Financial Performance

Income Statement

Summary of financial performance

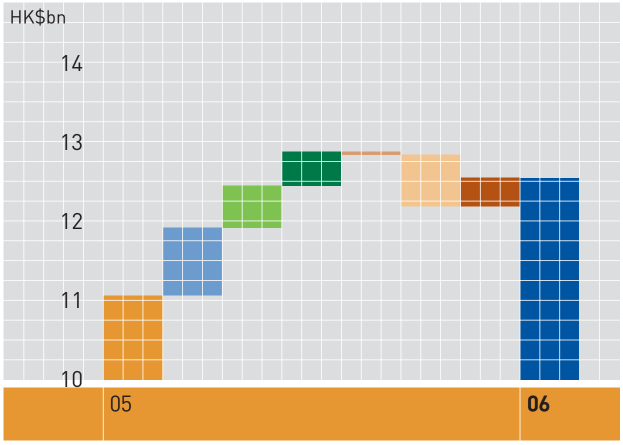
Figures in HK$m	2006	2005
Total operating income	26,158	23,246
Total operating expenses	5,241	4,546
Operating profit after loan impairment charges and other credit risk provisions	12,576	11,068
Profit before tax	14,395	13,358
Profit attributable to shareholders	12,038	11,342
Earnings per share (in HK$)	6.30	5.93

Hang Seng Bank Limited ("the Bank") and its subsidiaries and associates ("the Group") reported an audited profit attributable to shareholders of HK$12,038 million for 2006, a rise of 6.1 per cent over 2005. Earnings per share were HK$6.30, up 6.2 per cent from 2005.

Operating profit after loan impairment charges and other credit risk provisions rose 13.6 per cent to HK$12,576 million.

This reflected an encouraging growth in total operating income and a substantial reduction in loan impairment charges, benefiting from sustained economic growth, a buoyant stock market and good investment sentiment supported by ample liquidity and a benign credit environment.

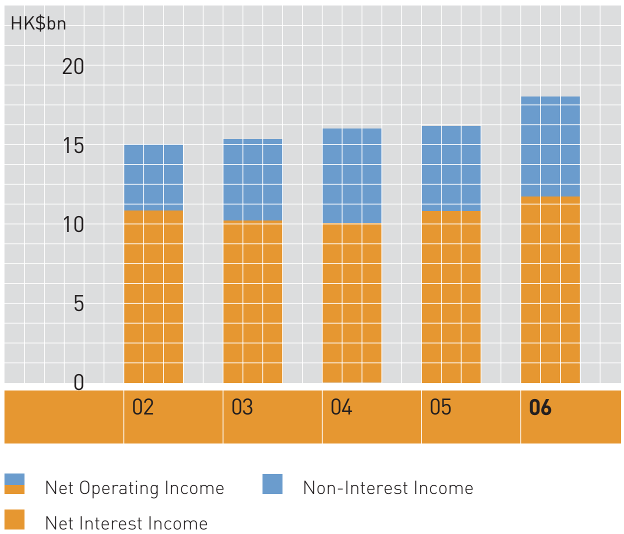
Operating Profit Analysis



	HK$m
2005 Operating Profit	11,068
Changes Due to:	
Net Interest Income	898
Net Fee Income	541
Trading Income	445
Other Operating Income	(35)
Operating Expenses	(695)
Loan Impairment Charges and Other Credit Risk Provisions	354
2006 Operating Profit	**12,576**

Net Operating Income

(Before loan impairment charges and other credit risk provisions)



Net interest income rose by HK$898 million, or 8.3 per cent, to HK$11,694 million with an increase of 10.6 per cent in average interest-earning assets.

Figures in HK$m	**2006**	2005 restated
Net interest income/(expense) arising from:		
– financial assets and liabilities that are not at fair value through profit and loss	**13,689**	11,068
– trading assets and liabilities	**(2,039)**	(306)
– financial instruments designated at fair value	**44**	34
	11,694	10,796
Average interest-earning assets	**578,588**	522,922
Net interest spread	**1.66%**	1.85%
Net interest margin	**2.02%**	2.06%

With effect from 2006 (and as restated for 2005), interest income and interest expense for all interest-bearing financial instruments are reported in "Interest income" and "Interest expense" respectively in the income statement. The change from the HSBC Group presentation has been made principally to match the interest expense arising from trading liabilities with the interest income from non-trading assets. This facilitates the comparison of Hang Seng's net interest income and net interest margin with peer banks in Hong Kong.

Average customer advances rose 4.5 per cent, driven by encouraging growth in higher yielding card advances, personal loans, trade finance and Mainland loans. BLR-based lending – mainly residential mortgages and certain trade finance, overdraft and SME loans – benefited from a wider BLR/HIBOR gap. The pricing of residential mortgages and corporate lending, however, was still under pressure due to intense market competition. Overall, the total loan portfolio contributed HK$419 million to the growth in net interest income.

Benefiting from the rise in both interest rate and funds balance, net free funds added HK$867 million to net interest income. Of this, HK$302 million was attributable to non-interest-bearing HK dollar current accounts. Net shareholders' funds increased due to the growth in retained profits and the proceeds from the disposal of properties, contributing HK$565 million.

The debt securities portfolio of life insurance fund investments grew by 50.9 per cent, adding HK$264 million to net interest income.

Average customer deposits rose by 11.3 per cent, mainly reflecting increases in time and structured deposits. However, the favourable impact of the growth in deposits was more than offset by the narrower deposit spread on HK dollar savings and the change in average deposit mix from savings and current account deposits to time and structured deposits. Net interest income from deposit products fell by HK$138 million. For structured deposits, the Bank earns a spread on the derivatives embedded in the structured deposits, which was reported as trading income. Thus, there was no deposit spread on structured deposits reported under net interest income.

Yields in treasury balance sheet management portfolios were further compressed by the rise in funding costs and flattened yield curves, and this resulted in a fall of HK$514 million in net interest income.

