



Retail Mortgage-Backed Securities

The Hong Kong Mortgage Corporation Limited as Guarantor

Bauhinia MBS Limited as Issuer



1-Year 1.70%	3-Year 2.65%
	4-Year 3.05%

Offer Period : 20 October 2004 to 29 October 2004

ARRANGER

HSBC 滙豐

JOINT UNDERWRITERS

HSBC 滙豐



PLACING BANKS



Prospectus dated 19 October 2004

We have registered this Prospectus, signed on behalf of our directors, with a letter from our auditors consenting to the inclusion of their audit report, with the Registrar of Companies in Hong Kong as required by section 342C of the Companies Ordinance. Neither the Registrar of Companies nor the Securities and Futures Commission takes any responsibility for the contents of this Prospectus.

IMPORTANT NOTICE

If you are in any doubt about this Prospectus you should consult your stockbroker, bank manager, solicitor, professional accountant or other professional adviser. Applicants should read this Prospectus in full.

RETAIL NOTES

This is a Prospectus under which Bauhinia is issuing three Classes of mortgage-backed Retail Notes to retail investors in Hong Kong.

ONLY RETAIL NOTES OFFERED TO RETAIL INVESTORS

The Retail Notes offered under this Prospectus are part of a Series of mortgage-backed Notes issued by Bauhinia. At the same time Bauhinia is also issuing two other Classes of Notes (forming part of the same Series) to professional investors. However, only Retail Notes are being offered to retail investors in Hong Kong.

FEATURES OF THE RETAIL NOTES

This Prospectus sets out specific features of the Retail Notes being issued. The Retail Notes are not available to US persons or residents of Canada.

DEFINED WORDS

Certain capitalised words used in this Prospectus have defined meanings. The Glossary in Section 10 contains a definition of these words.

GUARANTEE BY THE HKMC

Bauhinia's obligations to pay principal and interest to Retail Noteholders under the Retail Notes are guaranteed by The Hong Kong Mortgage Corporation Limited.

RISKS OF INVESTING

The terms of the Retail Notes and the risks associated with investing in the Retail Notes are described in Sections 3, 5 and 8 of this Prospectus.

YOU NEED TO CONSIDER YOUR OWN POSITION

This Prospectus does not take into account the investment objectives, financial situation or particular needs of any particular investor.

CONTENTS

What you need to do	3	8.6 Mortgage eligibility criteria	42
Key investment features	4	8.7 Pre and post-enforcement cashflows	43
Overview of the Offer	5	Section 9 - The Guarantor - The Hong Kong Mortgage Corporation Limited	46
Our mortgage-backed securitisation programme	6	The HKMC's business	46
The Offer at a glance	8	The HKMC's Board of Directors and Senior Management	48
Section 1 - How to invest	11	Further information about the HKMC	51
Section 2 - The Issuer - Bauhinia MBS Limited	17	Summary table of the HKMC's key business information	52
Section 3 - The Guarantee and the Series Assets	19	Section 10 - Glossary	54
Description of the Guarantee	19	Section 11 - Purchaser Confirmations	61
Use of proceeds and Series Assets	19	APPENDIX P-1	
The Provisional Pool and Pool Criteria	19	Auditors' report and financial statements of Bauhinia for the year ended 31 December 2003	62
Section 4 - Collections and cashflows	23	APPENDIX P-2	
Collections	23	Unaudited interim financial statements of Bauhinia for the 6 months ended 30 June 2004	72
Cashflows	23	APPENDIX P-3	
Section 5 - Investment risks	25	Capitalisation table of Bauhinia	79
Section 6 - Hong Kong taxation of Notes	32	APPENDIX P-4	
Section 7 - Information about Bauhinia and the Retail Note issue	33	Auditors' report and financial statements of the HKMC for the year ended 31 December 2003	80
Section 8 - Information about key agreements	36	APPENDIX P-5	
8.1 Terms and conditions of the Retail Notes	36	Unaudited interim financial statements of the HKMC for the 6 months ended 30 June 2004	108
8.2 The Trust Deed	37	APPENDIX P-6	
8.3 The Guarantee	37	Capitalisation table of the HKMC	128
8.4 Security arrangements	38		
8.5 Mortgage servicing arrangements	40		

WHAT YOU NEED TO DO

1 Read

Read this Prospectus in full, paying particular attention to the following:

- ◀ Important notice set out on the inside front cover; and
- ◀ Risks associated with investing in the Retail Notes set out in Section 5 ("*Investment risks*").

