testing method so that hedge accounting principles can be applied to offset the fair value changes in the Available-for-Sale securities or the Non-Trading Liabilities, and corresponding hedging derivative instruments like interest rate swaps can offset each other.

With the preparation done in the past few years for Basel II, the Group is ready to meet the requirements of the Standardised Approach by the end of 2006. A Basel II working committee was formed to coordinate credit risk, market risk and operational risk, implement necessary measures and institute system enhancements.

Meanwhile, the Group successfully implemented unique models for assessing impairment losses of financial assets in accordance with the requirements of sections 32 and 39 in the new Hong Kong Accounting Standards issued by HKICPA.

10.0 Future Prospect

The Group has built the infrastructure and a solid foundation in 2005 to support the transformational growth of its businesses going forward, enabling it to grasp the immense market opportunities that will arise from the implementation of China's 11th Five-Year Plan and from the country's formal accession into the World Trade Organisation.

Last year, while taking care to strengthen and expand its core businesses, the Group focused on establishing new competencies, especially in CKWB, in order to create new impetus to power the growth of its core performance and earnings capabilities going forward. The Group expects these efforts to start making an impact in 2006.

Meanwhile, in view of the increasingly convergent financial and capital markets in the Mainland and Hong Kong, the Group is collaborating with other CITIC Group financial institutions to develop cohesive partnership models. The proposed Acquisition represents an important step towards this goal, and will enable CITIC to harness the competitive strengths of its domestic and offshore commercial banking businesses.

The enhanced depth of collaboration between the Group and CNCB and the strength of CNCB's operations in the PRC will offer a unique platform for the Group to invest into the growth opportunities in the PRC banking sector. It will also improve the Group's service capability and its ability to provide "one-stop" solutions to Greater China and overseas customers who are active in cross-border business and trade with the PRC.

Where the Group is currently constrained by its scale to enter into certain product areas, information technology and personnel investments, the proposed Acquisition will allow the Group to benefit from economies of scale to expand capabilities in business and product developments. The expanded platform and additional development opportunities from the strengthened ties between the two banks will enable the Group to better attract and retain top talents. Additionally, the sharing of expertise and know-how with CNCB will deepen the Group's knowledge in developing business and relationships in China, while the management best practices already established by the Group will help to raise CITIC's combined banking businesses to international standards.

4. INDEBTEDNESS

As at 31 May 2006, the Group had the following indebtedness:

(a) HK$2,214 million of debt securities issued, representing 4.25% per annum notes with face value of US$300 million issued at discount on 17 November 2004. The notes were issued by CKWB and constitute direct, unconditional and unsecured obligations of CKWB. The notes will mature on 17 November 2009.

(b) HK$1,305 million of convertible bonds issued by CIFH (CB-I) Limited, a single purpose wholly-owned subsidiary of the Company, issued at 0.25% per annum with face value of US$180 million on 8 December 2003. The Company unconditionally and irrevocably guarantees all amounts payable under the convertible bonds.

Each convertible bond, at the option of the holder, is convertible on or after 18 January 2004 upto and including 8 November 2008 into fully paid ordinary shares with a par value of HK$1.00 of the Company at an initial conversion price of HK$4.269 per share. The convertible bonds can be redeemed at their principal amount together with accrued interest on 8 December 2008. The net proceeds from the issue of the convertible bonds have been used for general corporate purposes of the Group.

(c) HK$4,279 million of loan capital representing 7.625% per annum subordinated notes with face value of US$300 million issued on 5 July 2001 and 9.125% per annum perpetual subordinated notes with face value of US$250 million issued on 23 May 2002. The notes were issued by CKWB (Cayman Islands) Ltd and CKWH-UT2 Ltd respectively, two separate single purpose wholly-owned subsidiaries of CKWB and qualify as tier 2 capital. CKWB unconditionally and irrevocably guarantees all amounts payable under the notes. The 7.625% per annum subordinated notes will mature on 5 July 2011 whereas the 9.125% per annum perpetual subordinated notes will be callable by the CKWH-UT2 Ltd. in 2012.

(d) HK$41 million of notes issued representing 1 year USD Tracker Extensible Notes linked to CITIC Capital China Plus Fund with face value of US$5.3 million issued at par on 31 March 2006. The notes were issued by CKWB-SN Limited, a separate single purpose wholly-owned subsidiary of the Group. CKWB unconditionally irrevocably guarantees all amounts payable under the notes. The notes will mature on 17 May 2007 subject to the extended maturity option of the note holders to extend the final maturity date to 14 May 2009.

(e) borrowings from banks and money market takings from banks and other financial institutions, deposits from customers and certificates of deposits that arose from the normal course of our banking business carried mainly by CKWB, which is a wholly-owned subsidiary of the Company.

(f) direct credit substitutes, transaction-related contingencies, trade-related contingencies and other commitments that arose from the normal course of banking business carried mainly by CKWB.

Except as otherwise disclosed in this circular, we did not have, as at 31 May 2006, any outstanding mortgages, charges, debentures or other loan capital (issued or agreed to be issued), bank overdrafts, loans, liabilities under acceptance or other similar indebtedness, hire purchase and finance lease commitments or any guarantees or other material contingent liabilities.

5. WORKING CAPITAL

Rules 14.69(2) and 14.66(2) of the Listing Rules require a circular in relation to a very substantial acquisition to contain a statement by the Directors that, in their opinion, the working capital available to the Group is sufficient, or if not, how it is proposed to provide the additional working capital thought by the Directors to be necessary. The Company is of the view that the traditional concept of "working capital" does not apply to banking businesses including the business of the Group. CKWB is regulated by the HKMA and is required to meet minimum capital adequacy and liquidity requirements under the Banking Ordinance and requirements on the capital adequacy ratio under the guidelines issued by the HKMA. In addition, the Group is required to and has been regularly reporting its capital adequacy requirements to the HKMA. The Company has applied to the Stock Exchange for a waiver from the strict compliance with the requirements of Rules 14.69(2) and 14.66(2) in relation to the requirement of this circular to contain a statement by the Directors that, in their opinion, the working capital available to the Group is sufficient, or if not, how it is proposed to provide the additional working capital thought by the Directors to be necessary.

6. MATERIAL ADVERSE CHANGES

As at the Latest Practicable Date, the Directors were not aware of any material adverse change in the financial or trading position of the Group since 31 December 2005 (being the date to which the latest published audited financial statements of the Company were made up).

1. ACCOUNTANTS' REPORT ON CHINA CITIC BANK

(established in the People's Republic of China)

KPMG

8th Floor
Prince's Building
10 Chater Road
Central
Hong Kong

30 June 2006

The Board of Directors
CITIC International Financial Holdings Limited
Suites 1801-1802
Bank of America Tower
12 Harcourt Road
Central
Hong Kong

Dear Sirs,

Introduction

We set out below our report on the financial information relating to China CITIC Bank ("the Bank") and its subsidiaries (collectively the "Group"), in Sections I to V, including the consolidated balance sheets of the Group as at 31 December 2003, 2004 and 2005, balance sheets of the Bank as at 31 December 2003, 2004 and 2005 and related consolidated income statements, consolidated statement of changes in equity and consolidated statements of cash flows of the Group for each of the years ended 31 December 2003, 2004 and 2005 (the "relevant periods") and the notes thereto (collectively the "Financial Information"), for inclusion in the circular of CITIC International Financial Holdings Limited ("CIFH") dated 30 June 2006 (the "Circular") in connection with the proposed acquisition of 19.9% interest in the Bank.

The Bank is a state-owned financial institution established in the People's Republic of China (the "PRC" or "Mainland China"), excluding for the purpose of this report, the Hong Kong Special Administrative Region of the PRC, or Hong Kong, the Macau Special Administrative Region of the PRC, or Macau and Taiwan. The registered office of the Bank is located at Block C, Fuhua Mansion, 8 Chaoyangmen Beidajie, Dongcheng District, Beijing, the PRC.

As a state-owned financial institution, the Bank prepared its financial statements for the years ended 31 December 2003 and 2004 in accordance with the Accounting Standards for Business Enterprises, the Accounting Regulations for Financial Enterprises (jointly issued by the Ministry of Finance of the PRC (the "MOF") and the People's Bank of China (the "PBOC") in 1993) and other relevant regulations issued by the MOF (collectively "Previous PRC GAAP") and prepared its financial statements for the year ended 31 December 2005 in accordance with the Accounting Standards for Business Enterprises, the

Accounting Regulations for Financial Enterprises (issued by the MOF in 2001) and other regulations issued by the MOF (collectively named as "PRC GAAP"). These statutory financial statements were audited by Shine Wing Certified Public Accountants, a firm of professional accountants registered in the PRC. The Group also prepared a set of its consolidated financial statements for the year ended 31 December 2005 in accordance with International Financial Reporting Standards ("IFRS") and its interpretations promulgated by the International Accounting Standards Board ("IASB").

China Investment and Finance Limited ("CIFL") is a principal subsidiary of the Bank during the relevant periods. Throughout the relevant periods, Deloitte Touche Tohmatsu have acted as auditors of CIFL.

No financial statements of the Group have been prepared and audited subsequent to 31 December 2005.

Basis of preparation

The Financial Information has been prepared by the Directors of the Bank in accordance with IFRS and its interpretations promulgated by the International Accounting Standards Board based on the audited statutory financial statements of the Bank and its subsidiaries. Adjustments have been made, for the purpose of this report, to restate the statutory financial statements of the Bank and its subsidiaries in accordance with the basis set out in section V to conform with IFRS and the disclosure requirements of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited.

Responsibility

The Directors of the Bank are responsible for preparing the Financial Information which gives a true and fair view. In preparing the Financial Information which gives a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently that judgments and estimates are made which are prudent and reasonable and that reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on the Financial Information.

Basis of opinion

As a basis for forming an opinion on the Financial Information of the Group, for the purpose of this report, we have carried out appropriate audit procedures in respect of the Financial Information for the relevant periods in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") and have carried out such procedures as we considered necessary in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountants" issued by the HKICPA.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Information. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the Financial Information, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the Financial Information is free from material misstatement. In forming our opinion, we also evaluated the overall adequacy of the presentation of the Financial Information. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, for the purpose of this report, all adjustments considered necessary have been made and the Financial Information gives a true and fair view of the state of affairs of the Group as at 31 December 2003, 2004 and 2005 and of its consolidated results and consolidated cash flows for each of the three years ended 31 December 2003, 2004 and 2005 and the state of the affairs of the Bank as at 31 December 2003, 2004 and 2005 and have been properly prepared in accordance with IFRS.

I Consolidated income statements

For the year ended 31 December
(Expressed in millions of Renminbi unless otherwise stated)

	Note	**2003**	**2004**	**2005**
Interest income		12,967	17,795	22,511
Interest expense		(5,294)	(7,412)	(9,851)
Net interest income	*3*	7,673	10,383	12,660
Fee and commission income	*4*	353	449	608
Fee and commission expense		(88)	(131)	(190)
Net fee and commission income		265	318	418
Dividend income		–	1	1
Net profit on disposal of fixed assets		1	11	12
Net gain from trading securities	*5*	124	34	109
Net (loss)/gain from investment securities	*6*	(92)	11	(24)
Net gain arising from foreign currency dealing		151	227	266
Other operating income		246	161	213
Operating income		8,368	11,146	13,655
General and administrative expenses	*7*	(3,940)	(5,451)	(7,104)
Impairment losses charge	*8*	(2,145)	(1,634)	(1,098)
Profit before taxation		2,283	4,061	5,453
Income tax	*12*	(862)	(1,633)	(2,369)
Net profit		1,421	2,428	3,084
Attributable to:				
Equity owner of the Bank		1,419	2,427	3,083
Minority interests		2	1	1
Net profit		1,421	2,428	3,084

II Consolidated balance sheets

As at 31 December
(Expressed in millions of Renminbi)

	Note	**2003**	**2004**	**2005**
Assets				
Cash and balances with central bank	*14*	49,299	54,253	84,453
Amounts due from banks and other financial institutions	*15*	31,848	20,899	31,352
Loans and advances to customers	*16*	240,539	291,921	358,030
Investments	*17*	58,403	110,903	104,416
Property and equipment	*18*	6,826	8,090	8,614
Deferred tax assets	*19*	5,999	5,424	4,082
Other assets	*20*	3,903	3,955	3,655
Total assets		396,817	495,445	594,602
Liabilities				
Amounts due to central bank		3,921	300	240
Amounts due to banks and other financial institutions	*21*	37,600	38,190	28,021
Deposits from customers	*22*	345,356	435,020	530,573
Current tax liabilities		914	1,052	1,132
Deferred tax liabilities	*19*	74	–	71
Other liabilities and provisions	*23*	3,550	4,120	5,340
Subordinated debts issued	*25*	–	6,000	6,000
Total liabilities		391,415	484,682	571,377
Equity				
Owner's capital	*26*	14,032	17,790	26,661
Reserves	*26*	(8,633)	(7,031)	(3,441)
Minority interests		3	4	5
Total equity		5,402	10,763	23,225
Total equity and liabilities		396,817	495,445	594,602

II Balance sheets of the Bank

As at 31 December
(Expressed in millions of Renminbi)

	Note	2003	2004	2005
Assets				
Cash and balances with central bank		49,298	54,248	84,452
Amounts due from banks and other financial institutions		32,406	21,439	31,813
Loans and advances to customers		240,375	291,810	357,985
Investment		57,970	110,421	103,933
Investments in subsidiaries	*1(c)*	33	33	33
Property and equipment		6,801	8,066	8,589
Deferred tax assets		5,999	5,424	4,082
Other assets		3,893	3,946	3,647
Total assets		396,775	495,387	594,534
Liabilities				
Amounts due to central bank		3,921	300	240
Amounts due to banks and other financial institutions		37,600	38,190	28,021
Deposits from customers		345,356	435,020	530,573
Current tax liabilities		914	1,052	1,132
Deferred tax liabilities		73	–	71
Other liabilities and provisions		3,546	4,113	5,332
Subordinated debts issued		–	6,000	6,000
Total liabilities		391,410	484,675	571,369
Equity				
Owner's capital		14,032	17,790	26,661
Reserves		(8,667)	(7,078)	(3,496)
Total equity		5,365	10,712	23,165
Total equity and liabilities		396,775	495,387	594,534

III Consolidated statement of changes in equity

For the year ended 31 December
(Expressed in millions of Renminbi)

	Note	Owner's capital	Investment revaluation reserve	Properties revaluation reserve	Retained earnings	Minority interests	Total equity
As at 1 January 2003		6,809	295	1,179	(10,591)	1	(2,307)
Capital injection and capitalisation of earnings	26	7,223	–	–	(1,223)	–	6,000
Net profit		–	–	–	1,419	2	1,421
Net change in fair value of available-for-sale investments		–	(9)	–	–	–	(9)
Realised on disposal of available-for-sale investments		–	(119)	–	–	–	(119)
Revaluation gain of bank premises		–	–	416	–	–	416
Transfer of revaluation gain realised through disposal		–	–	(1)	1	–	–
As at 31 December 2003		14,032	167	1,594	(10,394)	3	5,402
Capital injection and capitalisation of earnings	26	3,758	–	–	(1,258)	–	2,500
Net profit		–	–	–	2,427	1	2,428
Net change in fair value of available-for-sale investments		–	(174)	–	–	–	(174)
Realised on disposal of available-for-sale investments		–	(2)	–	–	–	(2)
Revaluation gain of bank premises		–	–	609	–	–	609
Transfer of revaluation gain realised through disposal		–	–	(10)	10	–	–
As at 31 December 2004		17,790	(9)	2,193	(9,215)	4	10,763

	Note	Owner's capital	Investment revaluation reserve	Properties revaluation reserve	Retained earnings	Minority interests	Total equity
Capital injection and capitalisation of earnings	*26*	8,871	–	–	(271)	–	8,600
Net profit		–	–	–	3,083	1	3,084
Net change in fair value of available-for-sale investments		–	138	–	–	–	138
Realised on disposal of available-for-sale investments		–	52	–	–	–	52
Revaluation gain of bank premises		–	–	588	–	–	588
Transfer of revaluation gain realised through disposal		–	–	(9)	9	–	–
As at 31 December 2005		26,661	181	2,772	(6,394)	5	23,225

IV Consolidated cash flow statement

For the year ended 31 December
(Expressed in millions of Renminbi)

	Note	**2003**	**2004**	**2005**
Operating activities				
Profit before taxation		2,283	4,061	5,453
Adjustments for:				
– Revaluation gain on investments and derivatives		(19)	(5)	(83)
– Net gain on disposal of fixed assets		(1)	(11)	(12)
– Unrealised foreign exchange gain		(24)	(1)	(119)
– Impairment losses		2,145	1,634	1,098
– Depreciation and amortisation		600	579	681
– Interest expense on subordinated debts issued		–	136	298
		4,984	6,393	7,316
Changes in operating assets and liabilities:				
Increase in balances with central bank		(1,792)	(5,774)	(32,797)
(Increase)/decrease in amounts due from banks and other financial institutions		(2,365)	5,883	(5,979)
Increase in loans and advances to customers		(62,504)	(52,971)	(67,164)
Decrease/(increase) in other operating assets		1,288	(9,235)	5,065
Increase/(decrease) in amounts due to central bank		1,596	(3,621)	(60)
Increase/(decrease) in amounts due to banks and other financial institutions		1,173	590	(10,169)
Increase in deposits from customers		73,258	89,664	95,553
Income tax paid		(915)	(902)	(964)
Increase in other operating liabilities		360	229	1,549
Net cash flows from operating activities		15,083	30,256	(7,650)

	Note	2003	2004	2005
Investing activities				
Proceeds from disposal and redemption of investments		69,859	97,221	212,481
Proceeds from disposal of property and equipment, land use rights, and other assets		90	385	476
Payments on acquisition of investments		(83,807)	(123,666)	(207,956)
Payments on acquisition of property and equipment, and land use rights		(562)	(390)	(670)
Net cash used in investing activities		(14,420)	(26,450)	4,331
Financing activities				
Proceeds from capital injection		6,000	2,500	8,600
Interest paid on subordinated debts issued		–	(14)	(285)
Proceeds from debts issue		–	6,000	–
Net cash from financing activities		6,000	8,486	8,315
Net increase in cash and cash equivalents		6,663	12,292	4,996
Cash and cash equivalents as at 1 January		46,894	53,621	66,335
Effect of exchange rate changes on cash held		64	422	(1,201)
Cash and cash equivalents as at 31 December	*28*	53,621	66,335	70,130
Cash flows from operating activities include:				
Interest received		11,111	15,646	19,565
Interest paid, excluding interest expense on subordinated debts issued		(5,158)	(6,863)	(9,141)

V Notes to the Financial Information

(Expressed in millions of Renminbi unless otherwise stated)

1. Background and principal activities

(a) Background

China CITIC Bank (previously known as "CITIC Industrial Bank") was established on 7 April 1987, as a state-owned financial institution with a registered capital of RMB800 million in accordance with the notice, Guo Ban Han [1987] No. 14 "Approval on the incorporation of CITIC Industrial Bank" issued by the General Office of the State Council and the notice, Yin Fa [1987] No.75 "Notice to the incorporation of CITIC Industrial Bank" issued by the PBOC. The Bank holds the business licence of No.1000001000600 issued by the State Administration for Industry and Commerce and the financial business licence of No. B10611000H0001 issued by the China Banking Regulatory Commission (the "CBRC").

The Bank is wholly owned by the CITIC Group Company (or the "CITIC Group"), which was previously known as China International Trust and Investment Corporation. The name of the Bank was changed to China CITIC Bank on 2 August 2005.

(b) Principal activities

The principal activities of the Bank and its subsidiaries are the provision of corporate and personal banking services, conducting treasury business and corresponding banking business, and the provision of asset management, entrusted lending and custodian services.

As at 31 December 2005, the Bank had established branches and sub-branches in 18 provinces and municipalities directly under the central government in the PRC.

(c) Details of its subsidiaries

The particulars of the Bank's principal subsidiary as at 31 December 2005 are set out below. The results and affairs of its subsidiaries have been consolidated into the Financial Information of the Group.

Name of the company	Place of incorporation and operation	Particulars of the issued and paid up capital	% of ownership directly held by the Bank	Principal activities
CIFL	Hong Kong	250,000 shares of HK$100 each	95%	Money lending

2. Significant accounting policies

(a) Statement of compliance

The Financial Information has been prepared in accordance with IFRS and its interpretations promulgated by the IASB, and the disclosure requirements of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted and consistently applied by the Group in the preparation of the Financial Information is set out below.

All IFRS in issue which are relevant to the Group have been applied, except for IFRS 7 Financial Instruments: Disclosures ("IFRS 7") and the amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures ("IAS 1 Amendment") both of which were issued in August 2005 and are effective for the period beginning 1 January 2007.

IFRS 7 requires more detailed qualitative and quantitative disclosures primarily on fair value information and risk management. The Group has assessed the impact of IFRS 7 and concluded that IFRS 7 would only affect the level of details in the disclosure of the financial statements, and would not have financial impact nor result in a change in the Group's accounting policies.

The Group has concluded that the disclosures required by IAS 1 Amendment on how the Group manages its capital and complies with external capital requirements would not have any financial impact nor result in a change in the Group's accounting policies.

(b) Basis of preparation of the Financial Information

The Financial Information is presented in Renminbi ("RMB"), which is the Group's functional and presentation currency, rounded to the nearest million.

The Financial Information is prepared using the historical cost basis, except for the following assets and liabilities which are stated at their fair value: financial assets and financial liabilities at fair value through profit or loss and available-for-sale assets, except those for which a reliable measure of fair value is not available; and property.

The preparation of the Financial Information in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and other factors that are believed to be reasonable under the circumstances. The results of such estimates and assumptions form the basis of judgments 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 on-going basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years.

Judgments made by management in the application of IFRS that have significant effect on the Financial Information and estimates with a significant risk of material adjustment in the subsequent period are discussed in Note 36.

(c) Basis of consolidation

The consolidated Financial Information includes the Financial Information of the Bank and its subsidiaries. Subsidiaries are those enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operational policies of an enterprise so as to obtain benefits from its activities. The results and affairs of subsidiaries are included in the consolidated Financial Information from the date that control commences until the date that control ceases.

Investments in controlled subsidiaries are consolidated into the consolidated Financial Information 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 Financial Information. 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 at the balance sheet date, being the portion of the net assets of subsidiary attributable to equity interests that are not owned by the Bank, whether directly or indirectly through subsidiary, are presented in the consolidated balance sheet and consolidated statement of changes in equity within equity, separately from equity attributable to the equity owner of the Bank. 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 or loss for the year between minority interests and the equity owner of the Bank.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed to the Group has been recovered.

In the Bank's balance sheet, investments in subsidiaries are stated at cost less allowances for impairment losses.

(d) *Foreign currency translations*

Transactions in foreign currencies are translated into Renminbi at the foreign exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the foreign exchange rates ruling at that date. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated using the foreign exchange rates at the date of the transaction. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated using the foreign exchange rates at the date the fair value is determined. When the gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss is recognised directly in equity, all other foreign exchange differences arising on settlement and translation of monetary and non-monetary assets and liabilities are recognised in the income statement.

The assets and liabilities of the subsidiaries are translated into Renminbi at the foreign exchange rates ruling at the balance sheet date. The revenue, expenses and cash flows of the subsidiaries are translated into Renminbi at rates approximating the foreign exchange rates ruling at the date of the transaction. Foreign exchange differences arising on translation are recognised directly in equity.

(e) *Financial instruments*

(i) Recognition and measurement

All financial assets and financial liabilities are recognised in the balance sheet, when and only when, the Group or the Bank, as appropriate, becomes a party to the contractual provisions of the instrument. Financial assets are derecognised on the date when the contractual rights to the cash flows expire or substantially all the risks and rewards of ownership are transferred. Financial liabilities are derecognised on the date when the obligations specified in the contracts are discharged, cancelled or expired.