Net interest margin fell by four basis points to 2.02 per cent. Net interest spread fell 19 basis points to 1.66 per cent, due mainly to the treasury balance sheet management portfolios and deposit spreads on HK dollar savings and structured deposits as mentioned above, outweighing the impact of loan growth and margin enhancement. The fall in net spread was largely offset by the contribution from net free funds which rose 15 basis points to 0.36 per cent.

The HSBC Group reports interest income and interest expense arising from financial assets and financial liabilities held for trading as "Net trading income" and arising from financial instruments designated at fair value through profit and loss as "Net income from financial instruments designated at fair value" (other than for debt securities in issue and subordinated liabilities, together with derivatives managed in conjunction with them).

The table below presents the net interest income of Hang Seng, as included within the HSBC Group accounts:

Figures in HK$m	2006	2005
Net interest income	13,639	11,046
Average interest-earning assets	564,027	505,221
Net interest spread	1.83%	1.94%
Net interest margin	2.42%	2.19%

Net fee income rose by HK$541 million, or 18.3 per cent, compared with 2005.

Income from stockbroking and related services rose 63.3 per cent, driven by an 86.6 per cent growth in turnover with a 20.1 per cent growth in customer base. Benefiting from the favourable investment environment, income from private banking investment services rose 93.1 per cent. Card services income rose by 22.0 per cent, supported by a rise of 10.5 per cent in the number of cards in issue and an 11.7 per cent increase in cardholder spending. Deposit services and payment and cash management business also showed good progress, reporting growth in both account services fees and remittances of 21.8 per cent and 14.2 per cent respectively.

Trading income reached HK$1,330 million, a rise of HK$445 million, or 50.3 per cent, over 2005.

Foreign exchange income increased by HK$393 million, or 50.1 per cent, attributable to active position taking and increased customer activity. The increase in spreads earned on foreign exchange option-linked products offered to retail and corporate customers also contributed to foreign exchange income growth. Securities, derivatives and other trading rose by HK$52 million, attributable to the improvement in trading results and the growth in trading volume and profit earned on equity-linked products provided to customers.

With effect from 2006 reporting, interest income and expense from trading assets and liabilities are reported under "Net interest income".

Financial instruments designated at fair value reported a net income of HK$899 million, compared with a net expense of HK$32 million in 2005.

This was mainly investment returns from the life insurance fund portfolios, which form part of the "Income from life insurance business" analysed below.

With effect from 2006 reporting, interest income and interest expense from financial instruments designated at fair value are reported under "Net interest income".

Analysis of income from wealth management business

Figures in HK$m	2006	2005
Investment income:		
– retail investment products and funds under management	891	916
– structured investment products in issue	419	283
– private banking*	345	188
– stockbroking and related services	805	493
– margin trading	59	63
	2,519	1,943
Insurance income:		
– life insurance	1,476	1,256
– general insurance and others	286	289
	1,762	1,545
Total	4,281	3,488

* Income from private banking includes income reported under net fee income on the investment services and profit generated from selling of structured investment products in issue, reported under trading income.

Wealth management income gained strong growth momentum in 2006, reporting a rise of 22.7 per cent over 2005.

Investment services income rose by 29.6 per cent, benefiting from the buoyant stock market and positive investment sentiment. Our efficient and convenient e-banking and phone trading channels played key roles in the expansion of our securities broking business, which grew its customer base and market share. With the success of campaigns to acquire new accounts and promote active trading as well as offers such as special packages for IPO subscriptions, stockbroking turnover rose 86.6 per cent and income increased by 63.3 percent. Private banking continued to expand its customer base and product range. Assets under management rose 39.6 per cent and private banking income grew 83.5 per cent. Retail investment fund sales grew by 40.6 per cent over 2005, supported by a broad range of fund offerings from high-growth China and emerging market equity funds to capital-guaranteed and fixed-income funds. Equity, foreign exchange and other market-linked investment and deposit products reached record highs in terms of issue volume and income earned, which were up by 68.6 per cent and 48.1 per cent respectively.

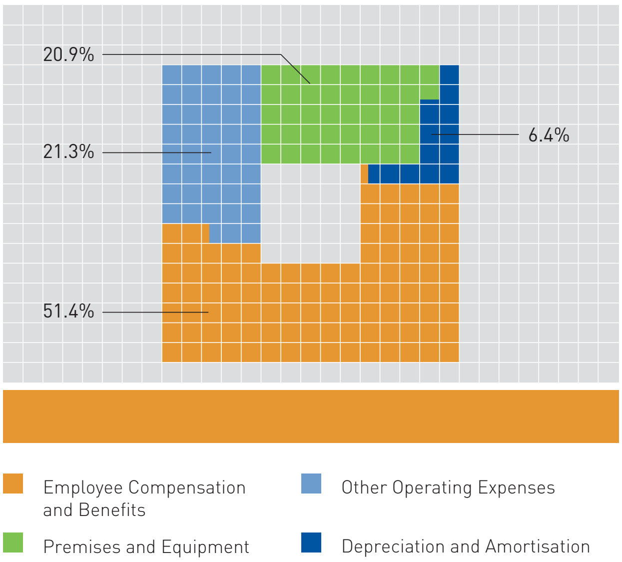
Life insurance recorded satisfactory income growth of 17.5 per cent to reach HK$1,476 million (as analysed in the table below). During the year, we continued to launch new products catering for customers' investment and protection needs. The Monthly Income Retirement Plan was successful in capturing a section of the lucrative retirement plan market and the MediCash Lifetime Insurance Plan, which targets mid-market pre-retirees, was also well received.