2 Consider

Consider all the risk factors and other information concerning the Retail Notes in light of your own individual investment objectives and circumstances.

3 Consult

If you have any questions about whether this investment is appropriate for you, please **consult your stockbroker, bank manager, solicitor, professional accountant or other professional adviser** before deciding to invest in the Retail Notes.

4 Apply

You can buy the Retail Notes from any of the banks listed in this Prospectus. Place your order with one of these banks. The bank will ask you to fill in their order form and to confirm certain things to them, including that you have read and understood this Prospectus.

5 Open an account

We do not issue individual certificates for the Retail Notes, so you must **arrange for your bank to hold them in a securities or investment account**. If you do not have a bank account and a securities or investment account already, you will have to open them before you can buy any Retail Notes.

KEY INVESTMENT FEATURES

Interest rate	The Retail Notes offer higher interest rates than Hong Kong Dollar time deposits of similar maturities.
Interest	The Retail Notes provide investors with a fixed rate of return with regular six-monthly interest payments until their Repayment Date.
Different Repayment Dates	To suit your investment needs, the Retail Notes are available with different Repayment Dates.
Mortgage-backed	The Retail Notes are backed by, and secured over, certain assets, including the Mortgage Pool. This provides, in addition to the Guarantee, another source of payment for Retail Noteholders so that Retail Noteholders can turn to those assets for payment of principal and interest on the Retail Notes even if the Guarantor does not meet its obligations under the Guarantee.
Rated	The Retail Notes will be rated Aa3 by Moody's Investors Service and AA- by Standard & Poor's which, at the date of this Prospectus, are the same currency ratings as those of the Hong Kong Government.
Principal and interest guaranteed	Irrespective of the performance of the Mortgage Pool and other assets backing this issue of Retail Notes, payments of both principal and interest on your Retail Notes are guaranteed by the HKMC.
Management of Mortgage Pool	The Mortgages in the Mortgage Pool will be managed by the HKMC.

OVERVIEW OF THE OFFER

This is an overview of the main features of the Retail Notes offered under this Prospectus.

Feature	Description	Prospectus section reference								
Issuer	Bauhinia MBS Limited, a limited liability Cayman Islands company	Section 2 - The Issuer - Bauhinia MBS Limited								
Series Assets	Interests in a portfolio of Mortgages together with certain other Series Assets; these assets will be secured in favour of Retail Noteholders and other creditors of the Series	Section 3 - The Guarantee and the Series Assets and Section 8.4 - The Security								
Guarantee	Principal and interest on the Retail Notes are guaranteed by the HKMC	Section 3 - The Guarantee and the Series Assets								
Repayment Date	<table border="1"> <thead> <tr> <th>Class of Notes</th> <th>Repayment Date</th> </tr> </thead> <tbody> <tr> <td>Class A</td> <td>5 November 2005</td> </tr> <tr> <td>Class B</td> <td>5 November 2007</td> </tr> <tr> <td>Class C</td> <td>5 November 2008</td> </tr> </tbody> </table> <p>These are the dates we repay 100% of the principal of the Retail Notes. In normal circumstances we will not repay principal on the Retail Notes before these dates</p>	Class of Notes	Repayment Date	Class A	5 November 2005	Class B	5 November 2007	Class C	5 November 2008	The Offer at a glance
Class of Notes	Repayment Date									
Class A	5 November 2005									
Class B	5 November 2007									
Class C	5 November 2008									
Interest rate	<p>Fixed rate per annum:</p> <p>Class A Notes: 1.70% per annum</p> <p>Class B Notes: 2.65% per annum</p> <p>Class C Notes: 3.05% per annum</p>	The Offer at a glance								
Interest	Paid every six months until the Repayment Date of the Retail Notes	The Offer at a glance								
Payments under the Retail Notes and Security	Payments of principal and interest on the Retail Notes will only be made from the Series Assets and from the Guarantee	Section 3 - The Guarantee and the Series Assets Section 4 - Collections and Cashflows Section 8.4 - The Security								