At initial recognition, all financial assets and financial liabilities are measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include observable market data. Transaction costs for financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

Financial assets and financial liabilities are categorised as follows:

– loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market, other than those that the Group intends to sell immediately or in the near term, and those that are designated as available for sale upon initial recognition, or those where the Group may not recover substantially all of its initial investment, other than because of credit determination, which will be classified as available-for-sale;

– held-to-maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity, other than those that meet the definition of loans and receivables, or that the Group designated as at fair value through profit or loss or as available-for-sale;

– financial assets and financial liabilities at fair value through profit or loss include trading assets and liabilities of those financial assets and financial liabilities held principally for the purpose of short term profit taking and financial assets and financial liabilities that are designated by the Group upon recognition as at fair value through profit or loss;

  All derivatives not qualified for hedging purposes are included in this category and are carried as assets when their fair value is positive and as liabilities when their fair value is negative; and

– available-for-sale assets are non-derivative financial assets that are designated as available for sale or are not classified as financial assets at fair value through profit or loss, loans and receivables or held-to-maturity assets.

Subsequent to initial recognition, financial assets and financial liabilities are measured at fair value, without any deduction for transaction costs that may occur on sale or other disposal except for loans and receivables, held-to-maturity financial assets and financial liabilities not designated at fair value through profit or loss, which are measured at amortised cost using the effective interest rate method. Financial assets and financial liabilities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost.

Gains and losses from changes in the fair value of financial instruments at fair value through profit or loss are included in the income statement when they arise. Gains and losses arising from a change in the fair value of available-for-sale assets are recognised directly in equity, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised at which time the cumulative gains or losses previously recognised in equity will be recognised in the income statement. For financial assets and liabilities carried at amortised cost, a gain or loss is recognised in the income statement when the financial asset or liability is derecognised or impaired, and through the amortisation process.

(ii) Impairment

Financial assets are assessed at each balance sheet date to determine whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The carrying amount of assets is reduced through the use of an allowance for impairment losses and a corresponding provision for impairment losses is recognised in the income statement.

Losses expected as a result of future events, no matter how likely, are not recognised because the necessary loss event has not yet occurred.

– Loans and receivables

The impairment allowance 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. Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for credit 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 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, 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. Impairment losses are recognised in the income statement.

(ii-1) Individual impairment allowances

All loans and advances in the corporate lending portfolios are considered individually significant and assessed individually for impairment. Individually impaired loans and advances are graded at a minimum at substandard (see note 34 (a) for the definitions of the loan classification).

Loans and advances which are assessed individually for impairment are evaluated in the light of objective evidence of loss events, for example:

i. Significant financial difficulty of the borrower

ii. A breach of contract, such as default or delinquency in interest payments or principal repayments

iii. For economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the Group would not otherwise consider

iv. It becoming probable that the borrower will enter bankruptcy or other financial reorganisation

It may not be possible to identify a single, discrete event that caused the impairment but it may be possible to identify impairment through the combined effect of several events.

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 merits.

(ii-2) Collective impairment allowances

Loans and receivables, which include the following, are assessed for impairment losses on a collective basis:

– All homogeneous groups of loans (representing all the retail loan portfolios) which are all considered not individually significant

– Individually assessed loans with no objective evidence of impairment on an individual basis

The collective impairment loss is assessed after taking into account:

– Historical loss experience in portfolios of similar risk characteristics;

– The emergence period between a loss occurring and that loss being identified; and

– The current economic and credit environments and whether in management's experience these indicate that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The emergence period between a loss occurring and its identification is determined by management based on the historical experience of the markets where the Group operates.

Impairment losses recognised on a collective basis represent an interim step pending the identification of impairment losses on individual assets (which are subject to individual assessment) in the pool of financial assets that are collectively assessed for impairment.

As soon as information is available that specifically identifies objective evidence of impairment on individual assets in a pool, those assets are removed from the pool of financial assets. 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 for impairment.

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 be charged or credited to the income statement.

When the borrower or the guarantor fails to repay the loan principal and interest, and repossessed assets are received by the Group for recovery of the impaired loans, the carrying value of the impaired loans is adjusted, if necessary, to the estimated fair value of the repossessed assets through impairment allowances. The adjusted carrying value of the impaired loans is transferred to repossessed assets, net of impairment allowances.

When there is no reasonable prospect of recovery for the loan and the related interest receivables, the loan and the interest receivables as well as impairment allowances are written off.

– Held-to-maturity assets

For held-to-maturity financial assets, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. (i.e. the effective interest rate computed at initial recognition of these assets). Impairment losses are recognised in the income statement. Held-to-maturity assets with a short duration are not discounted if the effect of discounting is immaterial.

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.

– Available-for-sale assets

When a decline in the fair value of an available-for-sale asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in the income statement even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from equity and 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 financial asset previously recognised in the income statement. For an available-for-sale asset that is not carried at fair value because its fair value cannot be reliably measured, such as an unquoted equity instrument, the amount of any impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed, with the amount of the reversal being recognised in the income statement. Impairment losses recognised in the income statement for an investment in an equity instrument classified as available-for-sale are not reversed through the income statement. Any increase in the fair value of such assets is recognised directly in equity.

(iii) Fair value measurement

The fair value of financial assets is based on their quoted market price in an active market at the valuation date without any deduction for transaction costs. A quoted market price is from an active market where price information is readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and that price information represents actual and regularly occurring market transactions on an arm's length basis. If a quoted market price is not available, the fair value of the financial assets is established using valuation techniques.

Valuation techniques applied include recent arm's length market transactions between knowledgeable and willing parties referenced to the fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. Periodically the Group calibrates the valuation techniques and tests them for validity.

In estimating the fair value of a financial asset and financial liability, the Group considers all factors, including but not limited to, interest rate, credit risk, foreign currency exchange price and market volatility, that are likely to affect the fair value of the financial asset and financial liability.

The Group obtains market data in the same market where the financial instrument was originated or purchased.

(iv) Derivative financial instruments

The Group uses derivative financial instruments to hedge its exposure to market risks arising from its investment activities. In accordance with its treasury policy, the Group generally does not hold or issue substantial derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as financial assets and financial liabilities at fair value through profit or loss.

Derivative financial instruments are recognised at fair value. The gain or loss on re-measurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

(f) Repurchase and resale agreements

Assets purchased subject to commitments to resell them at future dates are not recognised. The amounts paid are accounted for as balances with central bank, amounts due from banks and other financial institutions or loans and advances to customers depending on the identity of the counterparty.

Assets sold under repurchase agreements continue to be recognised in the balance sheet and are measured in accordance with the accounting policy for these assets. The proceeds from the sale of the assets are reported as amounts due to central bank, banks or other financial institutions depending on the identity of the counterparty.

The difference between the purchase and resale consideration or the sale and repurchase consideration is amortised over the period of the transaction and is included in interest income or expense, as appropriate.

(g) Property and equipment

(i) Cost or revaluation

Property and equipment are stated at cost upon initial recognition.

Subsequent to initial recognition, the Group adopts a revaluation policy to carry all classes of property at revaluation, being their fair value at the date of the revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Equipment is stated at cost less accumulated depreciation and impairment losses.

Increases in the carrying amount arising on revaluation of each property are credited to revaluation reserves in owner's equity. Decreases that offset previous increases of the same asset are charged against revaluation reserves; all other decreases are charged to the income statement.

Construction in progress represents property under construction and is stated at cost less impairment losses. Capitalisation of these costs ceases and the construction in progress is transferred to an appropriate class of property and equipment when the asset is substantially ready for its intended use.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

(ii) Subsequent costs

The Group recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense when incurred.

(iii) Depreciation

Depreciation is calculated to write off the cost or revalued value, less residual value if applicable, of property and equipment and is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. The estimated useful lives are as follows:

	Estimated useful lives
Bank premises	30 – 35 years
Computer equipment	3 – 5 years
Others	5 – 10 years

No depreciation is provided in respect of construction in progress.

The residual value, if not insignificant, is reassessed annually.

(iv) Impairment

The carrying amount of property and equipment is reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recognised in the income statement except for property where it is carried at valuation and the impairment loss does not exceed the revaluation surplus for the same asset, in which case it is treated as a revaluation decrease. The recoverable amount is the greater of the net selling price and value in use.

If in a subsequent period the amount of impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down or allowances are 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 the income statement in prior years.

(v) Disposal and retirement

Gains or losses arising from the disposal or retirement of property and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement on the date of disposal or retirement. In respect of the disposal or retirement of property, any revaluation reserve balance remaining attributable to the relevant asset is transferred to retained earnings and is shown as a movement in reserves.

(h) Land use rights

Land use rights are stated at cost less amortisation. Land use rights are amortised on a straight-line basis over the respective periods of grant.

(i) Repossessed assets

Repossessed assets are initially recognised at the carrying value of the loan principal and interest receivable, net of respective allowances for impairment losses, upon the seizure of these assets in lieu of the rights on the loans and advances and interest receivable. An impairment loss is recognised in the income statement whenever the carrying amount of such an asset exceeds its recoverable amount.

(j) Fiduciary activities

The Group acts in a fiduciary capacity as a custodian, trustee or an agent for customers. Assets held by the Group and the related undertakings to return such assets to customers are excluded from the balance sheet as the risks and rewards of the assets reside with the customers.

Entrusted lending is one of the principal fiduciary activities of the Group. The Group enters into entrusted loan agreements with a number of customers, whereby the customers provide funding (the "entrusted funds") to the Group, and the Group grants loans to third parties (the "entrusted loans") at the instruction of the customers. As the Group does not assume the risks and rewards of the entrusted loans and the corresponding entrusted funds, entrusted loans and funds are recorded as off-balance sheet items at their principal amounts and no impairment assessments are made for these entrusted loans.

(k) Provisions and contingent liabilities

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

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.

(l) Employee benefits

(i) Employment benefits

Salaries and bonuses, housing benefits and costs for social security benefits are accrued in the year in which the services are rendered by employees of the Group. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) Post employment benefits

Post employment benefits of the Group mainly include retirement benefits and supplementary retirement benefits.

Obligations for contributions to defined contribution retirement schemes are recognised as an expense in the income statement as incurred for current employees.

The Group's obligations in respect of supplementary retirement benefits are calculated by estimating the amount of future benefits that the Group is committed to pay to the employee after their retirement using actuarial techniques. Such benefits are discounted to determine their present values. The discount rate is the yield on PRC government bonds at the balance sheet date, the maturity dates of which approximate to the terms of the Group's obligations. In calculating the Group's obligations, any actuarial gains and losses are recognised in the income statement immediately in the same financial year.

(m) Income recognition

Provided it is probable that the 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:

(i) Interest income

Interest income for all interest-bearing assets is recognised in the income statement using the effective interest method or an applicable floating rate. Interest income includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

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.

The accrual of interest income of a loan where principal or interest of which is overdue over 90 days based on the original terms of the claim is discontinued. Instead, interest will continue to be recognised on the impaired financial assets using the rate of interest used to discount future cash flows ("unwinding of discount") for the purpose of measuring the related impairment loss.

(ii) Fee and commission income

Fee and commission income is recognised in the income statement when the corresponding service is provided.

Origination or commitment fees received 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 expiry.

(iii) Dividend

Dividend is recognised in the income statement on the date when the Group's right to receive payment is established.

(n) Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet when the Group has a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis, or realise the asset and settle the liability simultaneously.

(o) Cash and cash equivalents

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise cash, non-restricted balances with central bank, banks and other financial institutions, and short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

(p) Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the terms of the leases.

(q) Income tax

Income tax in the income statement comprises current tax and movements in deferred tax balances. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date. Deferred tax assets also arise from unused tax losses and unused tax credits.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(r) Profit appropriations

Profit payables are recognised as a liability in the year in which they are approved and declared.

(s) Related parties

Parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party, exercise significant influence or joint control over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control, common joint control or common significant influence. Related parties may be individuals and other entities.

(t) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

3. Net interest income

	2003	2004	2005
Interest income arises from:			
Balances with central bank	627	853	713
Amounts due from banks and other financial institutions	826	906	820
Loans and advances to customers *(note (i))*			
– corporate loans	8,130	11,508	14,481
– personal loans	760	1,288	1,972
– discounted bills	845	1,164	1,385
Investments in debt securities *(note (ii))*	1,664	1,963	3,009
Others	115	113	131
	12,967	17,795	22,511
Interest expense arises from:			
Balance due to central bank	(39)	(30)	(12)
Amounts due to banks and other financial institutions	(937)	(1,065)	(1,029)
Deposits from customers	(4,277)	(6,044)	(8,370)
Subordinated debts issued	–	(136)	(298)
Others	(41)	(137)	(142)
	(5,294)	(7,412)	(9,851)
Net interest income	7,673	10,383	12,660

Notes:

(i) Interest income arising from loans and advances to customers includes interest income accrued on individually assessed impaired loans and advances to customers of RMB306 million for the year ended 31 December 2005 (2004: RMB350 million; 2003: RMB396 million), which includes interest income on the unwinding of discount of allowances for loan impairment losses of RMB275 million for the year ended 31 December 2005 (2004: RMB307 million; 2003: RMB346 million) (Note 16(b)).

(ii) Interest income from investments in debt securities is mainly derived from unlisted investments.

4. Fee and commission income

	2003	2004	2005
Settlement fees	106	133	166
Guarantee fees	84	129	162
Agency fee for underwriting bonds and commission fee from bonds	34	37	113
Bank card fees	39	58	86
Commission for underwriting investment funds and agency fee for insurance services	3	17	12
Others	87	75	69
Total	353	449	608

5. Net gain from trading securities

	2003	2004	2005
Net gain/(loss) on debt securities trading	19	(17)	66
Revaluation gain of investments and derivatives	19	5	83
Others	86	46	(40)
Total	124	34	109

6. Net (loss)/gain from investment securities

	2003	2004	2005
Net (loss)/gain on disposal	(269)	8	53
Net revaluation gain/(loss) transferred from equity on disposal	177	3	(77)
Total	(92)	11	(24)

Net (loss)/gain on disposal primarily relates to available-for-sale securities.

7. General and administrative expenses

	2003	2004	2005
Staff costs			
– salaries, bonuses and staff welfare expenses	894	1,215	1,661
– contributions to defined contribution retirement schemes	83	107	125
– housing fund	31	63	67
– supplementary retirement benefits	–	9	–
– others	152	187	233
	1,160	1,581	2,086
Property and equipment expense			
– depreciation	553	548	617
– rent and property management expenses	314	345	376
– electronic equipment operating expenses	64	95	141
– maintenance	64	83	92
– others	86	96	112
	1,081	1,167	1,338
Other general and administrative expenses *(note (i))*	1,131	1,580	2,125
Management fee payable to CITIC Group	–	300	500
Business tax and surcharges *(note (ii))*	521	792	991
Amortisation expense	47	31	64
	3,940	5,451	7,104

Notes:

(i) The amount includes auditors' remuneration of RMB2 million for the year ended 31 December 2005 (2004: RMB1 million; 2003: RMB1 million).

(ii) Business tax of 5% is levied primarily on interest income from loans and advances to customers, and fee and commission income.

The surcharges, which include education surcharges and city construction tax, are charged at 3% and 7% of business tax paid respectively.

8. Impairment losses charge

	2003	2004	2005
Impairment losses charge/(release) on			
– loans and advances to customers	2,136	1,589	1,055
– bad and doubtful debts	23	16	46
– investments	–	61	1
– amount due from banks and other financial institutions	–	(17)	(6)
– others	(14)	(15)	2
	2,145	1,634	1,098

9. Directors' and supervisors' emoluments

The Board of Directors and the Board of Supervisors of the Bank were set up on 28 December 2005 and no director or supervisor was appointed by the Bank prior to this date. During the period from 28 December 2005 to 31 December 2005, no emoluments were paid or payable to any director or supervisor.

10. Individuals with highest emoluments

The aggregate emolument of the five individuals with the highest emoluments for the year ended 31 December 2003, 2004 and 2005 are as follows:

	2003	**2004**	**2005**
Salaries and other emoluments	1	1	1
Discretionary bonus	4	5	9
Contributions to defined contribution retirement schemes	1	1	1
	6	7	11

The number of the five highest paid individuals whose emoluments fell within the following bands is set out below:

	2003	**2004**	**2005**
RMB0 – RMB1,000,000	1	–	–
RMB1,000,001 – RMB1,500,000	4	4	–
RMB1,500,001 – RMB2,000,000	–	1	4
RMB2,500,001 – RMB3,000,000	–	–	1

11. Loans to directors, supervisors and officers

Loans to the Directors, Supervisor and Officers (and their affiliates) of the Bank as defined under section 161B of the Hong Kong Companies Ordinance during the three years ended 31 December 2003, 2004 and 2005 are as follows:

	2003	**2004**	**2005**
Aggregate amount of relevant loans outstanding at year end	1	1	1

	Years ended 31 December		
	2003	**2004**	**2005**
Maximum aggregate amount of relevant loans outstanding during the year	1	1	1

12. Income tax

(a) Recognised in the income statement

	2003	2004	2005
Current tax			
– Mainland China	1,023	1,041	1,044
– Hong Kong	1	–	–
Deferred tax *(Note 19(b))*	(162)	592	1,325
Income tax	862	1,633	2,369

(b) Reconciliation of profit before tax to income tax

	2003	2004	2005
Profit before tax	2,283	4,061	5,453
Expected PRC income tax charged at statutory tax rate of 33% *(note (i))*	753	1,340	1,799
Tax impact on non-deductible expenses			
– Staff costs	239	343	485
– Others *(note(ii))*	78	193	293
	317	536	778
Tax impact on non-taxable income			
– Interest income from PRC government bonds	(208)	(230)	(189)
– Others	–	(13)	(19)
	(208)	(243)	(208)
Income tax	862	1,633	2,369

Notes:

(i) The provision for PRC income tax of the Group is calculated based on the statutory tax rate of 33% in accordance with the relevant PRC income tax rules and regulations.

(ii) The amounts primarily represent management fee payable to CITIC Group, entertainment expenses, depreciation and amortisation charges exceeding the deductible amount, which are not tax deductible.

13. Earnings per share

Earnings per share is not disclosed as the Bank is not a shareholding company.

14. Cash and balances with central bank

	2003	2004	2005
Cash	1,375	1,459	1,678
Balances with central bank			
– Statutory deposit reserve funds *(note (i))*	18,369	23,717	29,282
– Surplus deposit reserve funds *(note (ii))*	29,499	28,595	25,779
– Fiscal deposits reserve funds	56	482	274
– Balances under resale agreement with the PBOC	–	–	27,440
	47,924	52,794	82,775
Total	49,299	54,253	84,453

Notes:

(i) Statutory deposit reserve funds placed with the PBOC were calculated at 7% of eligible RMB customers deposits of the Bank prior to 25 April 2004 and 7.5% thereafter. The Bank was also required to deposit an amount equivalent to 2% of its foreign currency deposits from customers as statutory deposit reserve funds prior to 15 January 2005. This was increased to 3% on 15 January 2005.

The statutory deposit reserve funds are not available for the Group's daily business.

(ii) The surplus deposit reserve funds were maintained with the PBOC for the purposes of clearing.

15. Amounts due from banks and other financial institutions

(a) Analysed by nature

	2003	2004	2005
Deposits	18,035	10,378	17,771
Money market placements	4,241	4,073	1,104
Balances under resale agreements	10,085	6,917	12,819
Gross balances	32,361	21,368	31,694
Less: Allowances for impairment losses *(Note 15(e))*	(513)	(469)	(342)
Net balances	31,848	20,899	31,352

(b) *Analysed by original maturity*

	2003	2004	2005
Balances maturing			
– less than one month	23,088	16,066	27,191
– between one month and one year	8,818	4,032	3,483
– more than one year	455	1,270	1,020
Gross balances	32,361	21,368	31,694

(c) *Analysed by geographical location*

	2003	2004	2005
Balances with			
– banks in Mainland China	20,792	12,880	20,291
– other financial institutions in Mainland China *(note)*	3,086	3,043	5,047
	23,878	15,923	25,338
Balances with banks outside Mainland China	8,483	5,445	6,356
Gross balances	32,361	21,368	31,694

Note:

Other financial institutions in Mainland China represent finance companies, investment trust companies and leasing companies which are registered with and under the supervision of the CBRC, other than banks in Mainland China, and securities companies and investment fund companies registered with and under the supervision of the China Securities Regulatory Commission.

(d) Analysed by legal form of counterparty

	2003	2004	2005
Balances with			
– PRC policy banks	2,800	–	2
– PRC state-owned banks and other financial institutions	7,803	9,147	16,734
– PRC joint-stock banks and other financial institutions	13,198	7,190	8,602
– Foreign-invested banks and other financial institutions	8,560	5,031	6,356
Gross balances	32,361	21,368	31,694
Less: Allowances for impairment losses on balances with			
– PRC state-owned banks and other financial institutions	(158)	(144)	(144)
– PRC joint-stock banks and other financial institutions	(355)	(325)	(198)
Total allowances for impairment losses	(513)	(469)	(342)
Net balances	31,848	20,899	31,352

(e) Movements of allowances for impairment losses

	2003	2004	2005
As at 1 January	(513)	(513)	(469)
Reversal for the year	–	17	6
Write-offs	–	27	121
As at 31 December	(513)	(469)	(342)

(f) Amounts due from banks and other financial institutions and allowances

	2003	2004	2005
Gross impaired amounts due from banks and other financial institutions	1,002	604	419
Impairment allowances against gross impaired amounts due from banks and other financial institutions *(note (i))*	(513)	(469)	(342)
Net total	489	135	77
Gross impaired amounts due from banks and other financial institutions as a percentage of total amounts due from banks and other financial institutions	3.10%	2.83%	1.32%

Notes:

(i) The allowances for impairment losses for amounts due from banks and financial institutions are individually assessed.

16. Loans and advances to customers

(a) Analysed by nature

	2003	2004	2005
Corporate loans	194,517	256,422	282,275
Personal loans	17,237	31,730	37,834
Discounted bills	45,559	18,727	50,151
Gross loans and advances to customers	257,313	306,879	370,260
Less:			
– Individual impairment allowances	(14,764)	(12,485)	(9,622)
– Collective impairment allowances	(2,010)	(2,473)	(2,608)
Less: Impairment allowances *(Note 16(b))*	(16,774)	(14,958)	(12,230)
Net loans and advances to customers	240,539	291,921	358,030

(b) Movements of allowances for impairment losses

	2003	2004	2005
As at 1 January	(15,360)	(16,774)	(14,958)
Charge for the year	(2,136)	(1,589)	(1,055)
Unwinding of discount	346	307	275
Transfers out	307	73	6
Write-offs	69	3,035	3,519
Recoveries of loans and advances previously written off	–	(10)	(17)
As at 31 December	(16,774)	(14,958)	(12,230)

(c) Loans and advances to customers and allowances

	2003	2004	2005
Gross impaired loans and advances to customers *(note (i))*	23,205	19,280	15,311
Impairment allowances against gross impaired loans			
– individually assessed	(14,764)	(12,485)	(9,622)
– collectively assessed	(165)	(213)	(225)
Subtotal	(14,929)	(12,698)	(9,847)
Net total	8,276	6,582	5,464
Gross impaired loans and advances to customers as a percentage of total loans and advances to customers	9.02%	6.28%	4.14%

Notes:

(i) Impaired loans and advances include loans for which objective evidence of impairment exists and which have been assessed as bearing significant impairment losses. These loans include loans and advances for which objective evidence of impairment has been identified:

– individually (representing corporate loans and advances which are graded substandard, doubtful or loss); or

– collectively; that is the portfolios of homogeneous loans (representing retail loans and advances which are graded substandard, doubtful or loss).

(ii) The definitions of the loan classification as stated above are described in Note 34(a).