Figures in HK$m	2006	2005
Net interest income and fee income	665	411
Investment return on life insurance funds	910	(25)
Net earned insurance premiums	7,534	7,483
Net insurance claims incurred and movement in policyholders' liabilities	(7,996)	(6,929)
Movement in present value of in-force long-term insurance business	363	316
	1,476	1,256

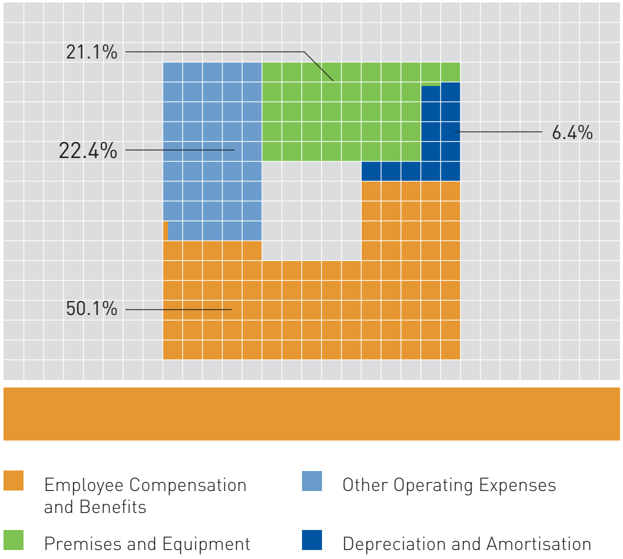
Income from general insurance and others maintained at the same level as 2005.

Operating expenses rose by HK$695 million, or 15.3 per cent, compared with 2005.

Operating Expenses for 2006



Operating Expenses for 2005



Employee compensation and benefits increased by 18.1 per cent, due to the annual salary increment, the increase in number of staff, and performance-based incentives and bonuses. General and administrative expenses were up 12.0 per cent. Rental expenses increased due to increases in rents for branches in Hong Kong and new branches on the Mainland. Other premises and equipment expenses increased by 10.4 per cent, attributable to IT systems development and enhancement for business expansion and regulatory related projects. The rise in marketing expenditure was attributable mainly to the launch of the Bank's new brand image and increased promotion of investment and insurance products and credit cards. Depreciation charges rose by 15.4 per cent as a result of the increase in fair value of business premises. The Bank's Mainland operations, which expanded its network from 12 to 15 outlets and increased its number of staff from 377 to 661 during 2006, also accounted for the Bank's increase in operating expenses.

Staff numbers* by region

	2006	2005
Hong Kong	7,748	7,425
Mainland	661	377
Others	55	43
Total	8,464	7,845

* Full-time equivalent

The number of full-time equivalent staff increased by 619 compared with the previous year-end. New staff in Hong Kong were hired to further expand private banking's financial advisory team and Commercial Banking's relationship management and corporate wealth management teams, as well as to support IT systems development and enhancement. The number of staff at Mainland branches rose by 75.3 per cent, mainly to support the network expansion, building up sales and marketing force for personal banking business, and strengthening of the corporate and commercial relationship management and trade services teams.

The cost efficiency ratio for 2006 was 29.0 per cent, compared with 28.0 per cent in 2005.

Loan impairment charges and other credit risk provisions decreased by HK$354 million, or 57.3 per cent, to HK$264 million.

Figures in HK$m	2006	2005
Loan impairment (charges)/ releases:		
– individually assessed	**(107)**	(309)
– collectively assessed	**(145)**	(309)
	(252)	(618)
of which:		
– new and additional	**(423)**	(1,070)
– releases	**106**	351
– recoveries	**65**	101
	(252)	(618)
Other provision	**(12)**	–
Loan impairment charges and other credit risk provisions	**(264)**	(618)

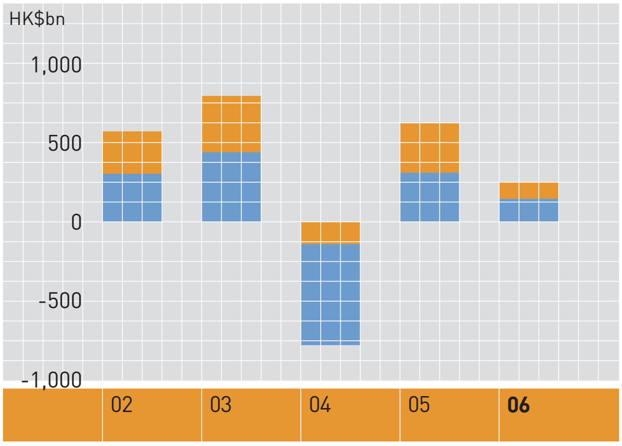
Under the benign credit environment, there was a decrease of HK$202 million in individually assessed provisions, mainly due to a substantial reduction in new and additional charges for commercial banking customers. Releases from commercial banking accounts increased but those from mortgages and personal lending were substantially lower. Of the collectively assessed charges, HK$139 million was made on card and personal loan portfolios, a rise of 13.9 per cent over last year. A charge of HK$6 million was made on advances not identified individually as impaired, compared with a charge of HK$187 million made in 2005. The reduction in historical loss rates used at the end of 2006 for calculation of this type of collectively assessed impairment provisions reflects the continued improvement in credit conditions in recent years.

Total loan impairment allowances as a percentage of gross advances to customers were as follows:

	2006 %	2005 %
Loan impairment allowances:		
– individually assessed	**0.15**	0.20
– collectively assessed	**0.18**	0.19
Total loan impairment allowances	**0.33**	0.39

Total loan impairment allowances as a percentage of gross advances to customers was 0.33 per cent at 31 December 2006, compared with 0.39 per cent at the previous year-end. Individually assessed allowances as a percentage of gross advances fell by 0.05 percentage points to 0.15 per cent, reflecting recoveries from doubtful accounts and writing off of irrecoverable balances against impairment allowances. The percentage of collectively assessed allowances was slightly lowered to 0.18 per cent from 0.19 per cent at the previous year-end.