Offer timetable*	
Offer Opening Date	20 October 2004
Offer Closing Date	29 October 2004
Price-fixing Date	3 November 2004
Issue Date	5 November 2004

Offer Details			
Total issue amount	Class of Notes	Issue Amount	The Offer at a glance
	Class A	HK\$250 million	
	Class B	HK\$400 million	
	Class C	HK\$250 million	
Separate classes	This Series of Notes includes three Classes of Retail Notes and two Classes of Professional Notes - we have named this Series "Series 2004-2"		The Offer at a glance
Application Price	102% of the principal amount of the Retail Notes you order		The Offer at a glance
Subscription Price	To be fixed by us on the Price-fixing Date		The Offer at a glance
Minimum investment	HK\$50,000		The Offer at a glance
Additional investment multiples	HK\$50,000		The Offer at a glance
Handling fee	0.15% of the Subscription Price of the Retail Notes you buy		The Offer at a glance

* These dates are indicative only. We have the right to close the Offer early or to extend the Offer Closing Date without notice. If the Offer Closing Date is varied, subsequent dates (such as the Price-fixing Date, Issue Date, Payment Dates, Interest Payment Dates and the Repayment Dates) may also be varied accordingly. Notice will be given of any such changes. We also have the right to cancel the Offer at any time before the Issue Date.

OUR MORTGAGE-BACKED SECURITISATION PROGRAMME

ESTABLISHMENT OF THE PROGRAMME

In December 2001, we established a US\$3,000,000,000 mortgage-backed securitisation programme.

Under our mortgage-backed securitisation programme, we acquire mortgages and we pay for those mortgages by issuing notes. Notes are issued in separate Series which may be divided into separate classes. Each Series is given a Series number at the time of issue to distinguish it from other Series. As at the date of this Prospectus, we have issued 3 Series of notes under our mortgage-backed securitisation programme - see Section 7 ("Information about Bauhinia and the Retail Note issue") and Appendix P-1 ("Auditors' report and financial statements of Bauhinia for the year ended 31 December 2003"). Please also refer to the capitalisation table of Bauhinia in Appendix P-3 ("Capitalisation table of Bauhinia").

