

Corporate Governance Report

Corporate Governance Practices

The board of directors of the Company believes that corporate governance is essential to the success of the Company and has adopted various measures to ensure that a high standard of corporate governance is maintained. With effect from 1 January 2005, the Company has applied the principles and complied with the requirements of the Code on Corporate Governance Practices (the “Code on CGP”) of the Rules Governing the Listing of Securities (the “Listing Rules”) on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”), except for the deviation in respect of the service term under code provision A.4.1 of the Listing Rules. The current practices will be reviewed and updated regularly to follow the latest practices in corporate governance.

Public Finance and Public Bank (Hong Kong), both being major subsidiaries of the Company, are a deposit taking company and a licensed bank respectively, and are incorporated in Hong Kong and are under the supervision of the Hong Kong Monetary Authority (“HKMA”). The respective boards of directors are fully committed to adopting and implementing the principles and best practices in corporate governance as set out in the guidelines on “Corporate Governance of Locally Incorporated Authorised Institutions” issued by the HKMA. Specialised committees with clear terms of references and specific authorities delegated by the boards of directors have been set up by the Company, Public Finance and Public Bank (Hong Kong).

Directors’ Securities Transactions

The Company has adopted the code of conduct regarding directors’ securities transactions as set out in the Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”) of the Listing Rules. All the directors have confirmed that they have complied with the required standards as set out in the Model Code throughout the year.

Board of Directors

The board of directors of the Company comprises:

Executive Directors	: Tan Yoke Kong Lee Huat Oon
Non-executive Directors	: Tan Sri Dato’ Sri Dr. Teh Hong Piow, <i>Chairman</i> Dato’ Sri Tay Ah Lek Dato’ Chang Kat Kiam Wong Kong Ming
Independent Non-executive Directors	: Tan Sri Dato’ Thong Yaw Hong, <i>Co-Chairman</i> (appointed on 1 July 2006) Dato’ Yeoh Chin Kee Lee Chin Guan Geh Cheng Hooi, Paul (resigned on 1 July 2006)

The non-executive directors provide the Group with a wide range of expertise and knowledge in the banking and finance sector. The independent non-executive directors are persons of high calibre; with academic and professional qualifications in the fields of accounting, law, banking and business management. With their experience gained from senior positions held in other companies, they provide strong support towards the effective discharge of the duties and responsibilities of the board. Each independent non-executive director has given an annual confirmation of his independence to the Company, and the Company considers these directors to be independent under Rule 3.13 of the Listing Rules.

Corporate Governance Report

Corporate Governance Practices (Continued)

Board of Directors (Continued)

During the year, eight full board meetings were held and the attendance of each director is set out as follows:

Name of director	Number of board meetings attended in 2006	Attendance rate
Tan Sri Dato' Sri Dr. Teh Hong Piow, <i>Chairman</i>	5/8	62.5%
Tan Sri Dato' Thong Yaw Hong, <i>Co-Chairman</i> (appointed on 1 July 2006)	3/4	75%
Tan Yoke Kong	7/8	87.5%
Lee Huat Oon	8/8	100%
Dato' Sri Tay Ah Lek	5/8	62.5%
Dato' Chang Kat Kiam	5/8	62.5%
Wong Kong Ming	8/8	100%
Dato' Yeoh Chin Kee	5/8	62.5%
Lee Chin Guan	6/8	75%
Geh Cheng Hooi, Paul (resigned on 1 July 2006)	3/4	75%

The board formulates overall strategy of the Group, monitors its financial performance and maintains effective oversight over the management. The board members are fully committed to their roles and have acted in good faith to maximize the shareholders' value in the long run, and have aligned the Group's goals and directions with the prevailing economic and market conditions. Daily operations and administration are delegated to the management.

The schedule of board meetings for a year is planned in the preceding year. At least 14 days notice of all board meetings is given to all directors and they can include matters for discussion in the agenda if the need arises. The Company Secretary assists the Chairman in preparing the agenda for meetings and ensures that all relevant rules and regulations are followed. The agenda and the accompanying board papers are sent to all directors at least 3 days before the date of every board meeting so that the directors have the time to review the documents. Minutes of every board meeting are circulated to all directors for their perusal prior to confirmation of the minutes at the following board meeting.