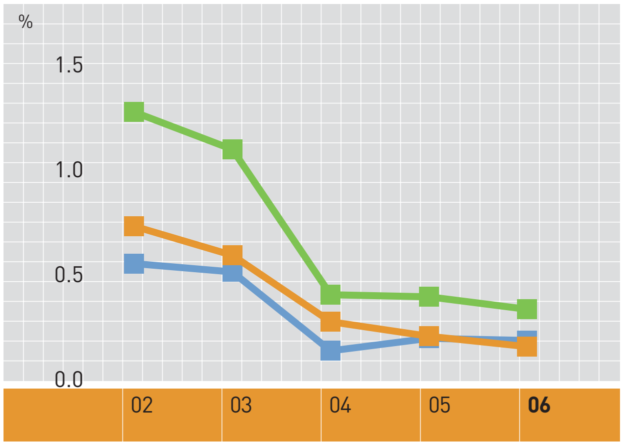
Net Charges/(Releases) for Loan Impairment Allowances



Individually Assessed Allowances#

Collectively Assessed Allowances*

Loan Impairment Allowances as a Percentage of Gross Advances to Customers



Individually Assessed Allowances#

Collectively Assessed Allowances*

Total

For 2002 to 2004, individually assessed allowances merely include the specific provision assessed on individual basis.

* For 2002 to 2004, collectively assessed allowances include the specific provision assessed on portfolio basis plus general provision.

Attributable profit

Profit before tax was up 7.8 per cent to HK$14,395 million after taking into account the increases in profit on disposal of fixed assets and financial investments and the share of profits from associates, and the decrease in net surplus on property revaluation. Attributable profit after taxation and minority interests increased by 6.1 per cent compared with 2005, to reach a record HK$12,038 million.

Profit on disposal of fixed assets and financial investments amounted to HK$843 million, an increase of 76.7 per cent over 2005.

Profit on disposal of fixed assets, mainly properties, rose by HK$486 million to HK$505 million. During the year, the Group sold properties for a total value of HK$3.1 billion, including the property at 77 Des Voeux Road Central, to rationalise the Bank's property portfolio and enhance shareholders' return. Profit on the disposal of equity investments fell to HK$338 million.

Net surplus on property revaluation fell by 75.6 per cent to HK$321 million.

Figures in HK$m	2006	2005
Net surplus on property revaluation:		
– bank premises	17	153
– investment properties	304	1,160
	321	1,313

On 30 September 2006, the Group's premises and investment properties were revalued by DTZ Debenham Tie Leung Limited who confirmed that there had been no material change in valuation as at 31 December 2006. The valuation was carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation of premises was open market value for existing use and the basis of valuation for investment properties was open market value. The revaluation surplus for Group premises amounted to HK$646 million of which HK$17 million was a reversal of revaluation deficits previously charged to the income statement. The balance of HK$629 million was credited to the premises revaluation reserve. Revaluation gains on investment properties of HK$304 million were recognised through the income statement. The related deferred tax provisions for Group premises and investment properties were HK$113 million and HK$53 million respectively.

Share of profits from associates rose by HK$155 million, or 31.0 per cent, mainly contributed by the Mainland's associate, Industrial Bank Co., Ltd.

Customer Group Performance

Personal Financial Services ("PFS") reported a growth of 5.4 per cent in operating profit excluding loan impairment charges to HK$7,840 million. Profit before tax was up by 0.6 per cent to HK$7,730 million. There was a net charge of HK$165 million in loan impairment provisions compared with a substantial net release of HK$232 million in 2005 (mainly from mortgages and personal loans). New and additional loan impairment charges were stable as the credit quality of the PFS loan portfolio remained benign.

Net interest income rose 4.7 per cent, driven by the growth in customer advances and improvement in spreads on BLR-based lending. The positive impact of encouraging growth of 13.6 per cent in customer deposits was, however, offset by the narrowing of deposit spreads on HK dollar savings and structured deposits.

The PFS loan portfolio grew 5.4 per cent, or HK$7,115 million, notwithstanding the fall in Government Home Ownership Scheme mortgages and the disposal of a part of the taxi loan portfolio to balance the overall loan portfolio structure. (Excluding such factors, PFS achieved a growth of 10.7 per cent in customer advances.) Residential mortgages, PFS's core loan product, reported encouraging growth of 5.9 per cent and gained market share amid intense market competition. Marketing efforts proved successful in improving credit card spending as well as consumer borrowing such that personal loans and card advances rose 46.4 per cent and 22.1 per cent respectively. Advances for investment and IPO subscriptions, mainly to Private Banking and Prestige Banking customers, also reported significant growth. Non-interest income reported encouraging growth of 14.2 per cent with wealth management income rising 22.7 per cent.

High levels of stock market and IPO activities, underpinned by ample liquidity and bullish investment sentiment, helped investment services achieve impressive growth:

- Our stockbroking business out-performed the market with the growth of 86.6 per cent in turnover. Together with a 20.0 per cent increase in customer base, our securities services income rose 63.3 per cent. This reflected the popularity of our efficient e-banking and phone trading channels, the competitive pricing of broker commissions, IPO subscription package offers and successful promotion campaigns.

- Our endeavours to maintain a broad range of quality funds from high-growth China and emerging markets equity funds to more conservative capital-guaranteed and fixed income bond funds resulted in much success and recognition. Retail investment fund sales grew by 40.6 per cent over 2005. Three funds managed by Hang Seng Investment Management Limited were named top-performing funds at the Lipper Fund Awards Hong Kong 2007.

  To capture the vast growth potential of the China equity market, Hang Seng continued to be active in launching and promoting China funds. The Bank's flagship China funds, the Hang Seng China H-Share Index Leveraged 150 Fund and Hang Seng China Equity Fund reported returns of 161.1 per cent and 107.6 per cent respectively in 2006.

- Structured deposits and instruments continued to grow with the launch of more sophisticated structures linked to equities, indices, foreign exchange and bullion. Spreads earned on structured products rose by 48.1 per cent.