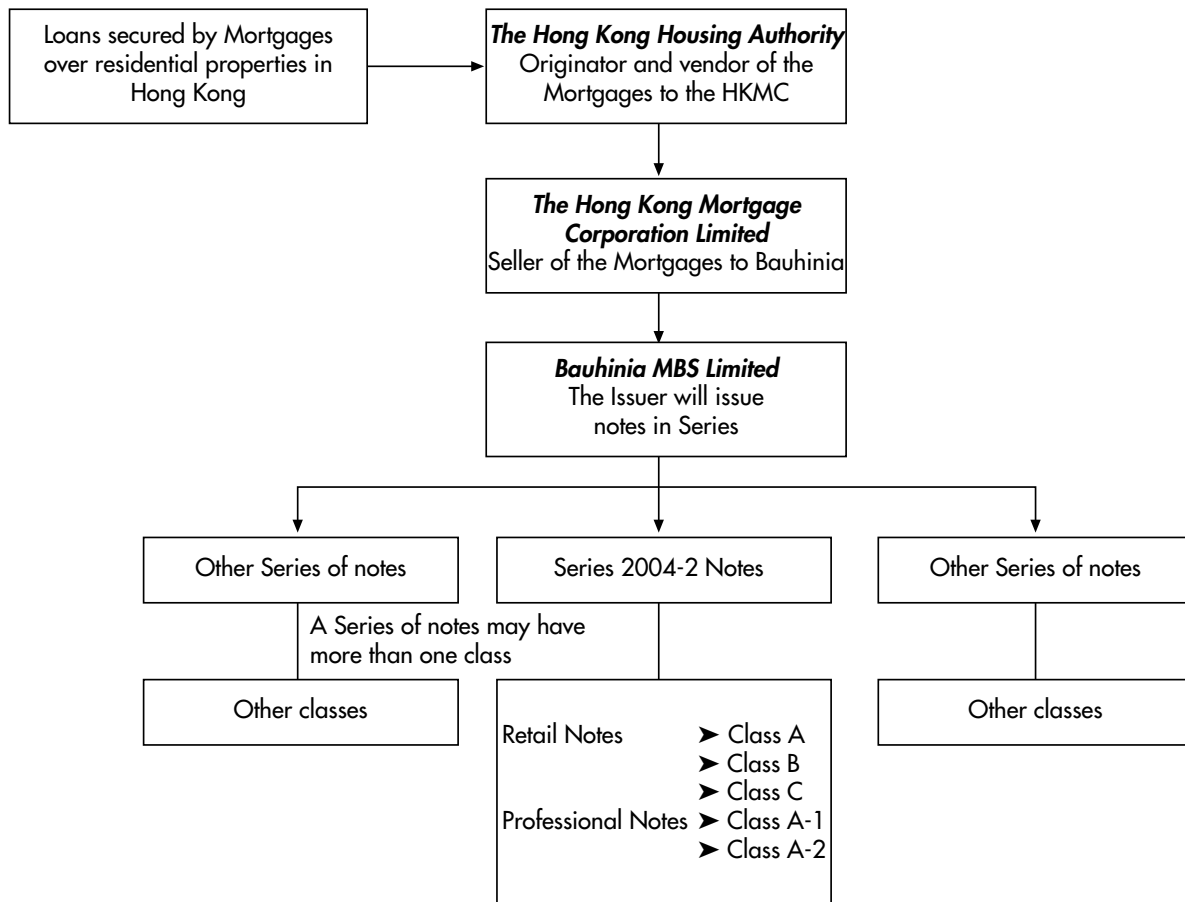
SEPARATE SERIES OF NOTES

This Series is known as Series 2004-2 and is divided into five different Classes of Notes, including three different Classes of Retail Notes.

Each Series under our mortgage-backed securitisation programme is backed by separate assets. This means that assets of a different Series cannot be used to pay money owing on the Retail Notes or to make any other payments under this Series 2004-2. It also means that the Series Assets backing this Series 2004-2 cannot be used to make payments on any other Series we have issued or may issue in the future.

TRANSACTION STRUCTURE

The following diagram sets out the transaction structure.



THE NOTES ARE CONSTITUTED BY A TRUST DEED

When issued, the Notes have the benefit of a Trust Deed.

The Trust Deed sets out the forms of the Notes as well as the terms and conditions that apply to various types of notes we may issue under our mortgage-backed securitisation programme. In the Trust Deed we promise to repay principal and to pay interest under the Notes. We also promise to perform other obligations, depending on the terms of the particular Notes.

The Trust Deed also contains the provisions of the Guarantee under which the HKMC (as Guarantor) guarantees repayment of principal, and payment of interest, under the Retail Notes. The Guarantor also guarantees repayment of principal, and payment of interest, under the Professional Notes.

Important features of the Trust Deed and the Guarantee are summarised in Section 8 (*"Information about key agreements"*).

SECURITY FOR OUR OBLIGATIONS

To provide security for our obligations under the Notes (which includes the Retail Notes), we have entered into a Deed of Charge with the Security Trustee and the Note Trustee, and will enter into the Deed of Joinder with the Security Trustee.

Important features of these security documents are summarised in Section 8.4 (*"The Security arrangements"*).

LIMITED RECOURSE

All notes (including the Notes) issued by us (and other contracts we enter into) are subject to limited recourse provisions. The effect of these provisions is summarised in Section 5 (*"Investment Risks" - "Limited recourse"*).

The limited recourse provisions do not limit the Guarantor's obligations under the Guarantee.