(d) Analysed by legal form of borrowers

	2003	2004	2005
Corporate loans to			
– Joint-stock enterprises	83,086	119,369	130,157
– State-owned enterprises	64,826	84,252	100,738
– Foreign invested enterprises	22,156	27,171	27,040
– Private enterprises	8,398	11,662	13,636
– Collectively-controlled enterprises	7,730	6,386	4,480
– Others	8,321	7,582	6,224
Subtotal	194,517	256,422	282,275
Personal loans			
– Home mortgage loans	8,149	17,838	26,246
– Credit card advances	11	208	447
– Others	9,077	13,684	11,141
Discounted bills	45,559	18,727	50,151
Subtotal	62,796	50,457	87,985
Gross loans and advances to customers	257,313	306,879	370,260
Less: Impairment allowances	(16,774)	(14,958)	(12,230)
Net loans and advances to customers	240,539	291,921	358,030

17. Investments

	2003	2004	2005
Held-to-maturity debt securities *(Note 17(a))*	30,710	61,370	67,727
Available-for-sale			
– debt securities *(Note 17(b))*	26,351	40,411	31,564
– equity investments *(Note 17(c))*	259	338	312
	26,610	40,749	31,876
Debt securities at fair value through profit or loss *(Note 17(d))*	1,083	8,784	4,813
Total	58,403	110,903	104,416

(a) *Held-to-maturity debt securities*

	2003	2004	2005
Issued by:			
Government			
– of Mainland China	15,295	18,022	17,545
– outside Mainland China	467	467	2,905
PBOC	1,245	23,883	17,569
Policy banks			
– in Mainland China	9,543	11,199	13,816
– outside Mainland China	206	262	274
Banks and other financial institutions			
– in Mainland China	1,219	1,268	917
– outside Mainland China	1,692	2,925	5,137
Public sector entities outside Mainland China	223	852	6,759
Corporate entities			
– in Mainland China	112	1,028	961
– outside Mainland China	708	1,464	1,844
Total	30,710	61,370	67,727
Listed in Hong Kong	109	83	80
Listed outside Hong Kong	1,491	3,639	5,386
Unlisted	29,110	57,648	62,261
Total	30,710	61,370	67,727
Market value of listed securities	1,657	3,763	5,425

(b) *Available-for-sale debt securities*

	2003	2004	2005
At fair value and issued by:			
Government			
– of Mainland China	6,492	3,284	2,844
– outside Mainland China	3,027	8,645	1,936
PBOC	498	7,892	8,259
Policy banks			
– in Mainland China	4,167	2,887	3,057
– outside Mainland China	829	224	113
Banks and other financial institutions			
– in Mainland China	239	199	–
– outside Mainland China	8,171	6,285	8,765
Public sector entities outside Mainland China	747	9,453	2,413
Corporate entities			
– in Mainland China	129	–	2,690
– outside Mainland China	2,052	1,542	1,487
Total	26,351	40,411	31,564
Listed in Hong Kong	332	363	352
Listed outside Hong Kong	4,592	18,257	7,040
Unlisted	21,427	21,791	24,172
Total	26,351	40,411	31,564

(c) *Available-for-sale equity investments*

	2003	2004	2005
At fair value and issued by:			
Banks and other financial institutions			
– in Mainland China	56	56	56
– outside Mainland China	125	220	220
Corporate entities			
– in Mainland China	49	38	36
– outside Mainland China	29	24	–
Total	259	338	312

All of the above equity investments are unlisted.

(d) *Debt securities at fair value through profit or loss*

	2003	2004	2005
At fair value and issued by:			
Government			
– of Mainland China	–	2,128	932
– outside Mainland China	–	83	–
PBOC	–	2,280	1,589
Policy banks in Mainland China	10	3,415	1,400
Banks and other financial institutions			
– in Mainland China	–	35	37
– outside Mainland China	745	511	572
Corporate entities			
– in Mainland China	–	41	–
– outside Mainland China	328	291	283
Total	1,083	8,784	4,813
Listed outside Hong Kong	183	77	118
Unlisted	900	8,707	4,695
Total	1,083	8,784	4,813

All of the above securities are held for trading purposes.

18. Property and equipment

	Bank premises *(Note 18(a))*	Construction in progress	Computer equipment	Others	Total
Cost or valuation:					
As at 1 January 2003	4,944	177	1,136	1,049	7,306
Additions	156	185	196	170	707
Disposals	(40)	–	(18)	(82)	(140)
Transfers	127	(134)	7	–	–
Surplus on revaluation	416	–	–	–	416
Elimination of accumulated depreciation on revaluation	(174)	–	–	–	(174)
As at 31 December 2003	5,429	228	1,321	1,137	8,115
As at 1 January 2004	5,429	228	1,321	1,137	8,115
Additions	1,021	57	68	120	1,266
Disposals	(56)	(2)	(46)	(89)	(193)
Transfers	63	(70)	3	4	–
Surplus on revaluation	609	–	–	–	609
Elimination of accumulated depreciation on revaluation	(171)	–	–	–	(171)
As at 31 December 2004	6,895	213	1,346	1,172	9,626
As at 1 January 2005	6,895	213	1,346	1,172	9,626
Additions	30	121	361	97	609
Disposals	(37)	(1)	(18)	(136)	(192)
Transfers	102	(264)	150	12	–
Surplus on revaluation	588	–	–	–	588
Elimination of accumulated depreciation on revaluation	(223)	–	–	–	(223)
As at 31 December 2005	7,355	69	1,839	1,145	10,408

	Bank premises *(Note 18(a))*	Construction in progress	Computer equipment	Others	Total
Accumulated depreciation and impairment losses:					
As at 1 January 2003	–	–	(456)	(534)	(990)
Depreciation charges	(175)	–	(208)	(170)	(553)
Disposals	1	–	6	73	80
Elimination on revaluation	174	–	–	–	174
As at 31 December 2003	–	–	(658)	(631)	(1,289)
As at 1 January 2004	–	–	(658)	(631)	(1,289)
Depreciation charges	(172)	–	(214)	(162)	(548)
Disposals	1	–	42	87	130
Elimination on revaluation	171	–	–	–	171
As at 31 December 2004	–	–	(830)	(706)	(1,536)
As at 1 January 2005	–	–	(830)	(706)	(1,536)
Depreciation charges	(224)	–	(283)	(110)	(617)
Disposals	1	–	–	135	136
Elimination on revaluation	223	–	–	–	223
As at 31 December 2005	–	–	(1,113)	(681)	(1,794)
Net carrying value:					
As at 31 December 2003	5,429	228	663	506	6,826
As at 31 December 2004	6,895	213	516	466	8,090
As at 31 December 2005	7,355	69	726	464	8,614

Note:

As at 31 December 2005, the net book value of the Group's bank premises for which the registration procedures for ownership had not been completed was approximately RMB1,174 million. The Group anticipates that there would be no significant issues and costs in completing such procedures.

(a) *Analysed by remaining term of leases*

The net carrying value of bank premises at the balance sheet is analysed by the remaining terms of the leases as follows:

	2003	2004	2005
Long term leases (over 50 years), held in Hong Kong	25	24	24
Medium term leases (10-50 years), held in the PRC	5,404	6,871	7,331
Total	5,429	6,895	7,355

(b) Valuation

The bank premises of the Group were revalued at the balance sheet date at their open market value by reference to recent market transactions in comparable properties. The valuations were carried out by an independent firm of valuer, China Enterprise Appraisals Co., Ltd.

The revaluation surpluses have been transferred to the properties revaluation reserve of the Group.

Had these bank premises been carried at cost less accumulated depreciation, the carrying amounts would have been RMB4,926 million (2004: RMB4,980 million; 2003: RMB4,027 million).

19. Deferred tax assets

(a) Analysed by nature

	2003	**2004**	**2005**
Deferred tax assets	5,999	5,424	4,082
Deferred tax liabilities	(74)	–	(71)
Net balance	5,925	5,424	4,011

(b) The components of deferred tax assets/(liabilities) recognised in the balance sheet and the movements during the year are as follows:

	Impairment loss on loans and advances to customers	**Impairment on repossessed assets**	**Fair value** *Note (i)*	**Others**	**Total deferred tax assets/ (liabilities)**
As at 1 January 2003	4,421	409	(126)	976	5,680
Recognised in income statement	277	82	(18)	(179)	162
Recognised in equity	–	–	83	–	83
As at 31 December 2003	4,698	491	(61)	797	5,925
As at 1 January 2004	4,698	491	(61)	797	5,925
Recognised in income statement	(466)	19	12	(157)	(592)
Recognised in equity	–	–	91	–	91
As at 31 December 2004	4,232	510	42	640	5,424
As at 1 January 2005	4,232	510	42	640	5,424
Recognised in income statement	(854)	(23)	(14)	(434)	(1,325)
Recognised in equity	–	–	(88)	–	(88)
As at 31 December 2005	3,378	487	(60)	206	4,011

Notes:

(i) Unrealised gains or losses arising from fair value adjustments for securities and derivatives are subject to tax when realised.

(ii) The Group did not have significant unrecognised deferred taxation arising at the balance sheet date.

20. Other assets

	2003	2004	2005
Interest receivable			
– debt securities	618	842	888
– loans and advances to customers	626	813	736
– others	13	12	26
	1,257	1,667	1,650
Repossessed assets	1,180	1,020	826
Positive fair value of derivatives *(Note 33)*	477	301	211
Land use rights	217	212	195
Intangible assets	22	21	40
Others	750	734	733
Total	3,903	3,955	3,655

21. Amounts due to banks and other financial institutions

(a) Analysed by nature

	2003	2004	2005
Deposits	31,870	29,661	25,993
Balances under repurchase agreements	450	6,351	1,280
Money market takings	5,280	2,178	748
Total	37,600	38,190	28,021

(b) Analysed by geographical location

	2003	2004	2005
Balances payable on demand			
– Banks in Mainland China	12,349	11,251	8,784
– Other financial institutions in Mainland China	12,162	8,724	7,906
	24,511	19,975	16,690
– Banks outside Mainland China	–	–	2
Term deposits			
– Banks in Mainland China	4,070	9,571	5,465
– Other financial institutions in Mainland China	8,688	8,644	5,864
	12,758	18,215	11,329
– Banks outside Mainland China	331	–	–
Total	37,600	38,190	28,021

(c) Analysed by legal form of counterparty

	2003	2004	2005
Balances with			
– PRC policy banks	389	799	304
– PRC state-owned banks and other financial institutions	1,947	2,078	1,053
– PRC joint-stock banks and other financial institutions	34,933	35,313	26,662
– Foreign-invested banks and other financial institutions	331	–	2
Total	37,600	38,190	28,021

22. Deposits from customers

(a) Analysed by nature

	2003	2004	2005
Demand deposits			
– Corporate customers	176,833	201,243	258,535
– Personal customers	6,188	7,430	11,929
	183,021	208,673	270,464
Time deposits			
– Corporate customers	136,219	186,003	200,786
– Personal customers	26,116	40,344	59,323
	162,335	226,347	260,109
Total	345,356	435,020	530,573

Deposits from customers include structured deposits, which are designated at fair value through profit or loss. The change in the fair value of these structured deposits is mainly attributable to changes in benchmark interest rates. The carrying amount of structured deposits as at 31 December 2005 was RMB12,656 million (2004: RMB7,032 million; 2003: RMB772 million).

(b) Analysed by geographical segments

	2003	2004	2005
Bohai Rim	131,092	167,713	207,676
Yangtze River Delta	95,109	127,269	155,861
Pearl River Delta and Cross-Straits Economic Region	50,914	59,003	72,855
Central	24,747	32,420	37,932
Western	31,619	34,250	39,204
Northeastern	11,121	13,793	16,579
Head Office	754	572	466
Total	345,356	435,020	530,573

See Note 32(b) for the definitions of geographical segments.

23. Other liabilities and provisions

	2003	2004	2005
Interest payable			
– deposits from customers	1,471	1,861	2,303
– others	23	182	165
	1,494	2,043	2,468
Salaries and welfare payables *(Note 23(a))*	288	576	1,064
Supplementary retirement benefit obligations *(Note 24(b))*	36	44	42
Settlement accounts	122	177	346
Business and other tax payables	158	270	318
Negative fair value of derivatives *(Note 33)*	228	314	314
Bond redemption payable	69	87	143
Dormant accounts	17	16	70
Payment and collection clearance account	23	39	57
Short positions in securities	658	111	–
Others	457	443	518
Total	3,550	4,120	5,340

(a) Salaries and welfare payables

Included under salaries and welfare payables, the Group has the following payables to defined contribution retirement schemes at the balance sheet date:

	2003	2004	2005
As at 31 December	19	17	18

24. Retirement benefits

(a) Defined contribution retirement schemes

In accordance with the labour regulations of the PRC, the Group participates in defined contribution retirement schemes organised by the municipal and provincial governments for its employees in Mainland China. The Group is required to make contributions to the government administered retirement schemes at certain rates of the salaries, bonuses and certain allowances of its employees.

In addition to the above retirement schemes, the Group has established a supplementary defined contribution plan for its qualified employees. The plan is administered by CITIC Group. The Group contributes an equivalent of 3% of a qualified employee's salary and bonus to the plan each year, which amounting to RMB25 million for the year ended 31 December 2005 (2004: RMB21 million; 2003: RMB19 million).

The Group is also required to make contributions to the Mandatory Provident Fund Scheme for employees working in Hong Kong at the rate set up by the local laws and regulations.

The Group's total contributions during the relevant periods are disclosed in note 7.

The Group has no other material obligations for the payment of its employees' retirement and other post retirement benefits other than the contributions described above and in note 24(b) below.

(b) Supplementary retirement benefit

The Group pays supplementary retirement benefits, which are unfunded, for all of its qualified retired employees in Mainland China. These benefits cover both employees currently employed and those have retired. The amounts recognised in the balance sheets represent the present value of the unfunded obligations.

The Group's obligations in respect of the supplementary retirement benefits at the balance sheet date were reviewed by an independent actuary company, Mercer Human Resources Consulting, using the projected unit credit actuarial cost method. Mercer Human Resources Consulting employs professional actuaries, who are members of Society of Actuaries of the United States of America.

Net liabilities recognised in the balance sheet represent:

	2003	**2004**	**2005**
Present value of the obligations	36	44	42

Movements in the net liabilities recognised in the balance sheet are as follows:

	2003	**2004**	**2005**
As at 1 January	39	36	44
Payments made	(1)	(1)	(1)
Net (income)/expense recognised in the income statement	(2)	9	(1)
As at 31 December	36	44	42

Net expense/(net income) recognised as staff cost/(other income) in the income statement comprises:

	2003	2004	2005
Current service cost	2	1	1
Interest cost on obligation	1	1	1
Actuarial (gain)/loss	(5)	7	(3)
Net (income)/expense	(2)	9	(1)

Principal actuarial assumptions at the balance sheet date are as follows:

	2003	2004	2005
Discount rate	4.00%	3.00%	3.50%

	1995-2005	2006-2007	2008-2010	2011-2015	Since 2016
Earnings inflation rate	16.00%	14.00%	12.00%	9.00%	6.50%

25. Subordinated debts issued

During the year ended 31 December 2004, the Group issued the following subordinated debts upon the approval of the PBOC and the CBRC. The carrying value of the Group's subordinated debts at the balance sheet date represents:

	Note	2003	2004	2005
Subordinated floating rate debts maturing				
in June 2010	*(i)*	–	4,778	4,778
in July 2010	*(i)*	–	602	602
in September 2010	*(i)*	–	300	300
in June 2010	*(ii)*	–	320	320
Total nominal value		–	6,000	6,000

Notes:

(i) The interest rate per annum on the subordinated floating rate debts is the PBOC one-year fixed deposit rate which is reset on anniversary, plus an interest margin of 2.72%.

(ii) The interest rate per annum on the subordinated floating rate debts is the PBOC one-year fixed deposit rate which is reset on anniversary, plus an interest margin of 2.60%.

26. Equity

(a) Owner's capital

	2003	2004	2005
At 1 January	6,809	14,032	17,790
Capitalisation of retained earnings	1,223	1,258	271
Capital injection by cash	6,000	2,500	8,600
At 31 December	14,032	17,790	26,661

The movements in the owner's capital of the Bank during the years ended 31 December 2003, 2004 and 2005 are as follows:

(i) In July 2003, the Bank appropriated RMB1,223 million from retained earnings to capital based on a resolution notice made by CITIC Group. Beijing Zhong Sheng CPA Company Limited verified the capital contribution and issued a capital verification report ([2003] No. 07006) on 3 August 2003.

In December 2003, CITIC Group made a capital injection of RMB6,000 million in cash to the Bank. Shine Wing Certified Public Accountants verified the capital contribution and issued a capital verification report (XYZH/A304047) on 10 February 2004.

The owner's capital of the Bank was RMB14,032 million as at 31 December 2003.

(ii) In December 2004, the Bank appropriated RMB1,258 million from retained earnings to capital based on a resolution notice made by CITIC Group. In addition, CITIC Group made a capital injection of RMB2,200 million and USD 36 million (equivalent to RMB300 million) in cash to the Bank. Shine Wing Certified Public Accountants verified the capital contributions and issued a capital verification report (XYZH/A305032) on 6 January 2005.

The owner's capital of the Bank was RMB17,790 million as at 31 December 2004.

(iii) In December 2005, the Bank appropriated RMB271 million from retained earnings to increase the capital of the Bank based on a resolution notice made by CITIC Group. In addition, CITIC Group made a capital injection of RMB8,600 million in cash to the Bank. Shine Wing Certified Public Accountants verified the capital contributions and issued a capital verification report (XYZH/2005A3012-10) on 11 January 2006. Related amendments to the commercial registration are in progress.

The owner's capital of the Bank was RMB26,661 million as at 31 December 2005.

(b) Surplus reserves

Surplus reserves consist of statutory surplus reserve, discretionary surplus reserve and statutory public welfare fund.

(i) Statutory surplus reserve and discretionary surplus reserve

The Bank is required to appropriate 10% of its net profit, as determined under PRC GAAP, to a statutory surplus reserve until the reserve balance reaches 50% of the registered capital. After making the appropriation to a statutory surplus reserve, the Bank may also appropriate its net profit to the discretionary surplus reserve upon approval by board of directors.

Subject to the approval of board of directors, statutory and discretionary surplus reserves may be used to make good prior year losses, if any, and may be converted into capital, provided that the balance of statutory surplus reserve after such capitalisation is not less than 25% of the registered capital.

(ii) Statutory public welfare fund

Prior to 1 January 2006, the Bank is required to appropriate 5% of its net profit, as determined under PRC GAAP, to the statutory public welfare fund. In accordance with The Company Law of the PRC (revised in 2005), which was issued on 27 October 2005 and effective from 1 January 2006, the Bank is no longer required to make further appropriation to the statutory public welfare fund with effect from 1 January 2006.

This fund can only be used to purchase capital items for the collective benefit of the Bank's employees such as the construction of dormitories, canteens and other staff welfare facilities.

The fund is non-distributable other than in liquidation.

The Group has adopted the Accounting Regulations for Financial Enterprises (issued by the MOF in 2001) since 1 January 2005. Accordingly, the Group has made retrospective adjustments resulting in a negative balance of the retained earnings as at 31 December 2005. As a result, the surplus reserves have been used to partially set off the negative balance of the retained earnings and have been adjusted to nil.

(c) *Investment revaluation reserve*

Investment revaluation reserve has been accounted for in accordance with the accounting policies adopted for the measurement of the available-for-sale investments at fair value.

(d) *Properties revaluation reserve*

Properties revaluation reserve has been created in accordance with the accounting policies adopted for properties in note 2(g)(i).

27. Profit appropriations

The Bank appropriated profits of RMB1,223 million, RMB1,258 million and RMB271 million from retained earnings as capital for the years ended 31 December 2003, 2004 and 2005 respectively.

28. Notes to consolidated cash flow statement

Cash and cash equivalents

	2003	**2004**	**2005**
Cash	1,375	1,459	1,678
Surplus deposit reserve funds	29,499	28,595	25,779
Amounts due from banks and other financial institutions	31,848	20,899	31,352
Less:			
– amounts due over three months when acquired	(3,989)	(1,318)	(1,522)
– balances under resale agreements	(10,085)	(6,917)	(12,819)
	17,774	12,664	17,011
Investment securities	4,973	23,617	25,662
Total	53,621	66,335	70,130

29. Commitments and contingent liabilities

(a) Credit commitments

At any given time the Group has outstanding commitments to extend credit. These commitments take the form of approved loans and credit card limits.

The Group provides financial guarantees and letters of credit to guarantee the performance of customers to third parties.

Acceptances comprise undertakings by the Group to pay bills of exchange drawn on customers. The Group expects most acceptances to be settled simultaneously with the reimbursement from the customers.

The contractual amounts of commitments and contingent liabilities are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amount reflected in the table for guarantees and letters of credit represents the maximum potential loss that would be recognised at the balance sheet date if counterparties failed completely to perform as contracted.

	2003	2004	2005
Contractual amount			
Loan commitments			
– with an original maturity of under one year	166	25	86
– with an original maturity of one year or over	2,126	1,458	2,440
	2,292	1,483	2,526
Guarantees and letters of credit	22,298	32,194	36,947
Acceptances	64,000	94,836	105,783
Credit card commitments	189	2,232	4,836
	88,779	130,745	150,092

These commitments and contingent liabilities have off-balance sheet credit risk. Before the commitments are fulfilled or expire, management assess and make allowances, which are recorded in other liabilities, for any probable losses accordingly. As the facilities may expire without being drawn upon, the total of the contractual amounts is not representative of expected future cash outflows.

	2003	2004	2005
Credit risk weighted amount of contingent liabilities and commitments	35,523	47,787	50,037

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% of contingent liabilities and commitments. The credit risk weighted amounts stated above have taken into account the effects of bilateral netting arrangements.

There are no relevant standards prescribed by IFRS in calculating the above credit risk weighted amounts.

(b) Capital commitments

The Group had the following authorised capital commitments at the balance sheet date:

	2003	**2004**	**2005**
Purchase of property and equipment			
– Contracted for	75	38	10

(c) Operating lease commitments

The Group leases certain properties under operating leases, which typically run for an initial period of one to five years and may include an option to renew the lease when all terms are renegotiated. At the balance sheet date, the Group's future minimum lease payments under non-cancellable operating leases for premises were as follows:

	2003	**2004**	**2005**
Within one year	200	248	298
After one year but within five years	604	675	781
After five years	260	407	459
Total	1,064	1,330	1,538

(d) Outstanding litigation and disputes

As at 31 December 2005, the Group was the defendant in certain pending litigations with gross claims of RMB229 million (2004: RMB296 million 2003; RMB177 million). The Group considered that no provision was required for these litigations based upon the opinions of the Group's internal and external legal counsel.

(e) Underwriting obligations

At the balance sheet date, the unexpired underwriting commitments of PRC government bonds were as follows:

	2003	**2004**	**2005**
Underwriting obligations	–	310	550

(f) Redemption obligations

As an underwriting agent of PRC government bonds, the Group has the responsibility to buy back those bonds sold by it should the holders decide to early redeem the bonds held. The redemption price for the bonds at any time before their maturity date is based on the coupon value plus any interest unpaid and accrued up to the redemption date. Accrued interest payables to the bond holders are calculated in accordance with relevant rules of the MOF and the PBOC. The redemption price may be different from the fair value of similar instruments traded at the redemption date.

The redemption obligations below represent the nominal value of government bonds underwritten and sold by the Group, but not yet matured at the balance sheet date:

	2003	**2004**	**2005**
Redemption obligations	9,922	13,302	14,662

The Group expects the amount of redemption before the maturity date of these government bonds through the Group will not be material.

(g) *Provision against commitments and contingent liabilities*

The Group has assessed and has made provision for any probable outflow of economic benefits in relation to the above commitments and contingent liabilities in accordance with the accounting policies. The Group has not made other provisions in respect of the above commitments and contingent liabilities at the balance sheet date.

30. Assets pledged as security

The following assets have been pledged as security for bills rediscounting transactions and securities sold under repurchase agreements. The related secured liabilities are recorded as amounts due to central bank, or banks and other financial institutions of approximately similar carrying value at the balance sheet date.