Private banking maintained its growth momentum and delivered an outstanding result by continuing to focus on providing tailor-made financial planning services. Total operating income rose 51.1 per cent to HK$731 million and profit before tax rose by 46.3 per cent to HK$556 million.

Hang Seng's life insurance business maintained its leading market position for new annualised premiums business with the launch of new annuities and medical insurance products tailored for the needs of pre-retirees and retirees. As a result, life insurance reported a rise of 17.5 per cent in operating income, driven by growth of 18.5 per cent in the number of policies in force.

Card spending grew 11.7 per cent, boosted by promotions in joint effort with merchants and the continued improvement in consumer sentiment. Card services income rose by 22.0 per cent. The number of cards in force increased by 10.5 per cent to 1.4 million. New cards launched during 2006 include the alpha card, a debit card to tap the youth market, and VISA Infinite, which targets top-tier affluent customers.

Commercial Banking ("CMB") achieved an encouraging increase of 21.5 per cent in operating profit excluding loan impairment charges, driven by strong growth in customer advances and corporate wealth management business. Taking into account the reduction in loan impairment provisions, profit before tax rose 109.8 per cent.

Net interest income reported strong growth of 28.3 per cent. Customer advances rose 22.2 per cent, highlighting significant growth in trade finance and factoring loans with good gains in market share, and advances to the property, manufacturing, and wholesale and retail sectors. The opening of a branch in Dongguan, together with the existing branches in Guangzhou, Shenzhen and Macau, further strengthened the Bank's competitive edge in providing seamless, one-stop commercial banking services to Hong Kong customers within the Pearl River Delta region.

The Bank further enhanced its position as the preferred SME bank through various initiatives, such as the SME "testimonial" TV commercial (part of the Bank's brand revitalisation campaign), the launch of the Business Partner Direct 24-hour manned telephone service hotline and the extended opening hours of MTR branches. New SME accounts acquired in the second half of 2006 outpaced the first half by 34.7 per cent, as a result of intensified marketing.

The heightened focus upon CMB under the Bank's Roadmap for Growth has resulted in growth of 13.5 per cent in net fees and commissions and 11.9 per cent in trading income.

The Bank has continued to launch customer-centric propositions for specific industries. The Bank is the only financial institution to have introduced Octopus Merchant services for retailers, which complement other retailer solutions such as credit card merchant services, renminbi deposits, retailer insurance protection and bulk cash deposit services. Net fee income from card acquiring business achieved strong growth of 45.1 per cent in 2006.

CMB identified great opportunities in developing corporate wealth management services. A dedicated wealth management team was established in early 2006 to better serve the investment, treasury and risk management needs of commercial customers. Furthermore, keyperson insurance was launched in early 2006. With these initiatives, corporate wealth management grew strongly and accounted for 22.5 per cent of CMB's non-interest income. An increasing trend in corporate wealth management is expected to further dilute the reliance on trade fee income.

The pace of online business banking has accelerated. At 31 December 2006, over 38,000 customers had registered for business e-banking services, an increase of 32.1 per cent from the end of 2005. The number of online business banking transactions also grew by 46.8 per cent.

Corporate Banking's ("CIB") net operating income increased by 11.8 per cent. Strong liquidity in the banking system continued to squeeze corporate loan margins, and CIB stayed focused on asset yield rather than loan growth. Customer deposits registered a healthy growth of 32.5 per cent. CIB also stepped up its efforts in collaboration with Treasury in providing corporate treasury services and structured products to grow non-fund income. Operating profit before impairment charges was down by 2.0 per cent. The strong growth of targeted business segments from diversification of customer base in Hong Kong and the Mainland largely compensated for the fall in lending to large corporates. Profit before tax increased by 9.9 per cent, benefiting from a release in collectively assessed impairment allowances.

Treasury's ("TRY") operating profit was down by 25.0 per cent at HK$887 million. Profit before tax, however, was down only 2.0 per cent, due to the absence of losses on the disposal of investment securities (a loss of HK$217 million was recorded in 2005). TRY continued to pursue its strategy of enhancing trading capability and providing more sophisticated products for corporate and individual customers. This led to a substantial 66.1 per cent increase in trading income, which reached HK$628 million. The balance sheet management portfolio, however, continued to face the challenge of the rise in funding costs, particularly for the US dollar portfolio, as well as flattened yield curves. Net interest income fell by 51.7 per cent. The position, however, has been improving since the second half of the year with the halt in US dollar interest rate hikes and subdued HK dollar interest rates due to ample market liquidity.

Mainland

The Bank expanded its network to 15 outlets in 2006 by upgrading its representative office in Dongguan to a branch and opening three new sub-branches in Shanghai and Guangzhou. This is in pursuance of its strategy to focus on the Yangtze River Delta and Pearl River Delta regions and to develop its Prestige Banking customer base through its sub-branch network in major cities. Strong growth was recorded in customer advances, which rose 50.9 per cent to HK$15.9 billion. Customer deposits also rose significantly by 51.1 per cent. Profit before tax rose 94.2 per cent to HK$134 million, with growth of 94.5 per cent in net operating income.

By customer group, Mainland PFS focused on the Prestige Banking segment, benefiting from Hang Seng's established strengths, including excellent customer service, strong wealth management capabilities and experience in mortgage business. CMB and CIB teams collaborated closely with their Hong Kong counterparts to serve customers' business needs on the Mainland and in Hong Kong, and to cultivate new relationships to expand the Bank's Mainland corporate customer base. TRY continued to manage the funding positions of the branches and develop structured investment products to meet customers' needs.

Including the Group's share of profit from Industrial Bank Co., Ltd., Mainland business contributed 6.1 per cent of total profit before tax, compared with 4.5 per cent in 2005.

Mainland business financial highlights

Figures in HK$m	2006	2005
Profit before tax of Mainland branches	**134**	69
Share of profit from Mainland associate on pre-tax basis	**763**	547
Profit before tax of Mainland business	**897**	616
Share of Group's profit before tax*	**6.1%**	4.5%

* Share of profit from associate is adjusted to pre-tax basis for the purpose of calculating the share of Group's profit before tax.