Every board member is entitled to have access to board papers and related materials and has unrestricted access to the advice and services of the Company Secretary, and has the liberty to seek external professional advice if so required. The Company Secretary continuously updates all directors on the latest development of the Listing Rules and other applicable regulatory requirements to ensure compliance and upkeep of good corporate governance practice.

Chairman, Co-Chairman and Chief Executive

The Chairman and the Chief Executive of the Company are Tan Sri Dato' Sri Dr. Teh Hong Piow and Mr. Tan Yoke Kong respectively. Tan Sri Dato' Thong Yaw Hong, an independent non-executive director, was appointed as the Co-Chairman of the Company on 14 July 2006 to share the workload of the Chairman.

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Corporate Governance Practices (Continued)

Chairman, Co-Chairman and Chief Executive (Continued)

The roles of the Chairman and the Chief Executive are segregated and assumed by two separate individuals who have no relationship with each other. It is aimed at striking a balance of power and authority so that the job responsibilities are not concentrated on any one individual. The Chairman of the board is responsible for the leadership and effective running of the board, while the Chief Executive is delegated with the authorities to manage the business of the Group in all aspects effectively. The division of responsibilities between the Chairman and the Chief Executive have been clearly established and set out in writing.

Appointment and Re-election of Directors

The Company has not fixed the terms of appointment for non-executive directors. However, they are appointed subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the provision of the Bye-laws. This deviates from the provision of A.4.1 of the Code on CGP which requires that non-executive directors be appointed for a specific term. The board has discussed and concluded that the current practice of appointing non-executive directors without specific terms but otherwise subject to rotation and re-election by shareholders is fair and reasonable, and does not intend to change the current practice at the moment.

In compliance with provision A.4.2 of the Code on CGP, the Company has amended its Bye-laws in March 2006 to the effect that any director appointed to fill casual vacancy be subject to election by shareholders at the first general meeting after his/her appointment, and every director, including those appointed for a specific term, be subject to retirement by rotation at least once every three years.

Remuneration Committee

The Remuneration Committee of the Company comprises two non-executive directors and three independent non-executive directors.

The Remuneration Committee was formed in January 2005 and meetings shall be held at least once a year. Two meetings were held in 2006. The attendance of each member is set out as follows:

Name of member	Number of meetings attended in 2006	Attendance rate
Tan Sri Dato' Sri Dr. Teh Hong Piow, <i>Chairman</i>	2/2	100%
Tan Sri Dato' Thong Yaw Hong (appointed on 1 July 2006)	1/1	100%
Dato' Sri Tay Ah Lek	2/2	100%
Dato' Yeoh Chin Kee	2/2	100%
Lee Chin Guan	2/2	100%
Geh Cheng Hooi, Paul (resigned on 1 July 2006)	1/1	100%

At the meetings held during the year, the directors' fees and meeting allowances of the Group for the year 2005 and the promotion, secondment and terms of employment of the management staff within the Group in 2006 were reviewed and noted.

The Company has adopted a share option scheme on 28 February 2002, which serves as an incentive to attract, retain and motivate talented eligible staff, including the directors. Details of the share option scheme are set out in note 36 to the financial statements. The emolument payable to directors will depend on their respective contractual terms under employment contracts, if any, and as recommended by the Remuneration Committee. Details of the directors' emoluments are set out in note 8 to the financial statements.