	2003	**2004**	**2005**
Available-for-sale debt securities	300	3,930	865
Discounted bills	6,197	2,223	75
Total	6,497	6,153	940

31. Entrusted lending business

The Group provides entrusted lending business services to corporations and individuals. All entrusted loans are made under the instruction or at the direction of these entities or individuals and are funded by entrusted funds from them.

For entrusted assets and liabilities and entrusted provident housing fund mortgage business, the Group generally does not take on credit risk in relation to these transactions. The Group acts as an agent to hold and manage these assets and liabilities at the direction of the entrustor and receives fee income for the services provided.

Trust assets are not assets of the Group and are not recognised in the balance sheet. Surplus funding is accounted for as deposits from customers. Income received and receivable for providing these services is included in the income statement as fee income.

At the balance sheet date, the entrusted assets and liabilities were as follows:

	2003	**2004**	**2005**
Entrusted loans	6,118	10,145	14,849
Entrusted funds	6,118	10,145	14,849

32. Segment reporting

Segment information is presented in respect of the Group's business and geographical segments. Business segment information has been chosen as the primary reporting format as it is more relevant to the Group's internal financial reporting.

(a) Business segments

The Group comprises the following main business segments:

Corporate banking

This segment represents the provision of a range of financial products and services to corporations, government agencies and financial institutions. The products and services include corporate loans, trade financing, deposit taking activities, agency services, remittance and settlement services and guarantee services.

Personal banking

This segment represents the provision of a range of financial products and services to individual customers. The products and services comprise personal loans, deposit services and securities agency services.

Treasury business

This segment covers the Group's treasury operations. The treasury enters into inter-bank money market transactions and repurchase transactions, and invests in debt instruments. It also trades in debt instruments, derivatives and foreign currency for its own account. The treasury carries out customer driven transactions on derivatives and foreign currency trading. Its function also includes the management of the Group's overall liquidity position, including the issuance of subordinated debts.

Others and unallocated

These represent equity investments and head office assets, liabilities, income and expenses that are not directly attributable to a segment or cannot be allocated on a reasonable basis.

	Year ended 31 December 2003				
	Corporate Banking	Personal Banking	Treasury Business	Others and unallocated	Total
External net interest income/ (expense)	5,641	396	1,655	(19)	7,673
Internal net interest income/ (expense)	721	316	(893)	(144)	–
Net interest income/(expense)	6,362	712	762	(163)	7,673
Net fee and commission income	162	40	17	46	265
Dividend income	–	–	–	–	–
Net gain arising from disposal of fixed assets	–	–	–	1	1
Net (loss)/gain arising from trading securities	(4)	–	128	–	124
Net loss arising from investment securities	–	–	(92)	–	(92)
Net gain/(loss) arising from foreign currencies dealing	82	–	89	(20)	151
Other income	65	1	1	179	246
Operating income	6,667	753	905	43	8,368
General and administrative expenses					
– depreciation and amortisation	(354)	(132)	(31)	(83)	(600)
– others	(2,244)	(594)	(213)	(289)	(3,340)
Impairment losses charge	(2,108)	(33)	–	(4)	(2,145)
Profit/(loss) before tax	1,961	(6)	661	(333)	2,283
Capital expenditure	407	151	39	128	725
	31 December 2003				
Segment assets	246,074	20,243	120,994	9,506	396,817
Segment liabilities	314,515	32,690	42,295	1,915	391,415
Off-balance sheet credit commitments	88,590	189	–	–	88,779

	Year ended 31 December 2004				
	Corporate Banking	Personal Banking	Treasury Business	Others and unallocated	Total
External net interest income/ (expense)	7,580	829	1,996	(22)	10,383
Internal net interest income/ (expense)	1,043	260	(1,163)	(140)	–
Net interest income/(expense)	8,623	1,089	833	(162)	10,383
Net fee and commission income	222	70	19	7	318
Dividend income	–	–	1	–	1
Net gain arising from disposal of fixed assets	–	–	–	11	11
Net gain arising from trading securities	–	–	34	–	34
Net gain arising from investment securities	–	–	11	–	11
Net gain/(loss) arising from foreign currencies dealing	111	–	120	(4)	227
Other income	83	8	–	70	161
Operating income/(expense)	9,039	1,167	1,018	(78)	11,146
General and administrative expenses					
– depreciation and amortisation	(322)	(140)	(30)	(87)	(579)
– others	(2,941)	(869)	(259)	(803)	(4,872)
Impairment losses charge	(1,553)	(37)	(28)	(16)	(1,634)
Profit/(loss) before tax	4,223	121	701	(984)	4,061
Capital expenditure	167	75	15	57	314
	31 December 2004				
Segment assets	288,292	36,214	161,652	9,287	495,445
Segment liabilities	391,723	48,189	42,646	2,124	484,682
Off-balance sheet credit commitments	128,513	2,232	–	–	130,745

	Year ended 31 December 2005				
	Corporate Banking	Personal Banking	Treasury Business	Others and unallocated	Total
External net interest income/ (expense)	9,113	840	2,717	(10)	12,660
Internal net interest income/ (expense)	1,310	743	(1,783)	(270)	–
Net interest income/(expense)	10,423	1,583	934	(280)	12,660
Net fee and commission income/ (expense)	309	102	57	(50)	418
Dividend income	–	–	1	–	1
Net gain arising from disposal of fixed assets	–	–	–	12	12
Net gain arising from trading securities	–	–	109	–	109
Net loss arising from investment securities	–	–	(24)	–	(24)
Net gain/(loss) arising from foreign currencies dealing	172	–	183	(89)	266
Other income	105	14	–	94	213
Operating income/(expense)	11,009	1,699	1,260	(313)	13,655
General and administrative expenses					
– depreciation and amortisation	(355)	(240)	(33)	(53)	(681)
– others	(3,720)	(1,422)	(367)	(914)	(6,423)
Impairment losses (charge)/release	(1,022)	(33)	2	(45)	(1,098)
Profit/(loss) before tax	5,912	4	862	(1,325)	5,453
Capital expenditure	316	238	30	61	645
	31 December 2005				
Segment assets	352,336	44,611	190,234	7,421	594,602
Segment liabilities	462,199	71,949	34,337	2,892	571,377
Off-balance sheet credit commitments	145,256	4,836	–	–	150,092

(b) Geographical segments

The Group operates principally in Mainland China with branches and sub-branches located in 18 provinces, autonomous regions and municipalities directly under the central government. The Group's principal subsidiary, CIFL, is registered and operating in Hong Kong.

In presenting information by geographical segment, operating income is allocated based on the location of the branches that generated the revenue. Segment assets and capital expenditure are allocated based on the geographical location of the underlying assets.

Geographical segments, as defined for management reporting purposes, are as follows:

– "Yangtze River Delta" refers to the following areas where tier-1 branches of the Group are located: Shanghai, Nanjing, Suzhou, Hangzhou and Ningbo;

– "Pearl River Delta and Cross-Straits Economic Region" refers to the following areas where tier-1 branches of the Group are located: Guangzhou, Shenzhen, Dongguan and Fuzhou;

– "Bohai Rim" refers to the following areas where tier-1 branches of the Group are located: Beijing, Tianjin, Qingdao, Shijiazhuang and Jinan;

– "Central" region refers to the following areas where tier-1 branches of the Group are located: Heifei, Zhengzhou, Wuhan and Changsha;

– "Western" region refers to the following areas where tier-1 branches of the Group are located: Chengdu, Chongqing, Xi'an and Kunming;

– "Northeastern" region refers to the following areas where tier-1 branches of the Group are located: Dalian and Shenyang;

– "Head Office" refers to the head office quarter of the Group which is located at Beijing; and

– "Hong Kong" region refers to the Hong Kong Special Administrative Region where the subsidiaries of the Bank is located.

	Year ended 31 December 2003									
	Yangtze River Delta	Pearl River Delta and Cross-Straits Economic Region	Bohai Rim	Central	Western	North-eastern	Head Office	Hong Kong	Elimination	Total
External net interest income	1,913	901	1,516	360	534	530	1,899	20	–	7,673
Internal net interest income/ (expense)	337	332	740	126	54	75	(1,654)	(10)	–	–
Net interest income	2,250	1,233	2,256	486	588	605	245	10	–	7,673
Net fee and commission income	72	24	103	12	15	11	28	–	–	265
Dividend income	–	–	–	–	–	–	–	–	–	–
Net gain/(loss) arising from disposal of fixed assets	1	1	–	–	–	–	(1)	–	–	1
Net gain arising from trading securities	–	–	–	–	–	–	124	–	–	124
Net (loss)/gain arising from investment securities	–	–	–	–	–	–	(95)	3	–	(92)
Net gain/(loss) arising from foreign currencies dealing	51	23	76	5	3	5	(12)	–	–	151
Other income	55	14	44	7	2	5	115	4	–	246
Operating income	2,429	1,295	2,479	510	608	626	404	17	–	8,368
General and administrative expenses										
– depreciation and amortisation	(173)	(52)	(126)	(34)	(45)	(49)	(121)	–	–	(600)
– others	(980)	(557)	(776)	(201)	(242)	(273)	(302)	(9)	–	(3,340)
Impairment losses (charge)/release	(142)	(812)	(839)	(106)	(113)	(136)	3	–	–	(2,145)
Profit/(loss) before tax	1,134	(126)	738	169	208	168	(16)	8	–	2,283
Capital expenditure	93	50	79	174	37	65	227	–	–	725
	31 December 2003									
Segment assets	104,856	62,110	142,229	27,647	30,227	24,118	176,310	774	(171,454)	396,817
Segment liabilities	106,792	70,023	146,842	27,795	30,157	25,298	155,256	706	(171,454)	391,415
Off-balance sheet credit commitments	28,090	5,902	31,321	10,314	6,396	6,567	189	–	–	88,779

	Year ended 31 December 2004									
	Yangtze River Delta	Pearl River Delta and Cross-Straits Economic Region	Bohai Rim	Central	Western	North-eastern	Head Office	Hong Kong	Elimination	Total
External net interest income	2,998	1,028	2,122	578	777	631	2,218	31	–	10,383
Internal net interest income/ (expense)	380	356	888	127	80	62	(1,873)	(20)	–	–
Net interest income	3,378	1,384	3,010	705	857	693	345	11	–	10,383
Net fee and commission income/ (expense)	100	24	130	22	20	23	(1)	–	–	318
Dividend income	–	–	–	–	–	–	1	–	–	1
Net gain/(loss) arising from disposal of fixed assets	4	(3)	(3)	–	–	4	9	–	–	11
Net (loss)/gain arising from trading securities	–	–	(1)	–	–	–	35	–	–	34
Net gain arising from investment securities	–	–	–	–	–	–	11	–	–	11
Net gain/(loss) arising from foreign currencies dealing	68	32	118	9	4	9	(13)	–	–	227
Other income	62	14	47	7	5	6	17	3	–	161
Operating income	3,612	1,451	3,301	743	886	735	404	14	–	11,146
General and administrative expenses										
– depreciation and amortisation	(171)	(53)	(125)	(30)	(44)	(43)	(113)	–	–	(579)
– others	(1,443)	(658)	(1,017)	(283)	(319)	(293)	(850)	(9)	–	(4,872)
Impairment losses (charge)/release	(230)	(428)	(442)	(135)	(192)	(210)	3	–	–	(1,634)
Profit/(loss) before tax	1,768	312	1,717	295	331	189	(556)	5	–	4,061
Capital expenditure	15	7	19	8	7	7	251	–	–	314
	31 December 2004									
Segment assets	134,756	72,707	169,537	35,288	38,713	29,361	242,617	767	(228,301)	495,445
Segment liabilities	135,908	80,770	173,090	35,354	38,595	30,596	217,985	685	(228,301)	484,682
Off-balance sheet credit commitments	46,108	7,683	41,822	13,897	9,906	9,097	2,232	–	–	130,745

	Year ended 31 December 2005									
	Yangtze River Delta	Pearl River Delta and Cross-Straits Economic Region	Bohai Rim	Central	Western	North-eastern	Head Office	Hong Kong	Elimination	Total
External net interest income	3,845	2,011	1,808	694	808	854	2,618	22	–	12,660
Internal net interest income/ (expense)	441	(272)	1,468	120	124	225	(2,086)	(20)	–	–
Net interest income	4,286	1,739	3,276	814	932	1,079	532	2	–	12,660
Net fee and commission income	149	18	158	27	30	20	16	–	–	418
Dividend income	1	–	–	–	–	–	–	–	–	1
Net gain arising from disposal of fixed assets	9	–	–	1	1	–	1	–	–	12
Net gain/(loss) arising from trading securities	1	1	(2)	3	–	–	106	–	–	109
Net gain/(loss) arising from investment securities	5	1	1	–	1	1	(33)	–	–	(24)
Net gain/(loss) arising from foreign currencies dealing	93	34	210	13	16	7	(107)	–	–	266
Other income	66	14	57	8	15	4	46	3	–	213
Operating income	4,610	1,807	3,700	866	995	1,111	561	5	–	13,655
General and administrative expenses										
– depreciation and amortisation	(138)	(47)	(113)	(37)	(36)	(38)	(273)	–	–	(682)
– others	(1,919)	(854)	(1,286)	(349)	(422)	(446)	(1,139)	(7)	–	(6,422)
Impairment losses release/(charge)	21	(155)	(327)	(279)	(277)	(79)	(2)	–	–	(1,098)
Profit/(loss) before tax	2,574	751	1,974	201	260	548	(853)	(2)	–	5,453
Capital expenditure	204	121	127	41	29	30	93	–	–	645
	31 December 2005									
Segment assets	175,114	83,440	215,365	35,290	42,139	45,993	314,698	693	(318,130)	594,602
Segment liabilities	174,435	88,901	217,325	36,224	42,224	45,759	284,036	603	(318,130)	571,377
Off-balance sheet credit commitments	56,987	13,546	41,239	15,277	9,774	8,433	4,836	–	–	150,092

33. Derivatives

Derivatives include forward, swap and option transactions undertaken by the Group in the foreign exchange and interest rate markets. The Group, through the operations of its branch network, acts as an intermediary between a wide range of customers for structuring deals to produce risk management products to suit individual customer needs. These positions are actively managed through entering back to back deals with external parties to ensure the Group's net exposures are within acceptable risk levels. The Group also uses derivatives (principally foreign exchange options and swaps, and interest rate swaps) in the management of its own asset and liability portfolios and structural positions.

The following tables provide an analysis of the notional amounts of derivatives of the Group by relevant maturity groupings based on the remaining periods to settlement and the corresponding fair values at the balance sheet date. The notional amounts of the derivatives indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

	2003						
	Notional amounts with remaining life of					Fair values	
	Less than three months	Between three months and one year	Between one year and five years	More than five years	Total	Assets	Liabilities
Interest rate derivatives							
Interest rate swaps	9,814	2,779	4,176	2,586	19,355	44	(92)
Cross-currency swaps	–	243	895	–	1,138	19	(18)
Forward rate agreement	2,295	44,078	–	–	46,373	30	(28)
Interest rate caps	–	–	331	414	745	6	–
Interest rate options	166	–	–	–	166	–	–
	12,275	47,100	5,402	3,000	67,777	99	(138)
Currency derivatives							
Spot	205	–	–	–	205	–	–
Forwards	1,022	640	–	–	1,662	50	(49)
Foreign exchange swaps	7,772	577	–	–	8,349	293	(11)
Currency options	899	67	–	–	966	30	(30)
	9,898	1,284	–	–	11,182	373	(90)
Credit derivatives							
Credit default swap	–	–	414	–	414	5	–
Total						477	(228)
						(Note 20)	*(Note 23)*

	2004						
	Notional amounts with remaining life of					Fair values	
	Less than three months	Between three months and one year	Between one year and five years	More than five years	Total	Assets	Liabilities
Interest rate derivatives							
Interest rate swaps	9,802	3,235	3,208	745	16,990	30	(122)
Cross-currency swaps	215	1,168	724	–	2,107	21	(14)
Forward rate agreement	16,426	26,150	–	–	42,576	31	(33)
Interest rate caps	–	331	–	331	662	6	–
Interest rate options	414	–	–	–	414	6	(3)
	26,857	30,884	3,932	1,076	62,749	94	(172)
Currency derivatives							
Spot	352	–	–	–	352	–	–
Forwards	7,748	925	383	204	9,260	111	(112)
Foreign exchange swaps	6,278	39	–	–	6,317	71	(11)
Currency options	603	102	–	–	705	17	(17)
	14,981	1,066	383	204	16,634	199	(140)
Credit derivatives							
Credit default swap	–	–	414	–	414	3	(2)
Asset swap	–	–	41	–	41	5	–
	–	–	455	–	455	8	(2)
Total						301	(314)
						(Note 20)	*(Note 23)*

	2005						
	Notional amounts with remaining life of					Fair values	
	Less than three months	Between three months and one year	Between one year and five years	More than five years	Total	Assets	Liabilities
Interest rate derivatives							
Interest rate swaps	10,456	8,107	6,280	3,418	28,261	75	(209)
Cross-currency swaps	6	104	84	–	194	3	(3)
Forward rate agreement	1,073	23,628	–	–	24,701	4	(2)
Interest rate options	242	81	–	–	323	–	(5)
	11,777	31,920	6,364	3,418	53,479	82	(219)
Currency derivatives							
Spot	507	–	–	–	507	–	–
Forwards	1,218	10,142	595	126	12,081	84	(66)
Foreign exchange swaps	19,237	707	–	–	19,944	37	(24)
Currency options	272	1,103	–	–	1,375	5	(5)
	21,234	11,952	595	126	33,907	126	(95)
Credit derivatives							
Credit default swap	–	162	242	323	727	2	–
Asset swap	–	40	–	–	40	1	–
	–	202	242	323	767	3	–
Total						211	(314)
						(Note 20)	*(Note 23)*

The replacement costs and credit risk weighted amounts in respect of these derivatives are as follows. These amounts have taken into account the effects of bilateral netting arrangements.

Replacement costs

	2003	2004	2005
Interest rate derivatives	99	94	82
Currency derivatives	373	199	126
Credit derivatives	5	8	3
	477	301	211

Replacement cost represents the cost of replacing all contracts which have a positive value when marked to market. Replacement cost is a close approximation of the credit risk for these derivative contracts as at the balance sheet date.

Credit risk weighted amounts

	2003	2004	2005
Interest rate derivatives	226	127	161
Currency derivatives	104	100	116
	330	227	277

The credit risk weighted amount has been computed in accordance with the rules set by the CBRC, and depends on the status of the counterparty and the maturity characteristics of the instrument.

34. Financial risk management

This section presents information about the Group's exposure to and its management and control of risks, in particular the primary risks associated with its use of financial instruments:

– **Credit risk:** the loss resulting from customer or counterparty default and arising on credit exposure in all forms, including settlement risk.

– **Market risk:** the exposure to market variables such as interest rates, exchange rates and equity markets.

– **Liquidity risk:** where Group is unable to meet its payment obligations when due, or that it is unable, on an ongoing basis, to borrow funds in the market on an unsecured, or even secured basis at an acceptable price to fund actual or proposed commitments.

– **Operational risk:** the risk arising from matters such as non-adherence to systems and procedures or from fraud resulting in financial or reputation loss.

The Group has established policies and procedures to identify and analyse these risks, to set appropriate risk limits and controls, and to constantly monitor the risks and limits by means of reliable and up-to-date management information systems. The Group regularly modifies and enhances its risk management policies and systems to reflect changes in markets, products and best practice risk management processes. Internal auditors also perform regular audits to ensure compliance with policies and procedures.

(a) Credit risk

This category includes credit and counterparty risks from loans and advances, issuer risks from the securities business, counterparty risks from trading activities, and country risks. The Group identifies and manages this risk through its target market definitions, credit approval process, post-disbursement monitoring and remedial management procedures.

In addition to underwriting standards, the principal means of managing credit risk is the credit approval process. The Group has policies and procedures to evaluate the potential credit risk of a particular counterparty or transaction and to approve the transaction.

The Group undertakes ongoing 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 Risk Management Committee monitors overall portfolio risk as well as individual problem loans, both actual and potential, on a regular basis.

In respect of the loan portfolio, the Group adopts a risk-based loan classification methodology and classifies loans into five categories: normal, special-mention, substandard, doubtful and loss, in accordance with the guidelines issued by the PBOC and the CBRC.

The core definitions of the five categories of loans and advances are set out below:

Normal	Borrowers can honour the terms of their loans. There is no reason to doubt their ability to repay principal and interest in full on a timely basis.
Special mention	Borrowers are able to service their loans currently, although repayment may be adversely affected by specific factors.
Substandard	Borrowers' abilities to service their loans are in question as they cannot rely entirely on normal business revenues to repay principal and interest. Losses may ensue even when collateral or guarantees are invoked.
Doubtful	Borrowers cannot repay principal and interest in full and significant losses will need to be recognised even when collateral or guarantees are invoked.
Loss	Only a small portion or no principal and interest can be recovered after taking all possible measures and exhausting all legal remedies.

The Group applies a series of criteria in determining the classification of loans. The loan classification criteria focuses on a number of factors, including (i) the borrower's ability to repay the loan; (ii) the borrower's repayment history; (iii) the borrower's willingness to repay; (iv) the net realisable value of any collateral; and (v) the prospect for the support from any financially responsible guarantor. The Bank also takes into account the length of time for which payments of principal and interest on a loan are overdue. In general, unsecured loans with principal or interest overdue for more than 90 days and secured loans with principal or interest overdue for more than 180 days are classified at substandard or below.

The Group's retail credit policy and approval process are designed for the fact that there are high volumes of relatively homogeneous, small value transactions in each retail loan category. Because of the nature of retail banking, the credit policies are based primarily on statistical analyses of risks with respect to different products and types of customers. The Group monitors its own and industry experience to determine and periodically revise product terms and desired customer profiles.

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, therefore, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans.

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect the Group's 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 industry, geographic and product sectors.

(i) Loans and advances to customers analysed by economic sector concentrations at the balance sheet date:

	2003	%	2004	%	2005	%
Corporate loans						
Domestic operations						
– Manufacturing	51,860	20.2	71,247	23.2	81,537	22.0
– Wholesale and retail	23,099	9.0	26,023	8.5	29,902	8.1
– Production and supply of electric power, gas and water	9,857	3.8	23,825	7.8	26,559	7.2
– Transportation, storage and post service	20,882	8.1	22,459	7.3	23,633	6.4
– Real Estate	25,313	9.8	27,640	9.0	22,957	6.2
– Water, environment and public utility management	10,926	4.3	18,109	5.9	20,811	5.6
– Rent and business service	7,370	2.9	14,538	4.7	18,566	5.0
– Construction	8,752	3.4	13,980	4.6	15,963	4.3
– Financing	6,148	2.4	7,376	2.4	9,188	2.5
– Public management and social organizations	3,148	1.2	5,748	1.9	7,858	2.1
– Other customers	26,882	10.4	25,256	8.2	25,149	6.8
	194,237	75.5	256,201	83.5	282,123	76.2
Hong Kong operations	280	0.1	221	0.1	152	0.0
Subtotal	194,517	75.6	256,422	83.6	282,275	76.2
Discounted bills	45,559	17.7	18,727	6.1	50,151	13.6
Personal loans	17,237	6.7	31,730	10.3	37,834	10.2
Gross loans and advances to customers	257,313	100.0	306,879	100.0	370,260	100.0
Less: Impairment allowance	(16,774)		(14,958)		(12,230)	
Net loans and advances to customers	240,539		291,921		358,030	

(ii) Loans and advances to customers analysed by geographical sector risk concentrations at the balance sheet date:

	2003	%	2004	%	2005	%
Yangtze River Delta	70,051	27.2	91,672	29.9	120,026	32.4
Bohai Rim	81,788	31.8	89,944	29.2	105,803	28.6
Pearl River Delta and Cross-Straits Economic Region	46,780	18.2	49,491	16.1	52,885	14.3
Central	21,396	8.3	27,477	9.0	36,255	9.8
Western	21,075	8.2	27,943	9.1	32,029	8.7
Northeastern	15,943	6.2	20,131	6.6	23,110	6.2
Hong Kong	280	0.1	221	0.1	152	0.0
Gross loans and advances to customers	257,313	100.0	306,879	100.0	370,260	100.0
Less: Impairment allowances	(16,774)		(14,958)		(12,230)	
Net loans and advances to customers	240,539		291,921		358,030	

See Note 32(b) for the definitions of geographical segments.