Economic Profit

Economic profit is calculated from post-tax profit, adjusted for any surplus/deficit arising from property revaluation and depreciation attributable to the revaluation surplus, and takes into account the cost of capital invested by the Bank's shareholders.

For the year 2006, economic profit was HK$7,343 million, an increase of HK$1,259 million, or 20.7 per cent, compared with 2005. Post-tax profit, adjusted for the property revaluation surplus net of deferred tax and depreciation attributable to the revaluation, rose by HK$1,537 million. Cost of capital rose by HK$278 million, in line with the growth in invested capital with the accumulation of retained profits.

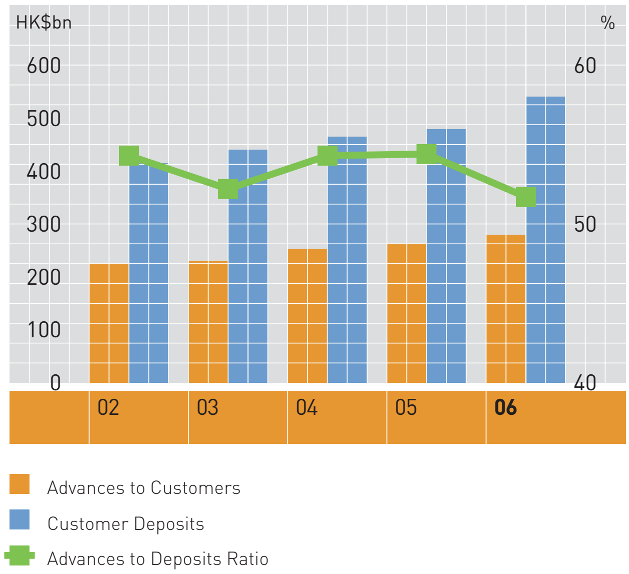
	2006 HK$m	2006 %	2005 HK$m	2005 %
Average invested capital	**38,962**		36,000	
Return on invested capital*	**11,840**	**30.4**	10,303	28.6
Cost of capital	**(4,497)**	**(11.5)**	(4,219)	(11.7)
Economic profit	**7,343**	**18.9**	6,084	16.9

* Return on invested capital is based on post-tax profit excluding any surplus/deficit arising from property revaluation and depreciation attributable to the revaluation surplus.

Balance Sheet

Total assets rose by HK$88.2 billion, or 15.2 per cent, to HK$669.1 billion. Customer advances rose by 7.2 per cent with encouraging growth in card and personal loans, trade finance, CMB lending and Mainland lending. Residential mortgages grew satisfactorily in an intense competitive market. Interbank placing and money market instruments also increased, driven by the 12.8 per cent growth in customer deposits. At 31 December 2006, the advances-to-deposits ratio was 51.7 per cent, compared with 54.4 per cent at the end of 2005.

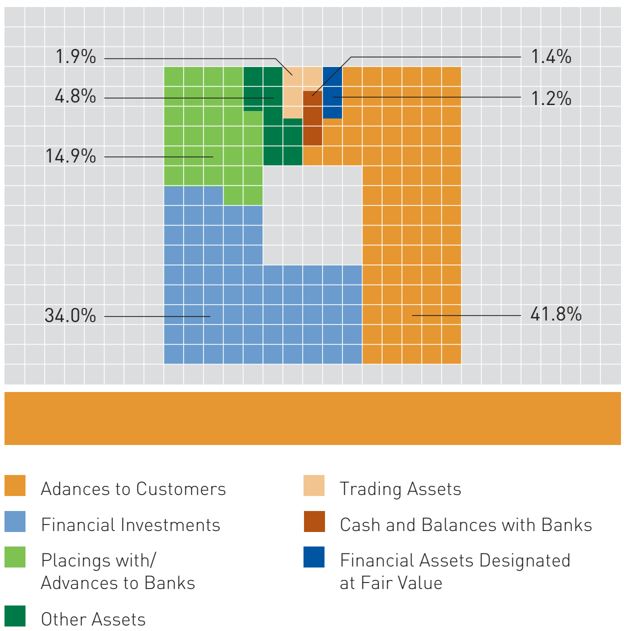
Advances to Customers and Customer Deposits



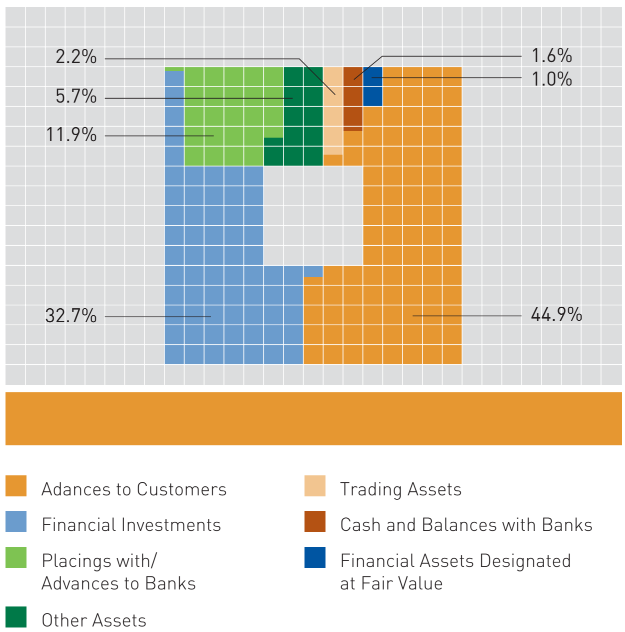
Assets deployment

	2006 HK$m	%	2005 HK$m	%
Cash and balances with banks	**9,390**	**1.4**	9,201	1.6
Placings with and advances to banks	**99,705**	**14.9**	69,286	11.9
Trading assets	**12,467**	**1.9**	12,600	2.2
Financial assets designated at fair value	**8,280**	**1.2**	6,027	1.0
Advances to customers	**279,353**	**41.8**	260,680	44.9
Financial investments	**227,710**	**34.0**	189,904	32.7
Other assets	**32,159**	**4.8**	33,122	5.7
Total assets	**669,064**	**100.0**	580,820	100.0

Assets Deployment for 2006



Assets Deployment for 2005



Advances to customers

Advances to customers rose by 7.2 per cent compared with the end of 2005.