Corporate Governance Report

Corporate Governance Practices (Continued)

Remuneration Committee (Continued)

The major role and function of the Group's Remuneration Committee are as follows:

1. To review annually and recommend to the board the overall remuneration policy for the directors, the Chief Executive and key senior management officers.
2. To review annually the performance of the executive directors, the Chief Executive and key senior management officers and recommend to the board specific adjustments in remuneration and/or reward payments.
3. To ensure that the level of remuneration for non-executive directors and independent non-executive directors are linked to their level of responsibilities undertaken and contribution to the effective functioning of the boards of the respective companies in the Group.
4. To review and approve the compensation payable to executive directors, the Chief Executive and key senior management officers in connection with any loss or termination of their office or appointment.
5. To review and approve compensation arrangements relating to dismissal or removal of directors for misconduct.
6. To ensure that no director is involved in deciding his own remuneration.

The terms of reference of the Remuneration Committee are posted on the Company's website.

Nomination Committee

The Nomination Committee of the Company comprises two non-executive directors and three independent non-executive directors.

The Nomination Committee was formed in January 2005 and meetings shall be held at least once a year. Two meetings were held in 2006. The attendance of each member is set out as follows:

Name of member	Number of meetings attended in 2006	Attendance rate
Tan Sri Dato' Sri Dr. Teh Hong Piow, <i>Chairman</i>	2/2	100%
Tan Sri Dato' Thong Yaw Hong (appointed on 1 July 2006)	1/1	100%
Dato' Sri Tay Ah Lek	2/2	100%
Dato' Yeoh Chin Kee	2/2	100%
Lee Chin Guan	2/2	100%
Geh Cheng Hooi, Paul (resigned on 1 July 2006)	1/1	100%

At the meetings held during the year, the independence of Mr. Geh Cheng Hooi, Paul was assessed and the proposed re-election of Tan Sri Dato' Sri Dr. Teh Hong Piow and Dato' Sri Tay Ah Lek as non-executive directors at the 2006 annual general meeting was recommended. In addition, the changes of management staff in Public Finance and Public Bank (Hong Kong) were noted and the mechanisms for annual assessment of the board and each individual directors were adopted.

Corporate Governance Report

Corporate Governance Practices (Continued)

Nomination Committee (Continued)

The major role and function of the Group's Nomination Committee are as follows:

1. To assess and recommend the appointment and re-appointment of directors and Chief Executive to the board.
2. To oversee the overall composition of the board, in terms of the appropriate size and skills, and the balance between executive directors, non-executive directors and independent non-executive directors through annual review.
3. To assess the independence of independent non-executive directors.
4. To establish a mechanism for the formal assessment on the effectiveness of the board as a whole and the performances of each director, the Chief Executive and other key senior management officers.
5. To oversee the appointment, management succession planning and performance evaluation of key senior management officers.

The terms of reference of the Nomination Committee are posted on the Company's website.

Accountability and Audit

The directors are responsible for overseeing the preparation of accounts of each financial period, which give a true and fair view of the state of affairs of the Group and of the results and cash flow for that period. In preparing the accounts for the year ended 31 December 2006, the directors have selected suitable accounting policies and have applied them consistently, adopted appropriate Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards which are pertinent to its operations and relevant to the financial statements, made judgements and estimates that are prudent and reasonable, and have prepared the accounts on the going concern basis.

Audit Committee

The Audit Committee of the Company comprises one non-executive director and three independent non-executive directors.

The Audit Committee shall meet at least twice a year. Five meetings were held during the year. The minutes of the Audit Committee meetings were tabled to the board for noting and for action by the board where appropriate. The attendance of each member is set out as follows:

Name of member	Number of meetings attended in 2006	Attendance rate
Tan Sri Dato' Thong Yaw Hong, <i>Chairman</i> (appointed on 1 July 2006)	3/3	100%
Dato' Yeoh Chin Kee	4/5	80%
Dato' Sri Tay Ah Lek	5/5	100%
Lee Chin Guan	5/5	100%
Geh Cheng Hooi, Paul (resigned on 1 July 2006)	2/2	100%

Corporate Governance Report

Accountability and Audit (Continued)

Audit Committee (Continued)

During the meetings held in 2006, the Audit Committee had performed the following work:

- (i) reviewed the financial reports for the year ended 31 December 2005 and for the six months ended 30 June 2006;
- (ii) reviewed the findings and recommendations of the Internal Audit Departments on the operations and performance of the branches and departments of Public Finance, Public Bank (Hong Kong) and other subsidiaries of the Group;
- (iii) reviewed the effectiveness of internal control system;
- (iv) reviewed the examination reports on Public Finance issued by the regulatory authorities, and the audit report on the examination of the computer centre and network operations of Public Finance issued by the Internal Auditors of Public Bank Berhad;
- (v) reviewed the external auditors' statutory audit plan and engagement letter;
- (vi) reviewed the management letter from the external auditors in relation to the audit of the Group for the year ended 31 December 2005;
- (vii) reviewed and recommended for approval by the board the 2006 audit scope and fees; and
- (viii) reviewed the connected transactions entered into by the Group during the year.

The major role and function of the Group's Audit Committee are as follows:

1. To consider the appointment of the external auditors, the audit fees, and any questions of resignation or dismissal of the external auditors of the Group.
2. To discuss with the external auditors the nature and scope of the audit.
3. To review the interim and annual financial statements before submission to the board of directors.
4. To discuss problems and reservations arising from the interim audit review and final audits, and any matters the auditors may wish to discuss.
5. To review the external auditors' management letters and management's response.
6. To review the Group companies' statements on internal control systems (where one is included in the annual report) prior to endorsement by the respective boards of directors.
7. To review the internal audit programme, ensure co-ordination between the internal and external auditors, and ensure that the internal audit function is adequately resourced and has appropriate standing within the Group.
8. To consider the major findings of internal investigations and management's response.

The terms of reference of the Audit Committee are posted on the Company's website.

Corporate Governance Report

Accountability and Audit (Continued)

Auditors' Remuneration

During the year under review, the remuneration paid/payable to the Company's auditors, Messrs Ernst & Young, is set out as follows:

Services rendered	Fees paid/payable HK\$'000
Audit services	2,950
Non-audit services	1,513
Total:	4,463

Internal Control

The board is responsible for the Group's system of internal controls and its effectiveness. However, such a system is designed to manage the Group's risks within an acceptable risk profile, rather than to eliminate the risk of failure to achieve the policies and business objectives of the Group. Accordingly, it can only provide reasonable assurance but not absolute assurance against material misstatement of management and financial information and records or against financial losses or fraud.

The board has established an on-going process for identifying, evaluating and managing the significant risks faced by the Group and this process includes updating the system of internal controls when there are changes to business environment or regulatory guidelines.

The board is of the view that the system of internal controls in place for the year under review and up to the date of issuance of the annual report and financial statements is sound and is sufficient to safeguard the interests of shareholders, customers and employees, and the Group's assets.

The management assists the board in the implementation of the board's policies and procedures on risk and control by identifying and assessing the risks faced, and involving in the design, operation and monitoring of suitable internal controls to mitigate and control these risks.

The key processes that have been established in reviewing the adequacy and integrity of the system of internal controls include the following:

- The Board Executive Committees under Public Finance and Public Bank (Hong Kong) consist of executive directors and non-executive directors and are responsible for the management of the businesses of Public Finance and Public Bank (Hong Kong) in all aspects and the implementation of strategic business plans and policies approved and formulated by the respective boards of directors.
- The Management Committees are established by the respective boards of Public Finance and Public Bank (Hong Kong) to ensure the effectiveness of the Group's daily operations and that the Group's operations are in accordance with the corporate objectives, strategies and the annual budget as well as the policies and business directions that have been approved.
- The Audit Committees are established at the Group level as well as at the bank level to review internal control issues identified by the Internal Audit Departments, external auditors, regulatory authorities and management, and evaluate the adequacy and effectiveness of the Group's risk management and internal control systems. They also conduct review of the internal audit functions with particular emphasis on the scope of audits, quality of internal audits and independence of the Internal Audit Departments. The minutes of the Audit Committee meetings are tabled to the board for noting and further action, where appropriate.