NOTES MAY BE DECLARED DUE AND PAYABLE EARLY IF THERE IS AN "EVENT OF DEFAULT"

The Terms and Conditions set out certain "Events of Default". If any Event of Default occurs and continues, the Note Trustee may, at its discretion, and must, at the request or direction of the Noteholders, declare the entire principal amount of all Notes of this Series 2004-2 to be due and payable immediately.

The Events of Default are set out in Section 8.1 (*"Terms and conditions of the Retail Notes" - "Events of Default"*) and include a failure to pay principal or interest on the Notes.

Noteholders cannot take action against us or the Guarantor directly to enforce the Notes or the Guarantee unless the Note Trustee fails to act in accordance with the Trust Deed. The Note Trustee can insist that the Noteholders indemnify it before it is bound to take any enforcement action.

Offer structure

We are offering three Classes of Retail Notes - Retail Notes Classes A, B and C as well as two Classes of Professional Notes - Class A-1 Professional Notes and Class A-2 Professional Notes.

This Prospectus only relates to the Retail Notes. If you are a retail investor you cannot buy Professional Notes.

All Classes of Notes (Retail Notes and Professional Notes) form part of a separate Series - Series 2004-2 - under our mortgage-backed securitisation programme.

Each Series (including this Series 2004-2) is backed by and legally secured over a separate pool of assets - see Section 3 (*"The Guarantee and the Series Assets"*).

Issuer

Bauhinia MBS Limited - see Section 2 (*"The Issuer - Bauhinia MBS Limited"*).

Total issue amount

Class of Notes	Issue Amount
Class A	HK\$250 million
Class B	HK\$400 million
Class C	HK\$250 million
Class A-1 Professional Notes	HK\$450 million
Class A-2 Professional Notes	HK\$650 million

Offer period

From 20 October 2004 to 29 October 2004 (or such earlier or later date as we consider appropriate).

Interest Rate, Interest Period and Interest Payment Dates

The Retail Notes pay interest every six months as follows:

Class of Notes	Interest Rate per annum	Expected Interest Payment Dates
Class A	1.70%	5th of each May and November
Class B	2.65%	5th of each May and November
Class C	3.05%	5th of each May and November

Interest will be paid semi-annually in arrears on the 5th of May and November each year until the Repayment Date of the Retail Notes. If the 5th is not a Business Day, we will pay interest on the next Business Day.

We will calculate the amount of interest payable on the Retail Notes by counting the actual number of calendar days in the Interest Period commencing from (and including) the preceding Interest Payment Date up to (but excluding) the current Interest Payment Date assuming a year of 365 days. The first Interest Period will commence on the Issue Date.

These Interest Payment Dates may be varied if such dates do not fall on a Business Day or if the Issue Date is varied. No notice will be given to investors if any of the Interest Payment Dates are varied only because it does not fall on a Business Day.

Currency

The Retail Notes will be denominated in Hong Kong Dollars.

Issue Date

The Retail Notes are scheduled to be issued on 5 November 2004. We may decide to close the Offer early or to keep it open for a longer period without prior notice. We reserve the right to cancel the Offer of Retail Notes at any time before the scheduled Issue Date.

Application Price

The Application Price is 102% of the principal amount of the Retail Notes.

For each Retail Note you order, you pay 102% of the principal amount of such Retail Note (the Application Price) plus 0.15% of the Application Price.

If the Subscription Price is less than the Application Price, your bank will refund the difference together with any excess handling fee to you without interest within 5 Business Days from the Issue Date. If the Subscription Price is more than the Application Price, you will have to pay the difference plus any extra handling fee to your bank by way of debit from your designated bank account with your bank on the Price-fixing Date. Please make sure that you have sufficient money in your designated bank account for such debit in case the Subscription Price is fixed at an amount which is more than the Application Price.

Subscription Price

The Subscription Price is the actual price you pay us for your Retail Notes. It represents the actual amount of your investment in the Retail Notes. However, in calculating the return on your investment, you should take into account any expenses you have incurred or will be incurring (including, for example, the handling fee) in relation to the Retail Notes.