Lending to the property development sector rose 9.8 per cent, reflecting the increase in financing of development projects by CIB and CMB. The 4.6 per cent rise in property investment was largely residential mortgages to property holding vehicles controlled by individuals. Lending to investment companies grouped under the financial concerns sector rose significantly, driven by the active investment market. The encouraging growth of the CMB loan portfolio was reflected in rises of 14.3 per cent and 18.4 per cent in lending to the wholesale and retail trade and manufacturing sector respectively. Lending to the transport and transport equipment sector recorded a fall of 6.5 per cent, attributable to the disposal of a part of the taxi portfolio to balance the overall loan portfolio structure. Excluding such effect, lending to this sector rose 5.5 per cent.

Trade finance recorded strong growth of 24.0 per cent and gained substantial market share in 2006, reflecting CMB's achievement in strengthening customer relationships and enhancing trade finance service efficiency.
Lending to individuals recorded a rise of 2.1 per cent. Excluding the fall in Government Home Ownership Scheme mortgages, lending to individuals grew by 5.4 per cent. Residential mortgages to individuals rose by 2.8 per cent and the Bank gained market share amid intense market competition. Including mortgages held in the name of investment holding vehicles which were grouped under the property investment sector as mentioned above, the growth rate reached 5.2 per cent.

With the improved economic environment and positive consumer sentiment, personal loans and card advances rose 46.4 per cent and 22.1 per cent respectively. PFS further expanded its consumer finance business by stepping up marketing initiatives and improving process efficiency.

Loans for use outside Hong Kong increased by HK$6,316 million, or 39.8 per cent, over the previous year-end. This was due largely to the 50.9 per cent expansion of lending by Mainland branches, which had reached HK$15,851 million at 31 December 2006. Strong growth was recorded in corporate lending, driven by renminbi loans which can be priced at a higher margin. Trade finance rose significantly, reflecting good collaboration between the Hong Kong and Mainland trade services teams. Mainland branches continued to grow residential mortgage business, leveraging the Bank's strong capabilities and experience in Hong Kong.

Customer deposits

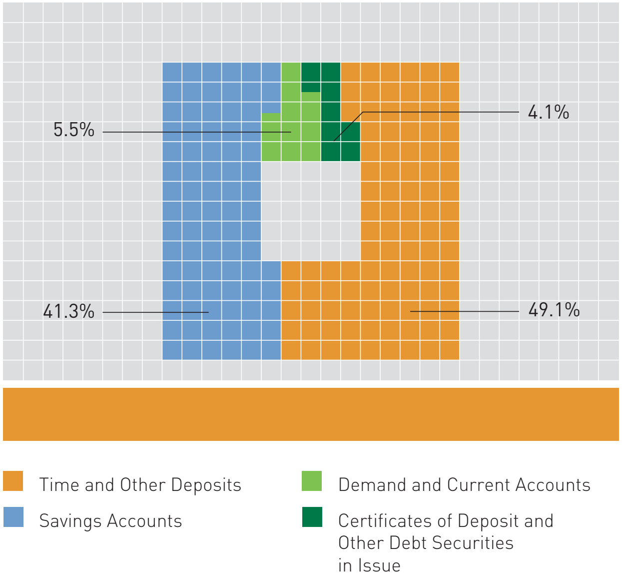
Customer deposits and certificates of deposit and other debt securities in issue rose by 12.8 per cent to HK$540.3 billion. Both HK dollar and US dollar savings accounts rose, reflecting customers' preference for liquidity in an active investment market. Structured deposits, structured certificates of deposit and other debt securities in issue rose 31.2 per cent as the Bank continued to increase the diversity and sophistication of these products for customers to capture market opportunities.

Deposits at Mainland branches grew 51.1 per cent following efforts to increase the customer base through expansion of the network and the PFS sales force. To further develop the wealth management business, the Mainland branches expanded the range of investment-linked deposit products to meet the needs of the Prestige Banking customer segment.

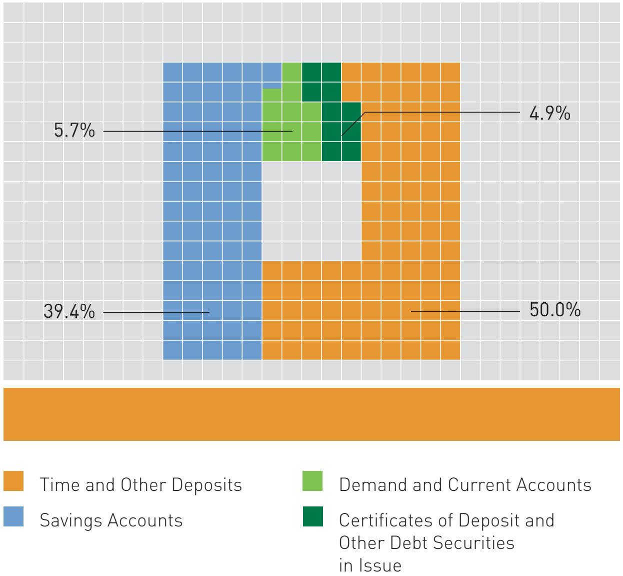
Subordinated liabilities

During 2006, the Bank issued floating-rate subordinated notes amounting to US$450 million that mature in July 2016 with a one-time call option exercisable by the Bank in July 2011. The notes were issued at the price of 99.869 per cent, bearing interest at the rate of three-month US dollar LIBOR plus 0.30 per cent, payable quarterly from the issue date to the call option date. Thereafter, if the notes are not redeemed on the call option date, the interest rate will be reset to three-month US dollar LIBOR plus 0.80 per cent payable quarterly. The notes, which qualify as tier 2 capital, serve to help the Bank maintain a more balanced capital structure and support business growth.