(iii) Loans and advances to customers analysed by type of collaterals:

	2003	%	2004	%	2005	%
Loans secured by monetary assets	24,183	9.4	34,700	11.3	36,663	9.9
Loans secured by tangible assets, other than monetary assets	38,781	15.1	64,641	21.1	77,845	21.0
Guaranteed loans	132,245	51.4	124,898	40.7	163,499	44.2
Unsecured loans	62,104	24.1	82,640	26.9	92,253	24.9
Gross loans and advances to customers	257,313	100.0	306,879	100.0	370,260	100.0
Less: Impairment allowances	(16,774)		(14,958)		(12,230)	
Net loans and advances to customers	240,539		291,921		358,030	

(b) Market risk

Market risk arises on all market risk sensitive financial instruments, including securities, foreign exchange contracts, equity and derivative instruments, as well as from balance sheet or structural positions. Market risk arises from adverse movement in market rates including interest rates, foreign exchange rates and stock prices etc. as well as their volatility. Market risk would arise from both the Group's trading and non-trading business. The objective of market risk management is to avoid excessive exposure of earnings and equity to loss and to reduce the Group's exposure to the volatility inherent in financial instruments.

The Financial Planning Department is responsible for formulating the Group's market risk management policies, and managing its overall market risk exposures. The Financial Planning Department sets the trigger and limit on the interest rates and foreign exchange rates of the Group, articulates periodical reviews and decide on future business strategy with respect to interest rates and foreign exchange rates. The Financial Planning Department has delegated the responsibility for ongoing trading book market risk to the Treasury Department. The Treasury Department manages the Group's RMB and foreign currency investment portfolios, conducts proprietary and customer-driven trades, implements market risk management policies and rules and performs daily identification, measurement, assessment and control of risks.

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 derivative instruments used by the Group are interest and foreign exchange rate related contracts, which are primarily over-the-counter derivatives.

Sensitivity analysis and foreign currency exposure analysis are the key methods used by the Group to measure and monitor the market risk of its trading business with Value-at-Risk ("VaR") as a supplementary method. Gap analysis is the key method used by the Group to monitor the market risk of its non-trading business.

The Group applies a wide range of sensitivity analyses to assess the potential impact on the Group's earnings as a result of a set of forward-looking movements in market prices and the result is regularly reviewed.

Foreign currency exposure analysis is a method to measure the effect on the Group's net earnings by foreign exchange rate changes. The Group calculates individual foreign currency exposure for both net spot and net forward positions. All the individual foreign currency exposures are then aggregated to form an overall exposure. Foreign currency exposure limits are set for individual currencies as well as the overall level. The Group also distinguishes between trading and non-trading foreign currency exposures.

VaR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The Group's Treasury Department calculates interest rate VaR using historical movement in market rates and prices, at 99% confidence level, with a 10-day holding period on its foreign currency denominated investments.

Gap analysis is a technique to project future cash flows in order to quantify the differences, for a range of future dates, between assets and liabilities.

Currently, the Group is upgrading its present market risk management information system to monitor its overall market risk through new Assets and Liability Management (ALM) and Fund Transfer Pricing (FTP) systems.

The Group does not actively trade in financial instruments and, in the opinion of the directors, the market risk related to trading activities to which the Group is exposed is not material. Accordingly, no quantitative market risk disclosures have been prepared.

(c) Interest rate risk

The Group's interest rate positions arise from treasury and commercial banking activities. Interest rate risk primarily results from the timing differences in the repricing of interest-bearing assets, liabilities and commitments. The Group sets sensitivity related limits to manage interest rate risk arising from trading business.

The following tables indicate the effective interest rates for the year and the expected next repricing dates (or maturity dates whichever are earlier) for the assets and liabilities at the balance sheet date.

	2003						
	Effective interest rate *(note (i))*	**Total**	**Non-interest bearing**	**Less than three months**	**Between three months and one year**	**Between one and five years**	**More than five years**
Assets							
Cash and balances with central bank	1.91%	49,299	1,375	47,924	–	–	–
Amounts due from banks and other financial institutions	1.97%	31,848	–	24,265	7,128	455	–
Loans and advances to customers *(note (ii))*	4.66%	240,539	–	102,908	136,216	1,415	–
Investments	3.38%	58,403	–	15,122	13,128	17,216	12,937
Others	–	16,728	16,728	–	–	–	–
Total assets		396,817	18,103	190,219	156,472	19,086	12,937
Liabilities							
Amounts due to central bank	3.16%	3,921	–	3,921	–	–	–
Amounts due to banks and other financial institutions	1.78%	37,600	–	35,973	373	788	466
Deposits from customers	1.55%	345,356	3,056	263,203	62,933	10,450	5,714
Others	–	4,538	4,538	–	–	–	–
Total liabilities		391,415	7,594	303,097	63,306	11,238	6,180
Asset-liability gap		5,402	10,509	(112,878)	93,166	7,848	6,757

	2004						
	Effective interest rate *(note (i))*	Total	Non-interest bearing	Less than three months	Between three months and one year	Between one and five years	More than five years
Assets							
Cash and balances with central bank	1.80%	54,253	1,459	52,794	–	–	–
Amounts due from banks and other financial institutions	2.20%	20,899	–	18,296	1,333	1,270	–
Loans and advances to customers *(note (ii))*	4.85%	291,921	–	134,079	155,869	1,973	–
Investments	3.19%	110,903	–	44,721	31,224	21,913	13,045
Others	–	17,469	17,469	–	–	–	–
Total assets		495,445	18,928	249,890	188,426	25,156	13,045
Liabilities							
Amounts due to central bank	3.20%	300	–	300	–	–	–
Amounts due to banks and other financial institutions	1.72%	38,190	–	30,998	5,091	1,312	789
Deposits from customers	1.66%	435,020	5,182	336,007	75,541	12,815	5,475
Subordinated debts issued	4.96%	6,000	–	6,000	–	–	–
Others	–	5,172	5,172	–	–	–	–
Total liabilities		484,682	10,354	373,305	80,632	14,127	6,264
Asset-liability gap		10,763	8,574	(123,415)	107,794	11,029	6,781

	2005						
	Effective interest rate *(note (i))*	Total	Non-interest bearing	Less than three months	Between three months and one year	Between one and five years	More than five years
Assets							
Cash and balances with central bank	1.53%	84,453	1,677	82,776	–	–	–
Amounts due from banks and other financial institutions	2.19%	31,352	–	27,084	3,248	1,020	–
Loans and advances to customers *(note (ii))*	5.18%	358,030	–	158,629	197,656	1,745	–
Investments	3.05%	104,416	–	50,201	17,864	23,060	13,291
Others	–	16,351	16,351	–	–	–	–
Total assets		594,602	18,028	318,690	218,768	25,825	13,291
Liabilities							
Amounts due to central bank	4.33%	240	–	240	–	–	–
Amounts due to banks and other financial institutions	1.87%	28,021	–	22,515	692	2,810	2,004
Deposits from customers	1.86%	530,573	18,929	416,860	78,392	11,916	4,476
Subordinated debts issued	4.96%	6,000	–	6,000	–	–	–
Others	–	6,543	6,543	–	–	–	–
Total liabilities		571,377	25,472	445,615	79,084	14,726	6,480
Asset-liability gap		23,225	(7,444)	(126,925)	139,684	11,099	6,811

Notes:

(i) Effective interest rate represents the ratio of interest income/expense to average interest bearing assets/liabilities.

(ii) For loans and advances to customers, the above "Less than three months" category includes overdue amounts (net of allowances for impairment losses) of RMB7,718 million as at 31 December 2005 (2004: RMB7,724 million; 2003: RMB8,219 million). Overdue amounts represent loans, of which the whole or part of the principals was overdue, or interest was overdue for more than 90 days but for which principal was not yet due.

(d) *Currency risk*

The Group's foreign currency positions arise from foreign exchange dealing, commercial bank operations and foreign currency capital related structural exposures. The foreign currency exposures arising in branch daily operations are aggregated to Treasury Department through back to back transactions.

The Treasury Department manages the currency risk within the limits approved by the Financial Planning Department by closing the exposure positions through external market transactions.

The Group manages other currency risk by spot and forward foreign exchange transactions and matching its foreign currency denominated assets with corresponding liabilities in the same currencies.

The exposures at the balance sheet date were as follows:

	2003			
	RMB	*USD*	*Others*	*Total*
Assets				
Cash and balances with central bank	47,410	1,668	221	49,299
Amounts due from banks and other financial institutions	22,461	8,480	907	31,848
Loans and advances to customers	228,794	10,342	1,403	240,539
Investments	37,468	18,849	2,086	58,403
Others	13,705	2,545	478	16,728
Total assets	349,838	41,884	5,095	396,817
Liabilities				
Amounts due to central bank	3,921	–	–	3,921
Amounts due to banks and other financial institutions	29,776	3,798	4,026	37,600
Deposits from customers	309,239	30,196	5,921	345,356
Others	4,338	161	39	4,538
Total liabilities	347,274	34,155	9,986	391,415
Net on-balance sheet position	2,564	7,729	(4,891)	5,402
Credit commitments	76,069	9,806	2,904	88,779
Derivatives *(note)*	(83)	(3,737)	4,096	276

The exposures at the balance sheet date were as follows:

	2004			
	RMB	*USD*	*Others*	*Total*
Assets				
Cash and balances with central bank	52,052	1,954	247	54,253
Amounts due from banks and other financial institutions	14,564	3,261	3,074	20,899
Loans and advances to customers	279,503	10,533	1,885	291,921
Investments	75,752	24,052	11,099	110,903
Others	15,912	1,310	247	17,469
Total assets	437,783	41,110	16,552	495,445
Liabilities				
Amounts due to central bank	300	–	–	300
Amounts due to banks and other financial institutions	30,272	2,845	5,073	38,190
Deposits from customers	391,516	26,759	16,745	435,020
Subordinated debts issued	6,000	–	–	6,000
Others	2,445	2,692	35	5,172
Total liabilities	430,533	32,296	21,853	484,682
Net on-balance sheet position	7,250	8,814	(5,301)	10,763
Credit commitments	114,192	12,994	3,559	130,745
Derivatives *(note)*	–	(3,328)	3,371	43

The exposures at the balance sheet date were as follows:

	2005			
	RMB	*USD*	*Others*	*Total*
Assets				
Cash and balances with central bank	81,554	2,485	414	84,453
Amounts due from banks and other financial institutions	14,394	6,129	10,829	31,352
Loans and advances to customers	339,589	17,045	1,396	358,030
Investments	69,327	28,266	6,823	104,416
Others	14,405	1,848	98	16,351
Total assets	519,269	55,773	19,560	594,602
Liabilities				
Amounts due to central bank	240	–	–	240
Amounts due to banks and other financial institutions	23,756	2,237	2,028	28,021
Deposits from customers	463,068	43,958	23,547	530,573
Subordinated debts issued	6,000	–	–	6,000
Others	6,523	–	20	6,543
Total liabilities	499,587	46,195	25,595	571,377
Net on-balance sheet position	19,682	9,578	(6,035)	23,225
Credit commitments	129,258	16,456	4,378	150,092
Derivatives *(note)*	699	(6,304)	5,707	102

Note:

The derivatives represent the net notional amount of currency derivatives, including undelivered foreign exchange spot, foreign exchange forward, foreign exchange swap and currency option.

(e) *Liquidity risk*

The purpose of liquidity management is to ensure sufficient cash flows for the Group 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 in full amounts as they mature, or to meet other obligations for payments, to comply with the statutory liquidity ratio, and to make new loans and investments as opportunities arise.

Liquidity is managed on a daily basis according to the Group's liquidity objectives by the Treasury under the direction of the Asset and Liability Committee. It is responsible for ensuring that the Group has adequate liquidity for RMB and foreign currency operations.

The Group manages liquidity risk by holding sufficient liquid assets (e.g. deposits at PBOC, other 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 demand for payments in the ordinary course of business.

The Group regularly stress tests its liquidity position.

In terms of measuring liquidity risk, the Group principally uses liquidity gap analysis. Different scenarios are applied to assess the impact on liquidity for proprietary trading and client businesses.

The following tables provide an analysis of assets and liabilities of the Group into relevant maturity groupings based on the remaining periods to repayment at the balance sheet date.

	2003						
	Overdue/ repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	Undated	Total
Assets							
Cash and balances with central bank *(note (i))*	30,874	–	–	–	–	18,425	49,299
Amounts due from banks and other financial institutions	16,419	7,846	7,128	455	–	–	31,848
Loans and advances to customers *(note (ii))*	8,229	68,802	102,333	43,053	18,122	–	240,539
Investments *(note (iii))*							
– Held-to-maturity debt securities	–	1,659	2,221	14,424	12,406	–	30,710
– Available-for-sale investments	–	6,706	4,066	6,867	8,971	–	26,610
– Debt securities at fair value through profit or loss	–	117	119	847	–	–	1,083
Others	294	620	1,114	132	50	14,518	16,728
Total assets	55,816	85,750	116,981	65,778	39,549	32,943	396,817
Liabilities							
Amounts due to central bank	–	3,621	300	–	–	–	3,921
Amounts due to banks and other financial institutions	30,065	5,908	373	788	466	–	37,600
Deposits from customers	170,492	66,640	63,447	34,442	6,645	3,690	345,356
Others	147	2,899	427	17	35	1,013	4,538
Total liabilities	200,704	79,068	64,547	35,247	7,146	4,703	391,415
Long/(short) position	(144,888)	6,682	52,434	30,531	32,403	28,240	5,402

	2004						
	Overdue/ repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	Undated	Total
Assets							
Cash and balances with central bank *(note (i))*	30,054	–	–	–	–	24,199	54,253
Amounts due from banks and other financial institutions	10,245	8,050	1,334	1,270	–	–	20,899
Loans and advances to customers *(note (ii))*	7,921	57,247	130,006	56,573	40,174	–	291,921
Investments *(note(iii))*							
– Held-to-maturity debt securities	–	8,282	23,391	16,550	13,147	–	61,370
– Available-for-sale investments	–	23,381	4,871	7,728	4,769	–	40,749
– Debt securities at fair value through profit or loss	–	–	2,380	3,179	3,225	–	8,784
Others	259	819	1,136	136	47	15,072	17,469
Total assets	48,479	97,779	163,118	85,436	61,362	39,271	495,445
Liabilities							
Amounts due to central bank	–	–	300	–	–	–	300
Amounts due to banks and other financial institutions	25,333	5,665	5,091	1,312	789	–	38,190
Deposits from customers	197,246	97,005	75,911	50,085	5,955	8,818	435,020
Subordinated debts issued	–	–	–	–	6,000	–	6,000
Others	125	3,422	486	16	44	1,079	5,172
Total liabilities	222,704	106,092	81,788	51,413	12,788	9,897	484,682
Long/(short) position	(174,225)	(8,313)	81,330	34,023	48,574	29,374	10,763

	2005						
	Overdue/ repayable on demand	Less than three months	Between three months and one year	Between one and five years	More than five years	Undated	Total
Assets							
Cash and balances with central bank *(note (i))*	27,456	27,440	–	–	–	29,557	84,453
Amounts due from banks and other financial institutions	17,152	9,932	3,248	1,020	–	–	31,352
Loans and advances to customers *(note (ii))*	8,147	68,142	172,168	61,230	48,343	–	358,030
Investments *(note (iii))*							
– Held-to-maturity debt securities	–	16,655	9,323	26,362	15,387	–	67,727
– Available-for-sale investments	–	12,906	4,155	7,487	7,328	–	31,876
– Debt securities at fair value through profit or loss	–	2,470	863	1,090	390	–	4,813
Others	264	790	1,063	120	37	14,077	16,351
Total assets	53,019	138,335	190,820	97,309	71,485	43,634	594,602
Liabilities							
Amounts due to central bank	–	–	240	–	–	–	240
Amounts due to banks and other financial institutions	20,230	2,285	692	2,810	2,004	–	28,021
Deposits from customers	268,150	107,268	80,352	47,086	3,396	24,321	530,573
Subordinated debts issued	–	–	–	6,000	–	–	6,000
Others	277	4,548	376	70	42	1,230	6,543
Total liabilities	288,657	114,101	81,660	55,966	5,442	25,551	571,377
Long/(short) position	(235,638)	24,234	109,160	41,343	66,043	18,083	23,225

Notes:

(i) For cash and balances with central bank, undated amount represents statutory deposit reserve funds and fiscal balances maintained with the PBOC.

(ii) For loans and advances to customers, overdue amount included in the above "overdue/repayable on demand" category represents loans of which the whole or part of the principals was overdue, or interest was overdue for more than 90 days but for which principal was not yet due. The overdue amount is stated net of appropriate allowances for impairment losses.

(iii) For debt securities held for trading purposes, the remaining term to maturities does not represent the Group's intention to hold them to final maturity.

(f) Operational risk

Operational risk includes the risk of direct or indirect loss due to an event or action causing failure of technology, processes, infrastructure and personnel, and other risks having an operational impact.

The Group manages this risk through a control-based environment by establishing a framework of policies and procedures in order to identify, assess, control, manage and report risks. The framework covers all business functions ranging from finance, credit, accounting, settlement, savings, treasury, intermediary business, computer applications and management, special assets resolution and legal affairs. This has allowed the Group to identify and address comprehensively the operational risk inherent in all key products, activities, processes and systems. Key controls include:

– authorisation limits for various business activities to branches are delegated after consideration of their respective business scope, risk management capabilities and credit approval procedures. Such authorities are revised on a timely basis to reflect changes in market conditions and business development and risk management needs;

– the use of the single legal responsibility framework and strict disciplinary measures in order to ensure accountability;

– systems and procedures to identify, control and report on the major risks: credit, market, liquidity and operational;

– promotion of a risk management culture throughout the organisation by building a team of risk management professionals, providing formal training and having an appraisal system in place, to raise the overall risk awareness among the Group's employees;

– from December 2002 onwards, a dedicated anti-money laundering division under the Accounting Department responsible for overseeing that cash management and account management are in compliance with the relevant regulations, and for improving training on anti-money laundering to ensure our staff are well-equipped with the necessary knowledge and basic skills;

– the review and approval by senior management of comprehensive financial and operating plans which are prepared by branches;

– the assessment of individual branches' financial performance against the comprehensive financial and operating plan; and

– the maintenance of contingent facilities (including backup systems and disaster recovery schemes) to support all major operations, especially back office operations, in the event of an unforeseen interruption. Insurance cover is arranged to mitigate potential losses associated with certain operational events.

In addition to the above, the Bank's Internal Audit Department, which directly reports to the Internal Audit Committee, examines and independently evaluates its risk management policies and procedures and internal controls. The Internal Audit Committee is under the direct supervision of the Executive Management Committee led by the President of the Bank.

The Internal Audit Committee determines the frequency and priority of audits of the Bank's different operating units and branches based on their assessment of the level of risk of those units and branches.

35. Fair value

(a) Financial assets

The Group's financial assets mainly include cash, amounts due from central bank, banks and other financial institutions, loans and advances to customers, and investments.

Amounts due from central bank, banks and other financial institutions

Amounts due from central bank, banks and other financial institutions are mainly priced at market interest rates and mature within one year. Accordingly, the carrying values approximate the fair values.

Loans and advances to customers

Loans and advances to customers are mostly priced at floating rates close to the PBOC rates. Accordingly, their carrying values approximate the fair values.

Investments

Available-for-sale investments and trading debt securities are stated at fair value in the balance sheet. The following table summarises the carrying values and the fair values of held-to-maturity debt securities which are not presented on the balance sheet at their fair values.

	Carrying values			Fair values		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**
Held-to-maturity debt securities	30,710	61,370	67,727	31,170	61,272	68,068

(b) Financial liabilities

The Group's financial liabilities mainly include amounts due to banks and other financial institutions, deposits from customers and subordinated debts issued. The carrying values of financial liabilities approximated their fair values at the balance sheet date.

36. Significant accounting estimates and judgments

In determining the carrying amounts of some assets and liabilities, the Group makes assumptions of the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimates involve assumptions about such items as risk adjustment to cash flows or discount rates used, future changes in salaries and future changes in prices affecting other costs. The Group's estimates and assumptions are based on historical experience and expectations of future events and are reviewed periodically. In addition to assumptions and estimations of future events, judgments are also made during the process of applying the Group's accounting policies.

(a) Impairment losses on loans and advances

Loan portfolios are assessed periodically to assess whether impairment losses exist and if they exist, the amounts of impairment losses. Objective evidence for impairment includes observable data indicating that there is a measurable decrease in the estimated future cash flows identified with an individual loan. It also includes observable data indicating adverse changes in the repayment status of borrowers in the loan portfolio or national or local or economic conditions that correlate with defaults on the loans in the portfolio. The impairment loss for a loan that is individually evaluated for impairment is the decrease in the estimated future cash flow of that loan.

When loans and advances are collectively evaluated for impairment, the estimate is based on historical loss experience for assets with credit risk characteristics similar to the loans and advances. Historical loss experience is adjusted on the basis of the relevant observable data that reflect current economic conditions. Management review the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

(b) *Impairment of available-for-sale equity investments*

For available-for-sale equity investments, a significant or prolonged decline in fair value below cost is considered to be objective evidence of impairment. Judgment is required when determining whether a decline in fair value has been significant or prolonged. In making this judgment, the historical data on market volatility as well as in the share price of the specific equity investment are taken into account. The Group also takes into account other factors, such as industry and sector performance and financial information regarding the investee.

(c) *Fair value of financial instruments*

The fair values for those financial instruments, where no quoted prices from an active market exist, are established by using valuation techniques. These techniques include using recent arm's length market transactions, reference to the current fair value of similar instruments and discounted cash flow analysis and option pricing models. The Group has established a process to ensure that valuation techniques are constructed by qualified personnel and are validated and reviewed by personnel independent of the area that constructed the valuation techniques. Valuation techniques are certified before being implemented for valuation and are calibrated to ensure that outputs reflect actual market conditions. Valuation models established by the Group make the maximum use of market inputs and rely as little as possible on Group-specific data. However, it should be noted that some inputs, such as credit and counterparty risk, and risk correlations, require management estimates. Management estimates and assumptions are reviewed periodically and are adjusted if necessary.

(d) *Held-to-maturity investments*

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity investments if the Group has the intention and ability to hold them until maturity. In evaluating whether the requirements to classify a financial asset as held-to-maturity are met, management make significant judgments. Failure in correctly assessing the Group's intention and ability to hold specific investments until maturity may result in reclassification of the whole portfolio as available-for-sale.

(e) *Income taxes*

Determining income tax provisions involves judgment on the future tax treatment of certain transactions. The Group carefully evaluates tax implications of transactions and tax provisions are set up accordingly. The tax treatment of such transactions is reconsidered periodically to take into account all changes in tax legislations.

Deferred tax assets are recognised for tax losses not yet used and temporary deductible differences. As those deferred tax assets can only be recognised to the extent that it is probable that future taxable profit will be available against which the unused tax credits can be utilised. Management's judgment is required to assess the probability of future taxable profits. Management's assessment is constantly reviewed and additional deferred tax assets are recognised if it becomes probable that future taxable profits will allow the deferred tax asset to be recovered.

37. Related parties

CITIC Group, the equity owner of the Bank, is a state-owned company established in 1979. CITIC Group's core business ranges from financial industry, industrial investment to service industries in both the Mainland China and overseas. The Group's related party transactions are the transactions between the Group and CITIC Group and its subsidiaries.

(a) Related transactions

During the relevant periods, the Group entered into transactions with related parties in the ordinary course of its banking business including lending, investment, deposit and off-balance sheet transactions. The banking transactions were priced at the relevant market rates prevailing at the time of each transaction. Interest rates on loans and deposits are required to be set in accordance with the benchmark rates set by the PBOC.