We expect to fix the Subscription Price for the Retail Notes (after the Offer closes) on 3 November 2004. This date is the Price-fixing Date. For further details see Section 1 (*"How to invest" - "How the Subscription Price of the Retail Notes will be fixed"*).

Handling fee

This is the fee you pay the bank which handles your order. It is calculated as 0.15% of the Subscription Price of Retail Notes you buy. If your application is unsuccessful, invalid or if Bauhinia does not proceed with the Offer, all amounts paid by you on account of the handling fee and the Application Price will be refunded to you without interest by credit to your designated bank account.

Repayment Dates

The Repayment Date is the date we will repay 100% of the principal amount of your Retail Notes. We will not make any principal repayments before the relevant Repayment Date of the Retail Notes.

Each Class of Retail Notes has a different Repayment Date:

Class of Notes	Term	Repayment Date
Class A	1 year	5 November 2005
Class B	3 years	5 November 2007
Class C	4 years	5 November 2008

These Repayment Dates may be varied if we change the scheduled Issue Date. If a Repayment Date is not a Business Day, we will repay the principal on the next Business Day.

The scheduled final repayment dates for Professional Notes are 5 November 2010 for Class A-1 Professional Notes and 5 November 2014 for Class A-2 Professional Notes. Holders of Class A-2 Professional Notes are entitled to receive principal repayments during the life of the Class A-2 Professional Notes, which means that they may be repaid before the Repayment Date for a class of Retail Notes or before 5 November 2014. Such repayment of principal on Class A-2 Professional Notes will have no impact on the repayment of the Retail Notes - see Section 8.7 (*"Pre and post-enforcement cashflows"*).

THE OFFER AT A GLANCE

Minimum investment	The Retail Notes are sold in individual units of HK\$50,000. You can buy Retail Notes only in multiples of HK\$50,000.								
Annualised yield	<p>The annualised yield is a measure of the actual return on your investment in the Retail Notes (before handling, account and other fees).</p> <p>The annualised yield of each Class of Retail Notes is:</p> <table><thead><tr><th>Class of Retail Notes</th><th>Annualised Yield</th></tr></thead><tbody><tr><td>Class A</td><td>EFB Y495 plus 0.08%</td></tr><tr><td>Class B</td><td>EFN 5712 plus 0.15%</td></tr><tr><td>Class C</td><td>EFN 5809 plus 0.30%</td></tr></tbody></table>	Class of Retail Notes	Annualised Yield	Class A	EFB Y495 plus 0.08%	Class B	EFN 5712 plus 0.15%	Class C	EFN 5809 plus 0.30%
Class of Retail Notes	Annualised Yield								
Class A	EFB Y495 plus 0.08%								
Class B	EFN 5712 plus 0.15%								
Class C	EFN 5809 plus 0.30%								
Security	The Retail Notes are secured over the Series Assets - see Section 3 (<i>"The Guarantee and the Series Assets"</i>) and Section 8.4 (<i>"Security arrangements"</i>).								
The Guarantee	Payments of both principal and interest on the Retail Notes are guaranteed by the HKMC as Guarantor.								
Rating	On issue, the Retail Notes and Professional Notes will be rated Aa3 by Moody's Investors Service (http://www.moody.com) and AA- by Standard & Poor's (http://www.standardandpoors.com), a division of the McGraw-Hill Companies, Inc. Information appearing on those websites does not form part of this Prospectus and investors should exercise caution when assessing the value of such information. The rating assigned to the Retail Notes is not a recommendation to buy, sell or hold the Retail Notes and may be changed, qualified or withdrawn.								
Secondary Trading	Those Placing Banks appointed by us to make a market in the Retail Notes to provide liquidity and secondary trading for the Retail Notes have agreed to quote two-way prices during normal banking hours, depending on the prevailing market condition - a price at which they are willing to purchase Retail Notes (a "bid" price) and a price at which they are willing to sell Retail Notes (an "offer" price). Each of those institutions may have internal guidelines on restricting exposure to any single entity. Subject to such internal guidelines, they have agreed to quote firm bid prices for so long as any Retail Notes remain outstanding. Quoted offer prices will be on a best efforts basis, for so long as any Retail Notes remain outstanding.								
Notice to Noteholders	We undertake to give notice to the Noteholders of any information about us and the HKMC undertakes to give notice to the Noteholders of any information about it, which is necessary to avoid the establishment of a false market in the Notes, or which in our case, may significantly affect our ability to make payment under the Notes and which in the HKMC's case, may significantly affect its ability to make payment under the Guarantee.								
No listing	The Retail Notes will not be listed on any stock exchange.								
CMU instrument numbers	<p>The instrument numbers of the Retail Notes are:</p> <ul style="list-style-type: none">◀ Class A - HKMCMB04041◀ Class B - HKMCMB04042◀ Class C - HKMCMB04043								
Offer jurisdiction	The Offer is being made in Hong Kong only. English law governs the Retail Notes and some other documents relating to the issue of the Retail Notes. Hong Kong law governs the security documents - see Section 8 (<i>"Information about key agreements"</i>).								