Customer Deposits for 2006



Customer Deposits for 2005



Shareholders' funds

Figures in HK$m	**2006**	2005
Share capital	**9,559**	9,559
Retained profits	**29,044**	26,052
Premises revaluation reserve	**3,491**	3,543
Cash flow hedges reserve	**(220)**	(483)
Available-for-sale investments reserve	**923**	(17)
Capital redemption reserve	**99**	99
Other reserves	**452**	185
Total reserves	**33,789**	29,379
	43,348	38,938
Proposed dividends	**3,633**	3,633
Shareholders' funds	**46,981**	42,571
Return on average shareholders' funds	**27.4%**	27.5%

Shareholders' funds (excluding proposed dividends) increased by HK$4,410 million, or 11.3 per cent, to HK$43,348 million at 31 December 2006. Retained profits rose by HK$2,992 million, reflecting the growth in attributable profit and the realisation of property revaluation reserves on the disposal of properties during the year. The available-for-sale investments reserve also rose.

The return on average shareholders' funds was 27.4 per cent, compared with 27.5 per cent in 2005.

Save for the US$450 million subordinated notes issue, there was no purchase, sale or redemption of the Group's listed securities by the Bank or any of its subsidiaries during 2006.

Capital Management

Capital Resources Management

Figures in HK$m	2006	2005
Capital base		
Tier 1 capital		
– Share capital	**9,559**	9,559
– Retained profits	**25,724**	21,439
– Classified as regulatory reserve	**(518)**	(510)
– Capital redemption reserve	**99**	99
– Less: goodwill	**(330)**	(318)
– Total	**34,534**	30,269
Tier 2 capital		
– Property revaluation reserve	**4,259**	5,114
– Available-for-sale investment and equity revaluation reserve	**542**	(5)
– Collective impairment allowances	**518**	510
– Regulatory reserve	**518**	510
– Term subordinated debt	**7,988**	4,479
– Total	**13,825**	10,608
Unconsolidated investments and other deductions	**(4,242)**	(3,444)
Total capital base after deductions	**44,117**	37,433
Risk-weighted assets		
On-balance sheet	**308,127**	277,617
Off-balance sheet	**15,251**	14,739
Total risk-weighted assets	**323,378**	292,356
Total risk-weighted assets adjusted for market risk	**324,007**	291,570
Capital adequacy ratios		
After adjusting for market risk		
– Tier 1*	**10.7%**	10.4%
– Total*	**13.6%**	12.8%
Before adjusting for market risk		
– Tier 1	**10.7%**	10.4%
– Total	**13.6%**	12.8%

* The capital ratios take into account market risks in accordance with the relevant HKMA guideline in the Supervisory Policy Manual.

In accordance with 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" from retained profits. This regulatory reserve is included as tier 2 capital together with the Group's collective impairment allowances.

The total capital ratio rose by 0.8 percentage points to 13.6 per cent at 31 December 2006, compared with 12.8 per cent at 31 December 2005. The tier 1 ratio increased from 10.4 per cent to 10.7 per cent. The capital base increased by HK$6,684 million to HK$44,117 million, mainly due to the increase in retained profits (including the realisation of property revaluation reserves on disposed properties) and the issue of US$450 million subordinated notes, which qualify as tier 2 capital. Risk-weighted assets adjusted for market risk grew by 11.1 per cent, attributable to the increase in advances to customers and financial investments.

Risk Management

The effectiveness of the Group's risk management polices and strategies is a key success factor. Operating in the financial services industry, the most important types of risks the Group is exposed to are credit, liquidity, market, insurance underwriting, operational and reputational risks. The Group has established policies and procedures to identify and analyse risks and to set appropriate risk limits to control this broad spectrum of risks. The risk management policies and major control limits are approved by the Board of Directors. Risk limits are monitored and controlled continually by dedicated departments by means of reliable and up-to-date management information systems. The management of various types of risks is well coordinated at the level of the Bank's Board and various Management committees, such as, the Executive Committee, Asset and Liability Management Committee and Credit Committee.

Note 61 "Financial risk management" to the financial statements provides a detailed discussion and analysis of the Group's credit risk, liquidity risk, market and interest rate risk and insurance underwriting risk. The management of operational risk and reputational risk are set out as follows:

Operational Risk

Operational risk is the risk of loss arising through fraud, unauthorised activities, error, omission, inefficiency, system failure or from external events. It is inherent to every business organisation and covers a wide spectrum of issues. The Group manages its operational risk through a controls-based environment in which the processes and controls are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by periodic independent review of the internal control systems by Internal Audit. The operational risk management framework comprises assignment of responsibilities at senior management level, assessment of risk factors inherent in each business and operations units, information systems to record operational losses and analysis of loss events. Operational risk is mitigated by adequate insurance coverage on assets and business losses. To reduce the impact and interruptions to business activities caused by system failure or natural disaster, back-up systems and contingency business resumption plans are in place for all business and critical operations functions. Operational risk management is coordinated by the Chief Operating Officer and monitored by the Operational Risk Management Committee.

Reputational Risk

Reputational risks can arise from social, ethical or environmental issues, or as a consequence of operational risk events. Standards are set and policies and procedures are established in all areas of reputational risk and are communicated to all level of staff. These include treating customers fairly, conflicts of interest, money laundering deterrence, environmental impact and anti-corruption measures. The reputation downside to the Group is fully appraised before any strategic decision is taken.

The Group is a socially and environmental responsible organization. Its corporate social responsibility policies and practices are discussed in the corporate responsibility section of this Annual Report.