Transactions during the year and the corresponding balances outstanding at the balance sheet date are as follows:

	2003		
	Ultimate holding Company	**Fellow Subsidiaries**	**Subsidiaries** *(note)*
Interest income	183	151	10
Interest expense	86	41	–
Management fee to CITIC Group	–	–	–
Other service fees	–	19	–
Loan impairment losses charge	–	71	–
Gross loans and advances to customers	2,680	3,806	117
Less: Impairment allowances	–	(829)	–
Net loans and advances to customers	2,680	2,977	117
Amounts due from banks and other financial institutions	–	192	557
Investments	1,093	33	66
Deposits from customers	2,255	1,686	1
Amounts due to banks and other financial institutions	–	1,623	–
Other liabilities	42	157	7
Off-balance sheet transactions	424	436	–
Guarantee for loans to third parties	–	138	–

	2004		
	Ultimate holding Company	**Fellow Subsidiaries**	**Subsidiaries** *(note)*
Interest income	171	139	19
Interest expense	92	49	–
Management fee to CITIC Group	300	–	–
Other service fees	–	13	–
Loan impairment losses release	–	(15)	–
Gross loans and advances to customers	2,680	3,699	110
Less: Impairment allowances	–	(814)	–
Net loans and advances to customers	2,680	2,885	110
Amounts due from banks and other financial institutions	–	122	542
Investments	1,110	66	33
Deposits from customers	2,513	1,493	16
Amounts due to banks and other financial institutions	–	2,287	–
Other liabilities	38	180	3
Off-balance sheet transactions	527	250	–
Guarantee for loans to third parties	–	176	–

	2005		
	Ultimate holding Company	**Fellow Subsidiaries**	**Subsidiaries** *(note)*
Interest income	176	114	20
Interest expense	50	49	–
Management fee to CITIC Group	500	–	–
Other service fees	–	4	–
Loan impairment losses release	–	(89)	–
Gross loans and advances to customers	2,620	2,848	106
Less: Impairment allowances	–	(725)	–
Net loans and advances to customers	2,620	2,123	106
Amounts due from banks and other financial institutions	–	368	462
Investments	908	65	32
Deposits from customers	2,428	3,693	25
Amounts due to banks and other financial institutions	–	1,039	–
Other liabilities	37	61	–
Off-balance sheet transactions	604	171	–
Guarantee for loans to third parties	–	210	–

Note: The related party transactions between the Bank and the subsidiaries are eliminated in consolidation.

(b) *Key management personnel and their close family members and related companies*

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including Directors, Supervisors and Executive Officers.

The Group enters into banking transactions with key management personnel and their close family members and those companies controlled or significantly influenced by them in the normal course of business. During the years ended 31 December 2003, 2004 and 2005, there were no transactions and balances with these individuals or companies in excess of RMB 1 million on an individual basis. The total amounts of loans to directors, supervisors and officers are disclosed in note 11.

The aggregate of the compensations in respect of Directors and Supervisors is disclosed in Note 9. The Executive Officers' compensations during the year are as follows:

	2003	**2004**	**2005**
Salaries and other emoluments	2	2	2
Discretionary bonuses	6	7	11
Contributions to defined contribution retirement schemes	1	1	1
	9	10	14

(c) *Contributions to defined contribution retirement schemes*

The Group participates in defined contribution retirement schemes organised by municipal and provincial governments for its employees in Mainland China.

The Group has also established a supplementary defined contribution plan for its qualified employees. The plan is administered by CITIC Group.

The Group is also required to make contributions to the Mandatory Provident Fund Scheme for employees working in Hong Kong at the rate set up by the local laws and regulations.

The details of the Group's defined contribution retirement schemes are described in Notes 23(a) and 24(a).

(d) *Transactions with other state-owned entities in the PRC*

The Group operates in an economic regime currently predominated by entities directly or indirectly owned by the PRC government through its government authorities, agencies, affiliations and other organisations (''state-owned entities'').

Transactions with other state-owned entities include but are not limited to the following:

- lending and deposit taking;
- taking and placing of inter-bank balances;
- entrusted lending and other custody services;
- insurance and securities agency, and other intermediary services;
- sale, purchase, underwriting and redemption of bonds issued by other state-owned entities;

– purchase, sale and leases of property and other assets; and

– rendering and receiving of utilities and other services.

These transactions are conducted in the ordinary course of the Group's banking business on terms similar to those that would have been entered into with non-state-owned entities. The Group has also established its pricing strategy and approval processes for major products and services, such as loans, deposits and commission income. The pricing strategy and approval processes do not depend on whether the customers are state-owned entities or not. Having due regard to the substance of the relationships, the Directors are of the opinion that none of these transactions are material related party transactions that require separate disclosure.

38. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2005

Up to the date of issue of this Accountants' Report, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the accounting period ending 31 December 2005 and which have not been adopted in the Financial Information:

		Effective for accounting periods beginning on or after
IFRS 7	Financial Instruments: Disclosures	1 January 2007
Amendment to IAS 1	Presentation of Financial Statements: Capital Disclosures	1 January 2007

The Group has assessed the impact of these amendments, new standards and new interpretations and concluded that they would only affect the level of details in the disclosure of the Financial Information, and would not have financial impact nor result in a change in the Group's accounting policies.

Yours faithfully,
KPMG
Certified Public Accountants
Hong Kong, China

2. UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

The information set out below does not form part of the audited financial information, and is included herein for information purposes only.

(a) Liquidity ratios

	2003	2004	2005
RMB current assets to RMB current liabilities	57.82%	61.28%	60.69%
Foreign currency current assets to foreign currency current liabilities	57.87%	74.52%	68.00%

The above liquidity ratios are calculated in accordance with the formula promulgated by the People's Bank of China (the "PBOC") and China Banking Regulatory Commission ("CBRC") and based on the financial statements of China CITIC Bank ("the Bank") prepared in accordance with the Accounting Standards for Business Enterprises, the Accounting Regulations for Financial Enterprises (jointly issued by the Ministry of Finance of the PRC (the "MOF") and the PBOC in 1993) and other relevant regulations issued by the MOF (collectively "Previous PRC GAAP") (for 31 December 2003 and 2004) and in accordance with the Accounting Standards for Business Enterprises, the Accounting Regulations for Financial Enterprises (issued by the MOF in 2001) and other regulations issued by the MOF (collectively named as "PRC GAAP") (for 31 December 2005).

(b) Capital adequacy ratio

The capital adequacy ratio is prepared on a solo basis in accordance with the guideline "Regulation Governing Capital Adequacy of Commercial Banks" [Order (2004) No.2] effective on 1 March 2004, which may have significant differences with the relevant requirements in Hong Kong of the PRC or other countries.

The capital adequacy ratios as at 31 December 2003 and 31 December 2004 reported to the CBRC respectively are not presented. The Group is of the opinion that they are not value added to the equity owners, given that the capital adequacy ratios are calculated based on the quantitative financial information of the Bank in accordance with the Previous PRC GAAP and the guideline issued by PBOC which was applicable for calculating capital adequacy ratios in 2003 has been replaced by the CBRC guideline since March 2004.

Capital Adequacy Guidelines

PRC commercial banks are subject to a minimum capital adequacy ratio of 8% and a minimum core capital adequacy ratio of 4%. The capital adequacy ratio and core capital adequacy ratio are calculated based on the quantitative financial information of the Bank in accordance with the PRC GAAP as follows:

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

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

Components of Capital

Total capital consists of core capital and supplementary capital. Supplementary capital may not exceed core capital.

Core capital includes the following items:

– paid-in capital;

– capital reserves;

– surplus reserves, including statutory and discretionary surplus reserves and the statutory public welfare fund;

– retained earnings; and

– minority interests.

Supplementary capital includes the following:

– up to 70% of the revaluation reserve;

– the general allowances for impairment losses under the CBRC's requirements;

– preference shares;

– qualifying bonds convertible into common shares; and

– qualifying subordinated debt with a maturity exceeding 5 years, not exceeding 50% of core capital.

Deductions from total capital consist of the following:

– goodwill;

– 100% of equity investments in non-consolidated financial institutions; and

– 100% of capital investments in real estate not used for the bank's own operations or equity investments in non-financial institutions.

Deductions from core capital consist of the following:

– goodwill;

– 50% of equity investments in non-consolidated financial institutions; and

– 50% of capital investments in real estate not used for the bank's own operations or equity investments in non-financial institutions.

Risk-weighted Assets

The guidelines provide for the calculation of risk-weighted assets net of any allowance for impairment losses by multiplying on-balance sheet items by their corresponding risk weighting. Off-balance sheet items, including foreign exchange contracts, interest rate contracts and other derivative contracts, are first converted to balance sheet credit-equivalent amounts by multiplying the nominal principal amount by a credit conversion factor. In addition, loans secured by certain types of pledges or guarantees are allocated the risk weighting of the pledges or guarantors. Partially pledged or guaranteed loans receive such lower risk-weighting only on the portion of the loan that is pledged or guaranteed. The following table sets forth risk weightings for different assets.

Risk Weighting	Assets
0%	– Cash – Gold – Claims on PRC incorporated commercial banks with an original maturity of four months or less – Claims on the PRC central government or deposits at the PBOC – Claims on the PBOC – Claims on PRC policy banks – Bonds issued by PRC financial asset management companies for the purpose of acquiring non-performing loans from state-owned banks – Claims on non-PRC central governments or central banks in countries or regions where the sovereign or region is rated AA - or above (These ratings refer to credit ratings of Standard & Poor's or equivalent rating agencies). – Claims on multilateral development banks
20%	– Claims on PRC incorporated commercial banks with an original maturity of more than four months – Claims on non-PRC commercial banks and securities companies incorporated in other countries or regions where the sovereign or region is rated AA - or above (These ratings refer to credit ratings of Standard & Poor's or equivalent rating agencies).
50%	– Residential mortgages – Claims on PRC public-sector entities owned by the central government – Claims on non-PRC public-sector entities owned by governments of countries or regions where the sovereign or region is rated AA - or above (These ratings refer to credit ratings of Standard & Poor's or equivalent rating agencies).
100%	– All other assets

Capital Charge for Market Risk

Since the first quarter of 2005, domestic banks with trading books greater than the lower of 10% of on- and off-balance sheet assets in aggregate and RMB 8.5 billion are required to take into consideration market risk arising from trading activities when determining capital adequacy. Market risk is the aggregated risk charge applied to the balance of each trading security where the risk charge is determined based on the type of the security and the counterparty and the remaining maturity of the security. The value of securities in the trading book must be marked to market. If the market risk capital charge is applicable, capital must be applied against the sum of risk-weighted assets and market risk to determine capital adequacy.

The capital adequacy ratios and the related components of the Bank as at December 31, 2005, calculated based on the statutory financial statements prepared in accordance with PRC GAAP, were as follows:

	2005
Core capital adequacy ratio	5.72%
Capital adequacy ratio	8.11%
Components of capital base	
Core capital:	
– Paid up ordinary share capital	26,661
– Reserves	(5,321)
	21,340
Supplementary capital:	
– General provision for loans and advances	2,961
– Subordinated debts	6,000
Total supplementary capital	8,961
Total capital base before deductions	30,301
Deductions:	
– Unconsolidated equity investments	142
Total capital base after deductions	30,159
Risk weighted assets	372,000

(c) Currency concentrations

	2003			
	US Dollars	HK Dollars	Others	Total
Spot assets	41,884	1,445	3,650	46,979
Spot liabilities	(34,155)	(2,980)	(7,006)	(44,141)
Forward purchases	3,513	2,105	5,820	11,438
Forward sales	(7,675)	(1,045)	(2,477)	(11,197)
Net option position	46	–	36	82
Net long position	3,613	(475)	23	3,161

	2004			
	US Dollars	HK Dollars	Others	Total
Spot assets	41,110	1,616	14,936	57,662
Spot liabilities	(32,296)	(5,399)	(16,454)	(54,149)
Forward purchases	7,955	2,522	7,633	18,110
Forward sales	(10,004)	(1,634)	(6,510)	(18,148)
Net option position	26	–	(26)	–
Net long position	6,791	(2,895)	(421)	3,475

	2005			
	US Dollars	HK Dollars	Others	Total
Spot assets	55,773	10,343	9,217	75,333
Spot liabilities	(46,195)	(14,139)	(11,456)	(71,790)
Forward purchases	13,026	7,949	6,557	27,532
Forward sales	(19,599)	(4,487)	(4,171)	(28,257)
Net option position	61	–	(61)	–
Net long position	3,066	(334)	86	2,818

(d) Cross-border claims

The Group is principally engaged in business operations within Mainland China, and regards all claims on third parties outside Mainland China as cross-border claims.

For the purpose of these unaudited supplementary financial information, Mainland China excludes Hong Kong, Macau and Taiwan.

Cross-border claims include loans and advances, balances and placements with banks and other financial institutions, holding of trade bills and certificates of deposit and investment securities.

Cross-border claims have been disclosed by different country or geographical areas. A country or geographical areas is reported where it constitutes 10% or more of the aggregate amount of cross-border claims, after taking into account any risk transfers. Risk transfers are only made 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.

	2003			
	Banks and other financial institutions	**Public sector entities**	**Others**	**Total**
Asia Pacific excluding Mainland China	2,706	293	770	3,769
– of which attributed to Hong Kong	1,250	293	419	1,962
Europe	4,983	10	2,237	7,230
North and South America	10,680	971	4,787	16,438
	18,369	1,274	7,794	27,437

	2004			
	Banks and other financial institutions	**Public sector entities**	**Others**	**Total**
Asia Pacific excluding Mainland China	3,772	250	961	4,983
– of which attributed to Hong Kong	1,547	250	311	2,108
Europe	3,610	117	9,686	13,413
North and South America	6,977	10,197	2,363	19,537
	14,359	10,564	13,010	37,933

	2005			
	Banks and other financial institutions	Public sector entities	Others	Total
Asia Pacific excluding Mainland China	3,701	531	1,140	5,372
– of which attributed to Hong Kong	1,317	482	164	1,963
Europe	6,492	49	1,006	7,547
North and South America	10,548	9,083	6,687	26,318
	20,741	9,663	8,833	39,237

(e) Overdue loans and advances to customers by geographic sector

	2003		
	Gross loans and advances	Loans and advances overdue over 3 months	Impaired loans
Yangtze River Delta	70,051	2,515	3,120
Pearl River Delta and Cross Straits Economic Region	46,780	7,526	8,241
Bohai Rim	81,788	8,060	9,285
Central	21,396	467	487
Western	21,075	201	178
Northeastern	15,943	1,960	1,894
Hong Kong	280	–	–
Total	257,313	20,729	23,205

		2004	
	Gross loans and advances	Loans and advances overdue over 3 months	Impaired loans
Yangtze River Delta	91,672	1,376	1,491
Pearl River Delta and Cross Straits Economic Region	49,491	8,072	8,196
Bohai Rim	89,944	5,656	6,693
Central	27,477	408	419
Western	27,943	597	593
Northeastern	20,131	1,810	1,888
Hong Kong	221	–	–
Total	306,879	17,919	19,280

		2005	
	Gross loans and advances	Loans and advances overdue over 3 months	Impaired loans
Yangtze River Delta	120,026	683	925
Pearl River Delta and Cross Straits Economic Region	52,885	6,086	6,467
Bohai Rim	105,803	5,140	5,174
Central	36,255	651	754
Western	32,029	602	660
Northeastern	23,110	1,122	1,331
Hong Kong	152	–	–
Total	370,260	14,284	15,311

Impaired loans and advances include loans for which objective evidence of impairment exists and which have been assessed as bearing significant impairment losses. These loans include loans for which objective evidence of impairment has been identified:

– individually (including corporate loans and advances which are graded substandard, doubtful or loss); or

– collectively: that is portfolios of homogeneous loans (including retail loans and advances which are graded substandard, doubtful or loss).

(f) Gross amount of overdue amounts due from banks and other financial institutions and overdue loans and advances to customers

(i) Gross overdue amounts due from banks and other financial institutions

	2003	2004	2005
Gross amounts due from banks and other financial institutions which have been overdue	1,002	604	419
As a percentage of total gross amounts due from banks and other financial institutions	3.10%	2.83%	1.32%

Note:

All overdue amounts have been overdue over 12 months.

(ii) Gross amounts of overdue loans and advances to customers

	2003	2004	2005
Gross loans and advances to customers which have been overdue with respect to either principal or interest for periods of:			
– between 3 and 6 months	802	1,414	1,283
– between 6 and 12 months	784	1,565	1,149
– over 12 months	19,143	14,940	11,852
Total	20,729	17,919	14,284
As a percentage of total gross loans and advances to customers:			
– between 3 and 6 months	0.31%	0.46%	0.35%
– between 6 and 12 months	0.30%	0.51%	0.31%
– over 12 months	7.44%	4.87%	3.20%
Total	8.05%	5.84%	3.86%

The overdue loans represent loans of which the whole or part of the principal was overdue, or interest was overdue. The definitions of overdue loans with various repayment terms are set out below:

– Loans with a specific repayment date are classified as overdue when the principal or interest is overdue and remains unpaid at year end.

– Where one or more instalments of a loan repayable by regular instalments are overdue and remain unpaid at year end, the entire loan balance is considered overdue.

– Loans repayable on demand are classified as overdue when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the demand notice. If loans and advances repayable on demand are continuously outside the approved limit that was advised to the borrower, they are also considered as overdue.

(g) Rescheduled amounts due from banks and other financial institutions and reschedule loans and advances to customers

(i) Rescheduled amounts due from banks and other financial institutions

The Group does not have any rescheduled amounts due from banks and other financial institutions for the year ended 31 December 2003, 2004 and 2005.

(ii) Rescheduled loans and advances to customers

	2003		2004		2005	
		% of total loans and advances		% of total loans and advances		% of total loans and advances
Rescheduled loans and advances	8,919	3.47%	9,148	2.98%	6,619	1.79%
Less:						
– rescheduled loans and advances but overdue more than 90 days	4,268	1.66%	4,040	1.32%	3,249	0.88%
Rescheduled loans and advances overdue less than 90 days	4,651	1.81%	5,108	1.66%	3,370	0.91%

Rescheduled loans and advances are those loans and advances which have been restructured or renegotiated because of a deterioration in the financial position of the borrower, or of the inability of the borrower to meet the original repayment schedule and for which the revised repayment terms are a concession that the Group would not otherwise consider. Rescheduled loans and advances are required to be graded at a minimum of substandard (see Note 34(a) for the core definitions of the loan classification) and subject to an observation period of six months, until when no upgrade to a higher loan classification is considered.

(h) Impairment allowances against loans and advances to customers recorded in the Accountants' Report prepared under IFRS and those recorded in the Bank's statutory financial statements prepared under Previous PRC GAAP and PRC GAAP

Impairment allowances	**2003**	**2004**	**2005**
As disclosed in the Accountants' Report prepared under IFRS	16,774	14,958	12,230
As disclosed in the statutory financial statements prepared under Previous PRC GAAP and PRC GAAP	3,127	3,922	11,938

Under IFRS, the Group is required to assess whether its loans and advances to customers are impaired and recognise impairment losses based on their estimated recoverable amounts.

The impairment allowances as recorded under Previous PRC GAAP and PRC GAAP for loans and advances to customers are made in accordance with relevant PRC rules and regulations on loan loss provisioning. Previous PRC GAAP does not require recognition of impairment losses against the assets based on their estimated recoverable amounts. Only an allowance of 1% of the total gross amount of certain assets, including loans and investments, is required to be made. In the Bank's 2005 statutory financial statements prepared under PRC GAAP, impairment allowances for loans and advances to customers are accrued based on a range of reference rates for each of the five loan categories as stated in "Guidelines on Loan Loss Provisions" issued by PBOC on 24 April 2002.

3. MANAGEMENT DISCUSSION AND ANALYSIS

The following discussion and analysis should be read in conjunction with the accountants' report on CNCB set out in section 1 of Appendix II in this circular.

Background

CNCB (previously known as "CITIC Industrial Bank") was established on 7 April 1987, as a state-owned financial institution. CNCB is wholly-owned by the CITIC Group. The principal activities of CNCB and its subsidiaries are the provision of corporate and personal banking services, conducting treasury business and corresponding banking business, and the provision of asset management, entrusted lending and custodian trustee services. As at 31 December 2005, CNCB had established branches and sub-branches in 18 provinces, autonomous regions and municipalities directly under the central government in the PRC.

Business Performance

Earnings

For the year ended 31 December 2005, the CNCB Group reported operating income of RMB13,655 million, representing an increase of 22.51% over 2004. For the year ended 31 December 2004, the CNCB Group reported operating income of RMB11,146 million, representing an increase of 33.20% over 2003. The increase in operating income for the two years ended 31 December 2005 and 2004 was mainly attributable to (a) an increase in net interest income and (b) an increase in net fee and commission income.

For the year ended 31 December 2003, the CNCB Group reported operating income of RMB8,368 million.

Net Interest Income

The net interest income of the CNCB Group accounts for the largest portion of the total operating income of the CNCB Group, representing 92.71%, 93.15% and 91.69% of the total operating income of CNCB Group for the years ended 31 December 2005, 2004 and 2003 respectively. Set out below is a table showing the interest income, interest expense and net interest income of the CNCB Group for the years ended 31 December 2005, 2004 and 2003.

	31 December 2003 *(expressed in millions of RMB)*	**31 December 2004** *(expressed in millions of RMB)*	**31 December 2005** *(expressed in millions of RMB)*
Interest income	12,967	17,795	22,511
Interest expense	(5,294)	(7,412)	(9,851)
Net interest income	7,673	10,383	12,660

For the year ended 31 December 2005, the net interest income of the CNCB Group increased by 21.93% to RMB12,660 million compared to RMB10,383 million for the year ended 31 December 2004. This increase reflects both an increase in interest income, which grew by 26.50% compared to the year ended 31 December 2004, and an increase in interest expense, which grew by 32.91% compared to the same period. For the year ended 31 December 2004, the net interest income of CNCB Group increased by 35.32% to RMB10,383 million compared to RMB7,673 million for the year ended 31 December 2003. This increase reflects both an increase in interest income, which grew by 37.23% compared to the year ended 31 December 2003, and an increase in interest expense, which grew by 40.01% compared to the same period. The increase in net interest income over the period from 2003 to 2005 was mainly attributable to the continued growth in loans and advances to customers of CNCB Group.

The table below sets out the principal components of the interest income and interest expense of CNCB:

	2003 *(expressed in millions of RMB)*	**2004** *(expressed in millions of RMB)*	**2005** *(expressed in millions of RMB)*
Interest income arises from:			
Balances with central bank	627	853	713
Amounts due from banks and other financial institutions	826	906	820
Loans and advances to customers *(note (i))*	9,735	13,960	17,838
Investments in debt securities *(note (ii))*	1,664	1,963	3,009
Others	115	113	131
	12,967	17,795	22,511
Interest expense arises from:			
Balances due to central bank	(39)	(30)	(12)
Amounts due to banks and other financial institutions	(937)	(1,065)	(1,029)
Deposits from customers	(4,277)	(6,044)	(8,370)
Subordinated debts issued	–	(136)	(298)
Others	(41)	(137)	(142)
	(5,294)	(7,412)	(9,851)
Net interest income	7,673	10,383	12,660

Notes:

(i) Interest income arising from loans and advances to customers includes interest income accrued on individually assessed impaired loans and advances to customers of RMB306 million for the year ended 31 December 2005 (2004: RMB350 million; 2003: RMB396 million), which includes interest income on the unwinding of discount of allowances for loan impairment losses of RMB275 million for the year ended 31 December 2005 (2004: RMB307 million; 2003: RMB346 million).

(ii) Interest income from investments in debt securities is mainly derived from unlisted investments.