SECTION 1. HOW TO INVEST

WHEN TO APPLY

The Offer of Retail Notes is expected to open at 9:00 am on 20 October 2004 and is expected to close at 2:00 pm on 29 October 2004.

We may close the Offer early or extend the Offer Closing Date without notice. If the Offer Closing Date is varied, subsequent dates (such as the Price-fixing Date, the Issue Date, Payment Dates, Interest Payment Dates and the Repayment Dates) may also be varied accordingly. Notice will be given of any such changes.

We will not issue an application form for the Retail Notes.

The bank with which you place your order will ask you to fill in their order form and to make a series of confirmations and

acknowledgements, including that you have read and understood this Prospectus. The text of the confirmations your bank will require you to make when you place your order is set out in Section 11 ("*Purchaser Confirmations*").

WHO MAY APPLY

The Notes are not available to US persons and residents of Canada.

HOW TO APPLY

You can buy our Retail Notes from any of the banks listed here. Call a hotline to find out more or to get a list of branches where you can place your order for the Retail Notes.

PLACING BANKS

Bank	Hotline Number	Bank	Hotline Number
Bank of America (Asia) Limited	2805 2383	The Hongkong and Shanghai Banking Corporation Limited	2269 2121
Bank of China (Hong Kong) Limited	2291 8000	Industrial and Commercial Bank of China (Asia) Limited	2887 0349
Bank of Communications (Hong Kong Branch)	2269 9699	International Bank of Asia Limited	2566 8181
The Bank of East Asia, Limited		Liu Chong Hing Bank Limited	2161 6888
(General Enquiry)	2211 1311	Nanyang Commercial Bank, Limited	2622 2633
(Cyberbanking-Phone Service)	2211 1888	Shanghai Commercial Bank Limited	2818 0282 (press "3" and then "8")
(SupremeGold Phone Service Hotline)	2211 1122	Standard Chartered Bank (Hong Kong) Limited	2886 8868 (press "2*9")
Chiyu Banking Corporation Limited	2232 3625	Wing Hang Bank, Ltd.	3199 9182
Citibank, N.A., Hong Kong Branch	2860 0222	Wing Lung Bank Limited	2526 5555
CITIC Ka Wah Bank Limited	2287 6767		
Dah Sing Bank, Limited	2828 8000		
DBS Bank (Hong Kong) Limited	2290 8888 (press "4")		
Hang Seng Bank Limited	2998 9898		
(Prestige Banking)	2998 9188		
(Stamina Banking/Femina Banking)	2822 8228		
('Bank-in-one Account' Customers (manned phone-banking))	2998 9333		
(Other 'Bank-in-one Account' customers)	2532 3838		

YOUR RETAIL NOTES MUST BE HELD THROUGH A BANK

The Retail Notes will be issued as global notes. We will not issue individual certificates for the Retail Notes, so you must arrange for your bank to hold them in a securities or investment account. If you do not have a bank account and a securities or investment account already, you will have to open them before you can buy our Retail Notes. Securities or investment accounts and other services will be supplied by your bank subject to its standard terms and conditions. We are not responsible for the way your bank handles your account.