Corporate Governance Report

Accountability and Audit (Continued)

Internal Control (Continued)

- The Internal Audit Departments monitor compliance with policies and procedures and the effectiveness of the internal control systems, and highlight significant findings in respect of any non-compliance. Audits are carried out on all branches, the frequency of which is determined by the level of risk assessed, to provide an independent and objective report on the operational and management activities of these branches. The annual audit plan of the Group is reviewed and approved by the Audit Committee and the findings of the audits are submitted to the Audit Committee for review.
 - The Credit Committees under Public Finance and Public Bank (Hong Kong) are responsible for making decision on loan applications for all types of loan facilities within its discretionary powers, assisting the respective boards of directors in formulating policy guidelines for Public Finance's and Public Bank (Hong Kong)'s lending business, and recommending applications for loan facilities exceeding the discretionary powers of the Credit Committees to the respective boards for approval.
 - The Assets and Liabilities Committee under Public Finance and the Asset and Liability Management Committee under Public Bank (Hong Kong) review and assess the risk profile and capital structure of Public Finance and Public Bank (Hong Kong), set the objectives for the asset and liability management function and implement the risk management policies approved by the respective boards of Public Finance and Public Bank (Hong Kong).
 - Operational committees have also been established under Public Finance and Public Bank (Hong Kong) with appropriate authorities to ensure effective management and supervision of the Group's core areas of business operations. These committees include the Human Resources Committees and the Information Technology Committees.
- The Human Resources Committees assist the respective boards of directors in formulating and implementing human resources policies including staff recruitment, promotion, career development, performance appraisal and remuneration of all staff.
- The Information Technology Committee under Public Finance and Information Technology (I.T.) Steering Committee under Public Bank (Hong Kong) are responsible for establishing objectives, policies and strategies for the computerisation of the Group, recommending to the respective boards on major acquisitions of computer hardware and software, and monitoring the progress of implementation of all information technology related projects.
 - The Finance Committees under Public Finance and Public Bank (Hong Kong) assist the respective boards of directors in the financial planning and budgeting process of the business of Public Finance and Public Bank (Hong Kong) and the review of the business performance, statutory and half year accounts.
 - Compliance Working Group of Public Finance and Compliance Department of Public Bank (Hong Kong) are established to review the relevant policies and guidelines issued from time to time by the HKMA and other regulatory authorities, to assess the impact of the relevant regulatory requirements on Public Finance and Public Bank (Hong Kong) and to ensure that the relevant business units and/or departments comply with the relevant regulatory requirements and internal policy guidelines of business units and departments.

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Management of Risks

The respective boards of directors of the subsidiaries are responsible for the oversight of risks and approval of risk management policies. The Internal Audit Departments perform regular audits to ensure compliance with the policies and reports directly to the respective Audit Committees. In addition, various committees were formed to mitigate and monitor various kinds of risks within the Group. In 2006, the Risk Management Committee of the Company was established to oversee the overall management of all risks covering market risk management, liquidity risk management, credit risk management and operational risk management of the Group.

Credit Risk

Credit risk is the risk associated with a customer or counterparty being unable to meet a commitment when it falls due, and arises from the lending, trade finance, treasury and other activities undertaken by the Group.

The Group has established policies and systems for the monitoring and control of credit risk. These policies define the credit extension and measurement criteria, the credit review, approval and monitoring processes, and the loan classification and the level of impairment allowances for impaired loans. It has a hierarchy of credit authorities which approve credits in compliance with the respective subsidiaries' credit policies; exposures are monitored against credit limits and other control limits (such as large exposures and concentration limits); segregation of duties in key credit functions is in place to ensure separate credit control and monitoring; management and recovery of problem credits are handled by an independent workout team.

The Group manages its credit risk within a conservative framework. The credit policies are regularly reviewed, taking into account factors such as prevailing business and economic conditions, regulatory requirements and capital resources.

Credit and compliance audits are periodically held to evaluate the effectiveness of the credit review, approval and monitoring processes and to test the compliance of established credit policies and procedures.