Non-Interest Income

CNCB's non-interest income for the year ended 31 December 2005 grew significantly by 30.41% to RMB995 million compared to RMB763 million for the year ended 31 December 2004. For the year ended 31 December 2004, CNCB's non-interest income grew by 9.78% to RMB763 million compared to RMB695 million for the year ended 31 December 2003. The increase in CNCB's non-interest income over the period from 2003 to 2005 was primarily due to an increase in the net fee and commission income and net gains arising from foreign currency dealing.

The proportion of non-interest income to total operating income for the years ended 31 December 2005, 2004 and 2003 was 7.29%, 6.85% and 8.31% respectively.

Set out below is a table showing a breakdown of the non-interest income for the years ended 31 December 2005, 2004 and 2003.

	For the year ended 31 December 2003 *(expressed in millions of RMB)*	**For the year ended 31 December 2004** *(expressed in millions of RMB)*	**For the year ended 31 December 2005** *(expressed in millions of RMB)*
Net fee and commission income	265	318	418
Dividend income	–	1	1
Net profit on disposal of fixed assets	1	11	12
Net gain from trading securities	124	34	109
Net (loss)/gain from investment securities	(92)	11	(24)
Net gains arising from foreign currency dealing	151	227	266
Other operating income	246	161	213
	695	763	995

General and Administrative Expenses

The general and administrative expenses of CNCB increased by 30.32% to RMB7,104 million for the year ended 31 December 2005 compared to RMB5,451 million for the year ended 31 December 2004. This was primarily due to (a) the continued increase in staff costs resulting from an increase in the number of staff employed by CNCB Group and (b) an increase in other general and administrative expenses including management fees payable to CITIC Group.

For the year ended 31 December 2004, the general and administrative expenses of CNCB increased by 38.35% to RMB5,451 million for the year ended 31 December 2004 compared to RMB3,940 million for the year ended 31 December 2003. This is primarily due to (a) a significant increase in staff costs as the CNCB Group expands its operations and (b) an increase in other general and administrative expenses.

Set out below is a table showing the principal components of general and administrative expenses for the three years ended 31 December 2005, 2004 and 2003:

	2003	**2004**	**2005**
	(expressed in millions of RMB)	*(expressed in millions of RMB)*	*(expressed in millions of RMB)*
Staff costs			
– salaries, bonuses and staff welfare expenses	894	1,215	1,661
– contributions to defined contribution retirement schemes	83	107	125
– housing fund	31	63	67
– supplementary retirement benefits	–	9	–
– others	152	187	233
	1,160	1,581	2,086
Property and equipment expense			
– depreciation	553	548	617
– rent and property management expenses	314	345	376
– electronic equipment operating expenses	64	95	141
– maintenance	64	83	92
– others	86	96	112
	1,081	1,167	1,338
Other general and administrative expenses	1,131	1,580	2,125
Management fee payable to CITIC Group	–	300	500
Business tax and surcharges *(note (i))*	521	792	991
Amortisation expense	47	31	64
	3,940	5,451	7,104

Note:

(i) Business tax of 5% is levied primarily on interest income from loans and advances to customers, and fee and commission income.

The surcharges, which include education surcharges and city construction tax, are charged at 3% and 7% of business tax paid respectively.

Impairment Losses Charge

The impairment losses charge comprises mainly of provision for loans and advances to customers which represents approximately 96.08%, 97.25% and 99.58% of the total impairment losses charges for the three years ended 31 December 2005, 2004 and 2003 respectively.

For the year ended 31 December 2005, total impairment charges on loans and advances to customers decreased by 33.61% from RMB1,589 million in 2004 to RMB1,055 million in 2005. For the year ended 31 December 2004, total impairment charges on loans and advances to customers decreased by 25.61% from RMB2,136 million in 2003 to RMB1,589 million in 2004. Such decrease over the three years was primarily due to the improvement in the loan portfolio of CNCB due to the adoption of various risk management procedures and continued improvement in the control over the lending process of CNCB.

Total Assets

As at 31 December 2005, CNCB Group's total assets were RMB594,602 million representing a 20.01% increase from RMB495,445 million for the year ended 31 December 2004. As at 31 December 2004, CNCB Group's total assets were RMB495,445 million representing a 24.85% increase from RMB396,817 million for the year ended 31 December 2003.

Loans and advances to customers is a major component of the total assets of CNCB Group and represents approximately 60.21%, 58.92% and 60.62% of the total assets of CNCB Group as at 31 December 2005, 2004 and 2003 respectively. Investments constitute the second largest component of the total assets of CNCB Group and represents approximately 17.56%, 22.38% and 14.72% of the total assets of CNCB Group as at 31 December 2005, 2004 and 2003 respectively.

The table below sets out the components of the assets of CNCB Group for the years ended 31 December 2005, 2004 and 2003.

	2003 *(expressed in millions of RMB)*	**2004** *(expressed in millions of RMB)*	**2005** *(expressed in millions of RMB)*
Assets			
Cash and balances with central bank	49,299	54,253	84,453
Amounts due from banks and other financial institutions	31,848	20,899	31,352
Loans and advances to customers	240,539	291,921	358,030
Investments *(note)*	58,403	110,903	104,416
Property and equipment	6,826	8,090	8,614
Deferred tax assets	5,999	5,424	4,082
Other assets	3,903	3,955	3,655
Total assets	396,817	495,445	594,602

Note: Please refer to note 17 of the accountants' report of CNCB Group.

Customer Loans and Deposits

As at 31 December 2005, customer loans were RMB358,030 million representing an increase of 22.65% from the 2004 year end. Total deposits as at 31 December 2005 were RMB530,573 million representing an increase of 21.97% from the 2004 year end. As at 31 December 2004, customer loans were RMB291,921 million representing an increase of 21.36% from the 2003 year end. Total deposits as at 31 December 2004 were RMB435,020 million representing an increase of 25.96% from the 2003 year end. As at 31 December 2003, customer loans were RMB240,539 million and total deposits were RMB345,356 million.

The increase in customer loans over the period from 2003 to 2005 was due to an increased demand for loans resulting from the growth in the business of CNCB Group.

Loan Portfolio

Set out below is a table setting out further information in respect of the loan portfolio of CNCB for the years ended 31 December 2005, 2004, 2003.

(a) Analysed by nature

	2003 *(expressed in millions of RMB)*	**2004** *(expressed in millions of RMB)*	**2005** *(expressed in millions of RMB)*
Corporate loans	194,517	256,422	282,275
Personal loans	17,237	31,730	37,834
Discounted bills	45,559	18,727	50,151
Gross loans and advances to customers	257,313	306,879	370,260
Less:			
– Individual impairment allowances	(14,764)	(12,485)	(9,622)
– Collective impairment allowances	(2,010)	(2,473)	(2,608)
Less: Impairment allowances	(16,774)	(14,958)	(12,230)
Net loans and advances to customers	240,539	291,921	358,030

(b) Analysed by legal form of borrowers

	2003 *(expressed in millions of RMB)*	**2004** *(expressed in millions of RMB)*	**2005** *(expressed in millions of RMB)*
Corporate loans to			
– Joint-stock enterprises	83,086	119,369	130,157
– State-owned enterprises	64,826	84,252	100,738
– Foreign invested enterprises	22,156	27,171	27,040
– Private enterprises	8,398	11,662	13,636
– Collectively-controlled enterprises	7,730	6,386	4,480
– Others	8,321	7,582	6,224
Subtotal	194,517	256,422	282,275
Personal loans			
– Home mortgage loans	8,149	17,838	26,246
– Credit card advances	11	208	447
– Others	9,077	13,684	11,141
Subtotal	17,237	31,730	37,834
Discounted bills	45,559	18,727	50,151
Gross loans and advances to customers	257,313	306,879	370,260
Less: Impairment allowances	(16,774)	(14,958)	(12,230)
Net loans and advances to customers	240,539	291,921	358,030

(c) Loans and advances to customers analysed by expected next repricing date and effective interest rate

	Effective interest rate	Total	Non-interest bearing	Less than three months	Between three months and one year	Between one and five years	More than five years
For the year 2003	4.66%	240,539	–	102,908	136,216	1,415	–
For the year 2004	4.85%	291,921	–	134,079	155,869	1,973	–
For the year 2005	5.18%	358,030	–	158,629	197,656	1,745	–

Deposits

Set out below is a table setting out further information on the deposits of CNCB for the years ended 31 December 2005, 2004, 2003:

(a) Analysed by nature

	2003 *(expressed in millions of RMB)*	2004 *(expressed in millions of RMB)*	2005 *(expressed in millions of RMB)*
Demand deposits			
– Corporate customers	176,833	201,243	258,535
– Personal customers	6,188	7,430	11,929
	183,021	208,673	270,464
Time deposits			
– Corporate customers	136,219	186,003	200,786
– Personal customers	26,116	40,344	59,323
	162,335	226,347	260,109
Total	345,356	435,020	530,573

(b) Analysed by geographical segments

	2003 *(expressed in millions of RMB)*	**2004** *(expressed in millions of RMB)*	**2005** *(expressed in millions of RMB)*
Bohai Rim	131,092	167,713	207,676
Yangtze River Delta	95,109	127,269	155,861
Pearl River Delta and Cross-Straits Economic Region	50,914	59,003	72,855
Central	24,747	32,420	37,932
Western	31,619	34,250	39,204
Northeastern	11,121	13,793	16,579
Head Office	754	572	466
Total	345,356	435,020	530,573

(c) Deposits from customers analysed by expected next repricing date and effective interest rate

	Effective interest rate	**Total**	**Non-interest bearing**	**Less than three months**	**Between three months and one year**	**Between one and five years**	**More than five years**
For the year 2003	1.55%	345,356	3,056	263,203	62,933	10,450	5,714
For the year 2004	1.66%	435,020	5,182	336,007	75,541	12,815	5,475
For the year 2005	1.86%	530,573	18,929	416,860	78,392	11,916	4,476

Key Financial Ratios

Set out below is a table setting out the asset quality indicators of CNCB for the years ended 31 December 2005, 2004 and 2003.

	31 December 2003	31 December 2004	31 December 2005
Capital adequacy ratio(1)	–	–	8.11%
RMB current assets to RMB current liabilities(2)	57.82%	61.28%	60.69%
Foreign currency current assets to foreign currency current liabilities(2)	57.87%	74.52%	68.00%
Loans to deposits(3)	74.51%	70.54%	69.78%
Loans to total assets(4)	64.84%	61.94%	62.27%
Gross impaired loans and advances to customers as a percentage of total loans and advances to customers	9.02%	6.28%	4.14%
Loan loss coverage(5)	72.29%	77.58%	79.88%

Notes

(1) The capital adequacy ratio is calculated in accordance with the guideline "Regulation Governing Capital Adequacy of Commercial Banks" Order (2004) No. 21 effective on 1 March 2004 and based on CNCB's financial statements prepared in accordance with the Accounting Standards for Business Enterprises, the Accounting Regulations for Financial Enterprises (issued by the MOF in 2001) and other regulations issued by the MOF (collectively named as "PRC GAAP"). It is calculated by dividing the total capital base after deduction by risk weighted assets.

The capital adequacy ratios as at 31 December 2003 and 31 December 2004 reported to the CBRC respectively are not presented as the Group is of the opinion that they provide no real value to the equity owner given that they are based on the financial information of CNCB calculated in accordance with the Accounting Standards for Business Enterprises, the Accounting Regulations for Financial Enterprises (jointly issued by the MOF and PBOC in 1993) and other relevant regulations issued by the MOF (collectively "Previous PRC GAAP") and the guideline issued by the PBOC, which has been replaced by the CBRC guideline since March 2004.

(2) Calculated in accordance with the formula promulgated by the PBOC and CBRC and based on CNCB's financial statements prepared in accordance with Previous PRC GAAP (for the 31 December 2003 and 2004) and in accordance with PRC GAAP (for 31 December 2005).

(3) Calculated by dividing the total gross advances to customers by the total of deposits from customers.

(4) Calculated by dividing the total gross advances to customers by the total assets.

(5) Calculated by dividing the allowance for impairment losses for total gross loans and advances to customers by the gross impaired loans and advances to customers.

Segmental Information

An analysis of the segment information in respect of the business of CNCB Group is set out in note 32 to the accountants' report on CNCB set out in Appendix II to this circular.

Staff and Remuneration policy

As at the end of 2005, CNCB Group had 13,485 staff under its employment and the total staff costs were RMB2,086 million, representing an increase of 31.94% from 2004. As at the end 2004, CNCB Group had 11,598 staff in its employment and the total staff costs were RMB1,581 million, representing an increase of 36.29% from RMB1,160 million in 2003.

Charges on Assets and contingent liabilities

The following assets have been pledged as security for bills rediscounting transactions and securities sold under repurchase agreements. The related secured liabilities are recorded as amounts due to central bank, or banks and other financial institutions of approximately similar carrying value at the balance sheet date.

	2003	**2004**	**2005**
Available-for-sale debt securities	300	3,930	865
Discounted bills	6,197	2,223	75
Total	6,497	6,153	940

An analysis of the contingent liabilities of CNCB Group is set out in note 29 to the accountants' report on CNCB set out in Appendix II to this circular.

Hedging and Currency Exposure

CNCB Group has undertaken forward, swap and option transactions in the foreign exchange and interest rate markets and, through the operations of its branch network, acts as an intermediary between a wide range of customers structuring deals to produce risk management products for its customers. These positions are managed through back to back deals entered into by CNCB Group with external parties to ensure that the CNCB Group's net exposures are within acceptable risk levels. A table setting out an analysis of the notional amounts of derivatives of CNCB Group is set out in note 33 to the accountants' report on CNCB in Appendix II to this circular.

CNCB Group's foreign currency positions arise from foreign exchange dealing, commercial bank operations and foreign currency capital related structural exposures. CNCB Group has a treasury department which manages the currency risk within its internal approved limits and manages other currency risk by spot and forward foreign exchange transactions and matching its foreign currency denominated assets with corresponding liabilities in the same currencies.

Future Plans

CNCB has plans to list its shares on the Stock Exchange and to expand its business.

INTRODUCTION

The unaudited pro forma financial information of the Combined Group is based on a number of assumptions, estimates, uncertainties and currently available information, and is provided for illustrative purposes. Accordingly, as a result of the uncertain nature of the accompanying unaudited pro forma financial information of the Combined Group, it may not give a true picture of the actual financial position or results of the Combined Group's operations that would have been attained had the Acquisition actually occurred on the dates indicated herein. Further, the accompanying unaudited pro forma financial information of the Combined Group does not purport to predict the Combined Group's future financial position or results of operations.

1. UNAUDITED PRO FORMA COMBINED CONSOLIDATED BALANCE SHEET OF THE GROUP AFTER COMPLETION

For illustrative purpose only, the following is the unaudited pro forma combined consolidated balance sheet of the Group, assuming that the Acquisition had been completed on 31 December 2005. The unaudited pro forma combined consolidated balance sheet is prepared based on the audited consolidated balance sheet of the Group as at 31 December 2005, as extracted from the annual report of the Group for the year ended 31 December 2005 and adjusted to reflect the effect of the Acquisition. As it was prepared for illustrative purpose only and because of its nature, it may not give a true picture of the financial position of the Group as at the date to which it is made up to or at any future date.

Unaudited Pro Forma Combined Consolidated Balance Sheet
as at 31 December 2005
(Expressed in Hong Kong dollars)

	CIFH	**CNCB Group**	**Combined Balance**
	HK$'000	*HK$'000*	*HK$'000*
Assets			
Cash and balances with banks and other financial institutions	1,161,309	–	1,161,309
Placements with banks and other financial institutions	5,265,044	–	5,265,044
Trade bills	406,364	–	406,364
Trading assets	6,473,029	–	6,473,029
Securities designated at fair value through profit or loss	1,139,908	–	1,139,908
Advances to customers and other accounts	44,108,183	–	44,108,183
Available-for-sale securities	5,945,960	–	5,945,960
Held-to-maturity investments	17,194,283	–	17,194,283
Interest in associates	1,291,180	5,172,439	6,463,619
Fixed assets			
– Investment property	64,994	–	64,994
– Other property and equipment	936,474	–	936,474
Goodwill	1,007,749	–	1,007,749
Deferred tax assets	42,201	–	42,201
Total assets	85,036,678	5,172,439	90,209,117

	CIFH	CNCB Group	Combined Balance
	HK$'000	*HK$'000*	*HK$'000*
Equity and liabilities			
Deposits and balances of banks and other financial institutions	4,157,446	–	4,157,446
Deposits from customers	54,415,279	–	54,415,279
Trading liabilities	661,137	–	661,137
Certificates of deposit issued	7,467,961	–	7,467,961
Debt securities issued	2,245,435	–	2,245,435
Convertible bonds issued	1,289,817	–	1,289,817
Current taxation	50,478	–	50,478
Deferred tax liabilities	45,466	–	45,466
Other liabilities	895,455	–	895,455
Loan capital	4,352,351	–	4,352,351
Total liabilities	75,580,825	–	75,580,825
Equity			
Share capital	3,197,859	1,516,844	4,714,703
Reserves	6,257,458	3,655,595	9,913,053
Total equity attributable to equity shareholders of the Company	9,455,317	5,172,439	14,627,756
Minority interests	536	–	536
Total equity	9,455,853	5,172,439	14,628,292
Total equity and liabilities	85,036,678	5,172,439	90,209,117

2. UNAUDITED PRO FORMA COMBINED CONSOLIDATED INCOME STATEMENT OF THE GROUP

For illustrative purpose only, the following is the unaudited pro forma combined income statement of the Group, assuming that the Acquisition had been completed on 1 January 2005. The unaudited pro forma combined consolidated income statement is prepared based on the audited consolidated income statement of the Group for the year ended 31 December 2005, as extracted from the annual report of the Group for the year ended 31 December 2005 and adjusted to reflect the effect of the Acquisition.

Unaudited Pro Forma Combined Consolidated Income Statement
For the year ended 31 December 2005
(Expressed in Hong Kong dollars)

	CIFH	CNCB Group	Combined Balance
	HK$'000	*HK$'000*	*HK$'000*
Interest income	3,007,372	–	3,007,372
Interest expense	(1,908,115)	–	(1,908,115)
Net interest income	1,099,257	–	1,099,257
Fee and commission income	439,662	–	439,662
Fee and commission expense	(12,837)	–	(12,837)
Net fee and commission income	426,825	–	426,825
Net trading income	343,466	–	343,466
Net income from financial instruments designated at fair value through profit or loss	22,481	–	22,481
Net hedging expense	(679)	–	(679)
Other operating income	79,301	–	79,301
Operating income	1,970,651	–	1,970,651
Operating expenses	(1,094,688)	–	(1,094,688)
	875,963	–	875,963
Impairment losses written back on loans and advances	57,544	–	57,544
Impairment losses written back on held-to-maturity investments	6,306	–	6,306
Impairment losses on available-for-sale securities	(7,817)	–	(7,817)
Impairment losses written back on properties	1,517	–	1,517
Impairment losses written back	57,550	–	57,550

	CIFH	CNCB Group	Combined Balance
	HK$'000	*HK$'000*	*HK$'000*
Operating profit	933,513	–	933,513
Loss on disposal of associates	(6,352)	–	(6,352)
Net profit on disposal of fixed assets	240,222	–	240,222
Revaluation gain on investment properties	2,140	–	2,140
Share of profits less losses of associates	46,123	595,696	641,819
Profit before taxation	1,215,646	595,696	1,811,342
Income tax	(112,206)	–	(112,206)
Profit for the year	1,103,440	595,696	1,699,136
Attributable to:			
Equity shareholders of the Company	1,103,395	595,696	1,699,091
Minority interests	45	–	45
Profit for the year	1,103,440	595,696	1,699,136
Earnings per Share			
Basic	34.51¢		36.04¢
Diluted	32.38¢		33.70¢

3. UNAUDITED PRO FORMA COMBINED CONSOLIDATED CASH FLOW STATEMENT

For illustrative purpose only, the following is the unaudited pro forma combined consolidated cash flow statement of the Group, assuming that the Acquisition had been completed on 1 January 2005. The unaudited pro forma combined consolidated cash flow statement is prepared based on the audited consolidated cash flow statement of the Group as at 31 December 2005, as extracted from the annual report of the Group for the year ended 31 December 2005 and adjusted to reflect the effect of the Acquisition.

Unaudited Pro Forma Combined Consolidated Cash Flow Statement
For the year ended 31 December 2005
(Expressed in Hong Kong dollars)

	CIFH	CNCB Group	Combined Balance
	HK$'000	*HK$'000*	*HK$'000*
OPERATING ACTIVITIES			
Profit for the year before taxation	1,215,646	595,696	1,811,342
Adjustments for non-cash items:			
Impairment losses written back on loans and advances	(57,544)	–	(57,544)
Share of profits less losses on associates	(46,123)	(595,696)	(641,819)
Revaluation gain on investment properties	(2,140)	–	(2,140)
Net profit on disposal of fixed assets	(240,222)	–	(240,222)
Impairment losses written back on held-to-maturity investments	(6,306)	–	(6,306)
Impairment loss written back on properties	(1,517)	–	(1,517)
Impairment loss on available-for-sale securities	7,817	–	7,817
Share-based payment	5,796	–	5,796
Amortization of deferred expenses	94,260	–	94,260
Interest expenses on convertible bonds	37,731	–	37,731
Depreciation on tangible fixed assets	112,837	–	112,837
Dividend income from equity investment securities	(25,717)	–	(25,717)
Interest expenses on loan capital	355,262	–	355,262
Loss on disposal of associates	6,352	–	6,352
Foreign exchange differences	(16,112)	–	(16,112)
	1,440,020	–	1,440,020

	CIFH	CNCB Group	Combined Balance
	HK$'000	*HK$'000*	*HK$'000*
(Increase)/decrease in operating assets			
Placements with banks and other financial institutions with original maturity beyond three months	(305,511)	–	(305,511)
Treasury bills with original maturity beyond three months	299,355	–	299,355
Certificates of deposit held with original maturity beyond three months	776,453	–	776,453
Trading assets	(2,677,493)	–	(2,677,493)
Securities designated at fair value through profit or loss	(70,110)	–	(70,110)
Trade bills and other accounts	(485,294)	–	(485,294)
Held-to-maturity investments	(494,513)	–	(494,513)
Available-for-sale securities	242,570	–	242,570
Increase/(decrease) in operating liabilities			
Deposits and balances of banks and other financial institutions	601,594	–	601,594
Deposits from customers	(1,036,448)	–	(1,036,448)
Trading liabilities	661,137	–	661,137
Certificates of deposit issued	502,577	–	502,577
Debt securities issued	(65,515)	–	(65,515)
Other liabilities	(810,308)	–	(810,308)
NET CASH USED IN OPERATIONS	(1,421,486)	–	(1,421,486)
Income tax			
Hong Kong profits tax paid	(113,585)	–	(113,585)
Overseas profits tax paid	(1,034)	–	(1,034)
NET CASH USED IN OPERATING ACTIVITIES	(1,536,105)	–	(1,536,105)
INVESTING ACTIVITIES			
Dividends received from equity investment securities	25,717	–	25,717
Purchase of fixed assets	(53,934)	–	(53,934)
Proceeds from disposal of fixed assets	439,065	–	439,065
Proceeds from disposal of associates	35,524	–	35,524
Purchase of an associate	(39)	–	(39)
NET CASH GENERATED FROM INVESTING ACTIVITIES	446,333	–	446,333
FINANCING ACTIVITIES			
Ordinary dividends paid	(601,197)	–	(601,197)
Interest paid on convertible bonds	(3,499)	–	(3,499)
Interest paid on loan capital	(355,733)	–	(355,733)
Proceeds from shares issued	7,970	–	7,970

	CIFH	CNCB Group	Combined Balance
	HK$'000	*HK$'000*	*HK$'000*
NET CASH USED IN FINANCING ACTIVITIES	(952,459)	–	(952,459)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,042,231)	–	(2,042,231)
CASH AND CASH EQUIVALENTS AT 1 JANUARY	8,054,509	–	8,054,509
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	6,012,278	–	6,012,278
Cash flows from operating activities include:			
Interest received	3,102,761	–	3,102,761
Interest paid	(2,027,636)	–	(2,027,636)

Major assumptions for Unaudited Pro Forma Financial Information of the Group After Completion:

(1) The Approved Valuation is equal to or lower than the Transaction Value.

(2) The translation of Renminbi into Hong Kong dollars has been made at the Circular Exchange Rate of RMB1.00 to HK$0.970638.

(3) Any capital injection by CITIC Group into CNCB and any other form of capital expansion of CNCB occurred subsequent to 31 December 2005 and before the completion of the Acquisition have not been taken into account in the Pro Forma Financial Information.

(4) There is no indication of goodwill impairment on the interest in associate relating to the acquisition of CNCB. Therefore no goodwill impairment adjustment is required.

(5) The accounting policy on property valuation between CNCB group and CIFH is not the same. Subsequent to initial recognition, CNCB adopts a revaluation policy to carry all classes of property at revaluation less accumulated depreciation and impairment losses. Meanwhile, CIFH adopts a cost method to carry property held under operating leases at cost less accumulated depreciation and impairment losses. The share of profits for CNCB in the unaudited pro forma combined consolidated income statement of the combined group has not taken into account the adjustment needed to be made for standardising the accounting policy as the effect is not material to the Group results.

(6) Intangible assets were acquired as part of the acquisition of CNCB and was included in the interest in associates. The share of profits for CNCB of the combined group has not taken into account the adjustment needed to be made for the amortisation of the acquired intangibles as the effect is not material to the Group's results.

The following is the text of a report, prepared for the sole purpose of inclusion in this circular, received from the independent reporting accountants, KPMG, Certificated Public Accountants, Hong Kong. As described in the section headed "Documents available for inspection" in Appendix IV, a copy of the following report is available for inspection.

KPMG

8th Floor
Prince's Building
10 Chater Road
Central
Hong Kong

30 June 2006

The Board of Directors
CITIC International Financial Holdings Limited
Suites 1801-1802 Bank of America Tower
12 Harcourt Road
Central
Hong Kong

Dear Sirs

We report on the unaudited pro forma combined consolidated income statement, pro forma combined consolidated balance sheet and pro forma combined consolidated cash flow statement of the Company and its subsidiaries (the "Group") as enlarged by equity accounting for the 19.9% equity interest in China CITIC Bank on the same accounting basis as at 31 December 2005 ("the Pro Forma Financial Information") set out on pages 287 to 293 in Appendix III of the Circular, which has been prepared by the Directors of the Company solely for illustrative purposes to provide information about how the Transaction might have affected the financial information presented. The basis of preparation of the Pro Forma Financial Information is set out on pages 287 to 293 of the Circular.

Responsibilities

It is the sole responsibility of the Directors of the Company to prepare the unaudited Pro Forma Financial Information in accordance with Paragraph 4.29 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and with reference to Accounting Guideline 7 "Preparation of Pro Forma Financial Information for inclusion in Investment Circulars" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

It is our responsibility to form an opinion, as required by paragraph 4.29 of the Listing Rules, on the unaudited Pro Forma Financial Information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the unaudited Pro Forma Financial Information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

Basis of opinion

We conducted our work in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 300 "Accountants' Reports on Pro Forma Financial Information in Investment Circulars" issued by the HKICPA. Our work consisted primarily of comparing the unadjusted financial information with source documents, considering the evidence supporting the adjustments and discussing the Pro Forma Financial Information with the Directors of the Company. The engagement did not involve independent examination of any of the underlying financial information.

Our work did not constitute an audit or review made in accordance with Hong Kong Standards on Auditing or Hong Kong Standards on Review Engagements issued by the HKICPA, and accordingly, we do not express any such audit or review assurance on the Pro Forma Financial Information.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Pro Forma Financial Information has been properly compiled by the Directors of the Company on the basis stated, that such basis is consistent with the accounting policies of the Group and that the adjustments are appropriate for the purposes of the unaudited Pro Forma Financial Information as disclosed pursuant to paragraph 4.29(1) of the Listing Rules.

The unaudited Pro Forma Financial Information is for illustrative purposes only, based on the judgements and assumptions of the Directors of the Company, and because of its hypothetical nature, it does not provide any assurance or indication that any event will take place in the future and may not be indicative of

- the financial position of the Group as at 31 December 2005 or any future dates; or
- the earnings per share and results of the Group for the year ended 31 December 2005 or any future periods.

Opinion

In our opinion:

(a) the unaudited Pro Forma Financial Information has been properly compiled on the basis stated;

(b) such basis is consistent with the accounting policies of the Group, and

(c) the adjustments are appropriate for the purposes of the unaudited Pro Forma Financial Information as disclosed pursuant to Paragraph 4.29(1) of the Listing Rules.

Yours faithfully
KPMG
Certified Public Accountants
Hong Kong

RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Group. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief, statements of fact expressed herein are true, accurate and not misleading, statements of opinion expressed herein have been arrived at after due and careful consideration and there are no other facts not contained in this circular the omission of which would make any statement herein misleading.

SHARE CAPITAL

Authorised and issued share capital

The authorised and issued share capital of the Company as at the Latest Practicable Date were as follows:

Authorised:	*HK$*
Ordinary Shares	
6,000,000,000 Shares	6,000,000,000.00
Issued and fully paid:	
Ordinary Shares	
3,201,423,375 Shares	3,201,423,375.00

All the existing issued Shares rank pari passu in all respects including all rights as to dividends, voting and return of capital.

As at the Latest Practicable Date, save for the Convertible Notes and options granted pursuant to share option scheme of the Company, the Group did not have any outstanding options, warrants or other securities carrying rights of conversion into or exchange or subscription for Shares.

DISCLOSURE OF INTERESTS

As at the Latest Practicable Date, the interests and short positions of the Directors and the chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Future Ordinance, Chapter 571 of the Laws of Hong Kong ("SFO")) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have taken under such provisions of the SFO); or were required, pursuant to Section 352 of the SFO, to be entered in the register kept by the Company, or were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies in the Listing Rules, to be notified to the Company and the Stock Exchange were as follows:

1. *Long positions in shares of the Company:*

Name of Director	Capacity	Number of Ordinary shares held	Percentage of issued share capital
Mrs. Chan Hui Dor Lam Doreen	Beneficial owner	2,074,689	0.065
Mr. Zhao Shengbiao	Beneficial owner	2,014,114	0.063

2. *Long positions (in respect of equity derivatives) in underlying shares of the Company:*

Share options, being unlisted physically settled equity derivatives, to subscribe for the ordinary shares of the Company were granted to Mr. Kong Dan, Mr. Dou Jianzhong, Mrs. Chan Hui Dor Lam Doreen, Mr. Lo Wing Yat Kelvin, Mr. Roger Clark Spyer and Mr. Zhao Shengbiao pursuant to the share option scheme of the Company. Details of these options are as follows:

Name of Director	Date of Options granted	Number of Options granted	Exercisable Price	Vesting Period	Exercisable Period	Outstanding Options
Mr. Kong Dan	17/11/2003	400,000	HK$3.540	17/11/2003–16/11/2005	17/11/2005–16/11/2013	400,000
	06/04/2004	400,000	HK$3.775	06/04/2004–05/04/2006	06/04/2006–05/04/2014	400,000
	13/06/2005	400,000	HK$2.925	13/06/2005–12/06/2007	13/06/2007–12/06/2015	400,000
	18/05/2006	400,000	HK$4.275	18/05/2006–17/05/2008	18/05/2008–17/05/2016	400,000
Mr. Dou Jianzhong	18/05/2006	400,000	HK$4.275	18/05/2006–17/05/2008	18/05/2008–17/05/2016	400,000

Name of Director	Date of Options granted	Number of Options granted	Exercisable Price	Vesting Period	Exercisable Period	Outstanding Options
Mrs. Chan Hui Dor Lam Doreen	17/11/2003	300,000	HK$3.540	17/11/2003–16/11/2005	17/11/2005–16/11/2013	300,000
	06/04/2004	300,000	HK$3.775	06/04/2004–05/04/2006	06/04/2006–05/04/2014	300,000
	13/06/2005	300,000	HK$2.925	13/06/2005–12/06/2007	13/06/2007–12/06/2015	300,000
	18/05/2006	300,000	HK$4.275	18/05/2006–17/05/2008	18/05/2008–17/05/2016	300,000
Mr. Lo Wing Yat Kelvin	17/11/2003	200,000	HK$3.540	17/11/2003–16/11/2005	17/11/2005–16/11/2013	200,000
	06/04/2004	200,000	HK$3.775	06/04/2004–05/04/2006	06/04/2006–05/04/2014	200,000
	13/06/2005	200,000	HK$2.925	13/06/2005–12/06/2007	13/06/2007–12/06/2015	200,000
	18/05/2006	200,000	HK$4.275	18/05/2006–17/05/2008	18/05/2008–17/05/2016	200,000
Mr. Roger Clark Spyer	18/05/2006	140,000	HK$4.275	18/05/2006–17/05/2008	18/05/2008–17/05/2016	140,000
Mr. Zhao Shengbiao	17/11/2003	40,000	HK$3.540	17/11/2003–16/11/2005	17/11/2005–16/11/2013	40,000
	06/04/2004	40,000	HK$3.775	06/04/2004–05/04/2006	06/04/2006–05/04/2014	40,000
	13/06/2005	40,000	HK$2.925	13/06/2005–12/06/2007	13/06/2007–12/06/2015	40,000
	18/05/2006	40,000	HK$4.275	18/05/2006–17/05/2008	18/05/2008–17/05/2016	40,000

In addition, the Equity Linked Deferred Award (the "**ELDA**") was granted by CKWB, a wholly owned subsidiary of the Company, to the following Directors:–

Name of Director	Offer date	Number of ordinary shares notionally subject to ELDA	ELDA price per share *(HK$)*
Mrs. Chan Hui Dor Lam Doreen	24/03/2005	150,000	2.00
	28/04/2006	250,000	2.00
Mr. Lo Wing Yat Kelvin	24/03/2005	80,000	2.00
Mr. Roger Clark Spyer	28/04/2006	100,000	2.00

3. *Short positions in shares and (in respect of equity derivatives) underlying shares of the Company:*

None.

4. *Long and short positions in shares of associated corporations of the Company:*

None.

5. *Long positions (in respect of equity derivatives) in underlying shares of associated corporations of the Company:*

Share options, being unlisted physically settled equity derivatives, to subscribe for the ordinary shares of CITIC Capital Holdings Limited ("**CCHL**"), an associated company of the Company, were granted by CCHL to the following Directors:–

Name of Director	Capacity	Number of CCHL's ordinary shares involved	Exercisable period
Mr. Kong Dan	Beneficial owner	30,000	02/03/2007 to 01/03/2010
	Beneficial owner	25,000	04/04/2008 to 03/04/2011
Mr. Dou Jianzhong	Beneficial owner	15,000	02/03/2007 to 01/03/2010
	Beneficial owner	10,000	04/04/2008 to 03/04/2011
Mrs. Chan Hui Dor Lam Doreen	Beneficial owner	15,000	02/03/2007 to 01/03/2010
	Beneficial owner	10,000	04/04/2008 to 03/04/2011
Mr. Wang Dongming	Beneficial owner	15,000	02/03/2007 to 01/03/2010
	Beneficial owner	10,000	04/04/2008 to 03/04/2011

6. *Short positions (in respect of equity derivatives) in underlying shares of associated corporations of the Company:*

None.

7. *Interests in debentures of the Company:*

None.

8. *Interests in subordinated notes of the associated corporations of the Company:*

Name of Director	Issuer	Capacity	Amount of subordinated notes held
Mrs. Chan Hui Dor Lam Doreen	CKWB (Cayman Islands) Limited	Beneficial owner	US$300,000
Mr. Lo Wing Yat Kelvin	CKWB (Cayman Islands) Limited	Beneficial owner	US$80,000

Save as disclosed above, as at the Latest Practicable Date, none of the Directors or chief executive of the Company were aware that they had any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which are required and are due to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are deemed or taken to have under such provisions of the SFO) or which are required, pursuant to section 352 of the SFO to be entered in the register referred to therein or which are required and are due, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, to be notified to the Company and the Stock Exchange.

SUBSTANTIAL SHAREHOLDER

So far as the Directors are aware, other than a Director or chief executive of the Company, the following persons had an interest of 5% or more of the issued share capital of the Company as at the Latest Practicable Date:

1. *Long positions in shares of the Company*

Name of Shareholder	Capacity	Number of ordinary shares held	Percentage of issued share capital
CITIC Group	Beneficial owner	1,789,048,220	55.88%
	Interest of controlled corporations	2,070,770	0.07%
China Construction Bank Corporation	Beneficial owner	168,599,268	5.27%

2. *Short positions in shares of the Company*

None.

3. *Long and short positions in (in respect of equity derivative) underlying shares of the Company*

None.

Save as disclosed above, the Directors or chief executive of the Company are not aware of any person (other than a Director or chief executive of the Company), who, as at the Latest Practicable Date, had interests or short positions in the shares or underlying shares of the Company which are required to be disclosed to the Company under the provision of Divisions 2 and 3 of Part XV of the SFO, or, who is expected, directly or indirectly, to be interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group.

RELATIONSHIP WITH CNCB

CITIC Group has been the controlling shareholder of the Company since 1986 and has wholly-owned CNCB since its establishment. The Company has operated as CITIC Group's Hong Kong based international banking arm whilst CNCB is the domestic banking platform of CITIC Group. Although under common control, the Company and CNCB are operated and managed independently. Mr. Kong Dan and Mr. Chen Xiaoxian, directors of the Company, are also directors of CNCB and Mr. Chen Xiaoxian is also its president.

The Company, through its subsidiary CKWB, and CNCB are in the process of agreeing business plans and strategies that will be complementary and supportive to each other's businesses. The Company does not believe that there is significant overlap or competition between CKWB and CNCB. With the planned change of name of CKWB to CITIC Bank International Limited, CKWB has signified its intention to concentrate on developing cross-border services, offshore financing and overseas business with CITIC Group's corporate and industrial clients. CKWB will also develop relationships with large regional and international corporations and institutions looking to develop their businesses in the PRC, linking with CNCB to provide the onshore product and service requirements where CKWB is unable to do so. Accordingly, the focus of CKWB's Shanghai branch office, its representative and presence in the PRC, will be to meet the cross-border needs of its international customers as well as providing cross-border services to PRC customers with business needs in Hong Kong and elsewhere. CNCB will provide domestic banking, trade and other PRC based products and services which link in as appropriate with CKWB.

Given the cooperative and supplementary nature of the business relationship and the clear delineation of business between CNCB and CKWB, and as both banks are under the supervision of a number of regulators, the Directors believe that the interests of minority shareholders of CKWB are adequately protected.

DIRECTORS' INTERESTS IN POTENTIALLY COMPETING BUSINESS

As at the Latest Practicable Date, the interests of the Directors and their respective associates required to be disclosed pursuant to Rule 8.10 of the Listing Rules were as follows:

1. Mr. Kong Dan is the vice chairman and Mr. Dou Jianzhong, Mr. Chen Xiaoxian, Mr. Ju Weimin and Mr. Wang Dongming are directors of CITIC Group, a conglomerate with businesses (through its subsidiaries) in the area of money lending and securities services;

2. Mr. Dou Jianzhong is a director of China Investment and Finance Limited, a subsidiary of CNCB, engaged in the provision of money lending services;

3. Mr. Wang Dongming is the chairman and Mr. Ju Weimin is a director of CITIC Securities Co., Ltd., an associate company of CITIC Group, engaged in the provision of securities services; and

4. Mr. Chang Zhenming is the vice chairman, president and an executive director of China Construction Bank Corporation Limited, engaged in the provision of banking and financial services in the PRC.

SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors have entered into any service contract with the Company or any members of the Group which will not expire or is not determinable by the employer within one year without payment of compensation (other than statutory compensation).

INTERESTS IN ASSETS AND/OR CONTRACTS AND OTHER INTERESTS

As at the Latest Practicable Date, none of the Directors had any direct or indirect interest in any assets which had been, since 31 December 2005, being the date to which the latest published audited accounts of the Company were made up, acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group.

As at the Latest Practicable Date, none of the Directors was materially interested in any contract or arrangement which is significant in relation to the business of the Group.

EXPERTS' QUALIFICATIONS AND CONSENTS

The following are the qualifications of the experts whose letters and reports (as the case may be) are contained in this circular:

Name	Qualification
Somerley Limited	a licensed corporation under the SFO to conduct type 1 (dealing in securities), type 4 (advising on securities), type 6 (advising on corporate finance) and type 9 (asset management) regulated activities under the SFO
KPMG	Certified Public Accountants

Each of Somerley Limited and KPMG has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its letter and/or report (as the case may be) and the references to its name, in the form and context in which they are included.

As at the Latest Practicable Date, none of Somerley Limited and KPMG had any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

As at the Latest Practicable Date, none of Somerley Limited and KPMG had any direct or indirect interest in any assets which had been, since 31 December 2005, being the date to which the latest published audited accounts of the Company were made up, acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group.

LITIGATION

As at the Latest Practicable Date, there was no litigation or claims of material importance pending or threatened against any member of the Group.

MATERIAL CONTRACTS

As at the Latest Practicable Date, the following are the material contracts (not being contracts entered into in the ordinary course of business) entered into by members of the Group within the two years immediately preceding the Latest Practicable Date:

1. CITIC Ka Wah Bank Limited, a wholly-owned subsidiary of the Company, has pursuant to the conditions of sale by tendor on 8 November 2004, sold to an independent third party, Ka Wah Bank Centre located at No. 232 Des Voeux Road Central, Hong Kong for a total consideration of HK$351 million; and

2. the Formal Sale and Purchase Agreement.

GENERAL

(a) The secretary of the Company is Ms. Kyna Y.C. Wong, Associate Member of The Institute of Chartered Secretaries & Administrators and The Hong Kong Institute of Company Secretaries.

(b) The qualified accountant of the Company appointed pursuant to rule 3.24 of the Listing Rules is Mr. Wong Ho Sing Steve, Fellow Member of The Association of Chartered Certified Accountants and The Hong Kong Institute of Certified Public Accountants, and Associate Member of The Institute of Chartered Secretaries & Administrators and The Hong Kong Institute of Company Secretaries.

(c) The registered office of the Company is at Suites 1801-2, Bank of America Tower, 12 Harcourt Road, Central, Hong Kong.

(d) In the event of inconsistency, the English language text of this circular shall prevail over the Chinese language text.

DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection during normal business hours at the offices of the Company at Suites 1801-2, Bank of America Tower, 12 Harcourt Road, Central, Hong Kong from the date of this circular up to and including the date of the EGM:–

(a) the Formal Sale and Purchase Agreement;

(b) the memorandum and articles of association of the Company;

(c) the material contracts referred to in the section headed "Material Contracts" in this appendix;

(d) the annual report of the Company for each of the two years ended 31 December 2004 and 31 December 2005;

(e) the accountants' report on CNCB from KPMG dated 30 June 2006, the text of which is set out in Appendix II to this circular;

(f) the letter on the unaudited pro forma financial information of the Company after Completion from KPMG dated 30 June 2006, the text of which is set out in Appendix III to this circular;

(g) the letter from the Independent Board Committee, the text of which is set out on page 17 of this circular;

(h) the letter of Somerley Limited, the text of which is set out on pages 18 to 54 of this circular; and

(i) the letters of consent referred to in the section headed "Experts' Qualifications and Consents" in this appendix.

中信國際金融控股有限公司
CITIC INTERNATIONAL FINANCIAL HOLDINGS LIMITED
(Incorporated in Hong Kong with limited liability under the Companies Ordinance)
(Stock Code: 183)

NOTICE IS HEREBY GIVEN THAT an Extraordinary General Meeting (the "Meeting") of the members of CITIC International Financial Holdings Limited (the "Company") will be held at The Atrium, 39th Floor, Island Shangri-La Hotel, Pacific Place II, 88 Queensway, Hong Kong on Wednesday, 19 July 2006 at 10:00 a.m. for the purposes of considering and, if thought fit, passing with or without modification, the following resolution as an ordinary resolution of the Company:

ORDINARY RESOLUTION

"**THAT**:

(a) the terms of the agreement (the "Formal Sale and Purchase Agreement"), a copy of which has been produced to this Meeting marked "A" and initialed by the chairman of the Meeting for identification dated 13 April 2006 between CITIC Group and CITIC International Financial Holdings Limited (the "Company") pursuant to which, inter alia, subject to the fulfillment of the conditions set out therein, the Company has agreed to acquire and CITIC Group has agreed to sell to the Company 19.9% of the existing interest in China CITIC Bank ("CNCB"), including rights to receive dividends declared from the profits of CNCB as may be allowed under the law of the People's Republic of China (the "Sale Interest") for a consideration to be determined in accordance with the terms of the Formal Sale and Purchase Agreement and to be satisfied by the issue and allotment by the Company to CITIC Group of ordinary shares of HK$1.00 each (the "Consideration Shares"), subject to adjustments as set out in the Formal Sale and Purchase Agreement and the details of which are described in the circular of the Company dated 30 June 2006, be and is hereby approved;

(b) the issue and allotment by the Company to CITIC Group of the Consideration Shares be and is hereby approved;

(c) the board of directors of the Company be and are hereby authorised to exercise all the powers of the Company and take all steps as might in their opinion be desirable or necessary in connection with the Formal Sale and Purchase Agreement and the execution and performance thereof, including, without limitation to:

    (i) the execution, amendment, supplement, delivery, submission and implementation of any further documents or agreements including any promoters agreements or other agreements with CNCB or any other parties in relation to the acquisition of the Sale Interest and/or any agreements in connection with any capital or asset reorganisation of CNCB;

(ii) the amendment of the terms of the Formal Sale and Purchase Agreement; and

(iii) the taking of all other necessary actions to implement the acquisition of the Sale Interest."

By Order of the Board
CITIC International Financial Holdings Limited
Kyna Y. C. Wong
Company Secretary

Dated 30 June 2006

Notes:

1. Every member entitled to attend and vote at the Meeting convened by the above notice is entitled to appoint one or more proxies to attend and vote in his stead provided that if more than one person is authorised, the proxy/authorisation must specify the number of Shares in respect of which each such person is so authorised. The proxy need not be a member of the Company.

2. A form of proxy for use at the Meeting convened by the above notice is enclosed herewith. To be valid, the form of proxy and the power of attorney or other authority (if any) under which it is signed (or a notarially certified copy of such power of attorney or authority) must be completed, signed and deposited to the Company's share registrar, Computershare Hong Kong Investor Services Limited, at 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not less than 48 hours before the time appointed for holding the Meeting or any adjournment thereof.

3. The instrument appointing a proxy shall be in writing in any usual or common form or in any other form which the Directors may accept (provided that this shall not preclude the use of the two-way form), and shall be deemed, subject to the proviso described in note 4 below, to confer authority upon the proxy to vote on any resolution (or amendment thereto) put to the Meeting for which it is given as the proxy thinks fit.

4. Provided that any form issued to a Shareholder for him/her for appointing a proxy to attend at the Meeting at which special business is to be transacted shall be such as to enable the Shareholder according to his intention to instruct the proxy to vote in favour of or against (or, in default of instructions, to exercise his discretion in respect of) each resolution dealing with any such special business and shall, unless the contrary is stated therein, be valid as well for any adjournment of the Meeting and for the Meeting to which it relates.

5. Delivery of an instrument appointing a proxy shall not preclude a Shareholder from attending and voting in person at the Meeting or poll concerned and, in such event, the instrument appointing a proxy shall be deemed to be revoked.

6. Where two or more persons are registered as the holder of any Share, the Company shall be at liberty to treat the person whose name stands first in the register of members as one of the joint holders of any Shares as solely entitled to attend or vote at the Meeting, but any one of such joint holders may be appointed the proxy of the persons entitled to vote on behalf of such joint holders, and as such proxy to attend and vote at the Meeting of the Company, but if more than one of such joint holders be present at any meeting personally or by proxy that one so present whose name stands first in the register of member in respect of such Shares shall alone be entitled to vote in respect thereof.