The Credit Risk Management Committee of Public Bank (Hong Kong) is responsible for establishing the framework for identifying, measuring, monitoring and controlling credit risk of existing and new products, and approving credit risk management policies and credit risk tolerable limits as and when necessary. It reports to the Risk Management Committee of the Company.

Market Risk

Market risk is the risk to the Group's earnings and capital due to changes in the market level of interest rates, securities, foreign exchange and equities as well as the volatilities of those prices.

The Group monitors market risk principally by limits established for transactions and open positions. These limits are reviewed and approved by the directors of the respective subsidiaries, and are monitored on a daily basis.

The Assets and Liabilities Committee of Public Finance and the Asset and Liability Management Committee of Public Bank (Hong Kong) meet regularly to review the balance sheet structure, interest rate risk management, liquidity management, and capital structure, allocation and planning. They evaluate the impact of alternative asset and liability management strategies, identify the types of risks inherent in Public Finance and Public Bank (Hong Kong) and assess the vulnerability of the net interest income to these risks. The latest development in interest rates and foreign exchange rate movements, fiscal and monetary policies will be brought to the attention of the respective boards of directors. All foreign exchange positions are managed by the Treasury Department of Public Bank (Hong Kong) within limits approved by its board of directors.

Corporate Governance Report

Management of Risks (Continued) Liquidity Risk

The main objectives of the Group's liquidity risk management are to ensure the availability of funds at reasonable costs to meet all contractual financial commitments, to fund loan growth and to generate reasonable returns from available funds.

The Assets and Liabilities Committee of Public Finance and the Asset and Liability Management Committee of Public Bank (Hong Kong) monitor the liquidity position as part of the ongoing assets and liabilities management, and set up trigger limits to monitor liquidity risk. They also closely monitor the liquidity of the respective subsidiaries on a periodic basis to ensure that the liquidity structure of the respective subsidiaries' assets, liabilities and commitments can meet the funding needs, and that the statutory liquidity ratio is always complied with. Standby facilities are maintained to provide liquidity to meet unexpected, material cash outflows in the ordinary course of business.

Operational Risk

Operational risk relates to the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events. Operational Risk Management Committees have been established under Public Finance and Public Bank (Hong Kong) to implement the operational risk management framework approved by the respective boards of directors and to develop specific policies, processes and procedures for managing operational risk in the material products, activities, processes and systems. They report to the Risk Management Committee of the Company.

Communications with Shareholders and Investors

The board recognises the importance of good communications with all shareholders. The Company's annual general meeting ("AGM") is a valuable forum for the board to communicate directly with the shareholders. The Chairman of the board as well as Chairmen of the Audit, Nomination and Remuneration Committees together with the external auditors are present to answer shareholders' questions. An AGM circular is distributed to all shareholders at least 21 days before the AGM. It sets out the procedures for demanding and conducting a poll and other relevant information of the proposed resolutions. The Chairman explains the procedures for demanding and conducting a poll again at the beginning of the AGM and (except where a poll is demanded) reveals how many proxies for and against have been filed in respect of each resolution. The results of the poll, if any, will be published in the newspapers and on the Company's website.

A key element of effective communication with shareholders and investors is the prompt and timely dissemination of information in relation to the Group. The Company has announced its annual and interim results in a timely manner within 20 days after the end of the relevant periods in 2006, which were well before the time limits as laid down in the Listing Rules.

The management personnel responsible for investor relations held regular meetings with equity research analysts, fund managers and institutional shareholders and investors.

The amendments to the Bye-laws of the Company were approved in the 2006 AGM to reflect the changes brought by the new Listing Rules effective on 1 January 2005.

The market capitalisation of the Company as at 29 December 2006 was HK\$6,727,464,201 (issued share capital: 1,093,896,618 shares at closing market price: HK\$6.15 per share). The public float is around 26.5%.

The 2007 AGM will be held at Shek O Room, Lower Level I, Kowloon Shangri-La Hotel, 64 Mody Road, Kowloon, Hong Kong on Tuesday, 13 March 2007 at 10:00 a.m.