Discuss this arrangement with your bank and shop around if you wish: banks charge varying fees to open and maintain these accounts and have different arrangements for processing orders. Ensure you are familiar with the standard terms and conditions which your bank will apply to your account.

The Retail Notes will be held in the Central Moneymarkets Unit Service (CMU), which is a clearing system run by the Hong Kong Monetary Authority. Individual investors cannot open a personal account at CMU.

If we default on the Retail Notes, or if the CMU closes down, we will issue individual certificates for the Retail Notes, but we will not issue individual certificates otherwise. The Trust Deed and the Agency Agreement detail the arrangements which will apply in the unlikely event that individual certificates have to be issued. If this happens, we will give a notice summarising these arrangements. If we are unable to deliver this notice through the CMU, we will publish it in The South China Morning Post or another English language newspaper and The Hong Kong Economic Times or another Chinese language newspaper of general circulation in Hong Kong.

INTERNET APPLICATIONS

If you have both a bank account and an investment account with The Bank of East Asia Limited, Hang Seng Bank Limited, The Hongkong and Shanghai Banking Corporation Limited or Wing Lung Bank Limited, and have made the necessary arrangements to use their internet banking facilities, you can also buy our Retail Notes by making an on-line application. On-line applications cannot be made with any of the other Placing Banks.

By making an on-line application through a Placing Bank you are required to comply with such Placing Bank's terms and conditions for use of their internet banking facilities.

The websites of The Bank of East Asia Limited, Hang Seng Bank Limited, The Hongkong and Shanghai Banking Corporation Limited and Wing Lung Bank Limited are:

The Bank of East Asia Limited	www.hkbea.com
Hang Seng Bank Limited	www.hangseng.com
The Hongkong and Shanghai Banking Corporation Limited	www.hsbc.com.hk
Wing Lung Bank Limited	www.winglungbank.com

The offer of the Retail Notes by Bauhinia is made solely on the basis of information contained in this Prospectus. Information appearing on such websites does not form part of this Prospectus and prospective investors should exercise an appropriate degree of caution when assessing the value of other information which may appear on these websites.

WE WILL MAKE PAYMENTS AND SEND NOTICES THROUGH YOUR BANK

Your bank will hold your Retail Notes for you in its account at CMU. We will pay principal and interest on the Retail Notes to the accounts of the banks which CMU tells us hold the Retail Notes. You will have to rely on your bank to credit payments on your Retail Notes to your account with your bank. Once we have made any payment in this way, you will have no further rights against us for that payment, even if your bank fails to transmit to you your share of the payment or transmits it late.

Any notices we give after the Retail Notes are issued will be given in the same way, and you will have to rely on your bank to forward them to you. In the same way, you will need to rely on your bank to transmit any of your notices to the CMU and the CMU will need to relay them to us or to the Note Trustee.

We, the Note Trustee and the Security Trustee will treat the Relevant Account Holders with the CMU as Retail Noteholders for all purposes under the Terms and Conditions and the Trust Deed. You, as the end investor holding an interest in the Retail Notes have no direct rights of enforcement under the Retail Notes. You will need to rely on your bank requesting the Note Trustee to take any necessary enforcement action on your behalf.

ARRANGEMENTS WITH THE BANKS SELLING THE RETAIL NOTES

We have appointed the Placing Banks to take orders for the Retail Notes.

The Hongkong and Shanghai Banking Corporation Limited and Standard Chartered Bank (Hong Kong) Limited have also agreed to underwrite our Retail Notes up to a principal amount of HK\$900 million, with each of them agreeing to underwrite up to HK\$450 million. There are no soft commission or rebate arrangements between us, the HKMC and any of the Placing Banks.

The Retail Notes are sold to you by subscription, through your bank, from us.

IF OFFER DOES NOT PROCEED

We reserve the right to not proceed with the Offer at any time before the Issue Date. If the Offer does not proceed, all application money will be refunded without interest. The timing of the refund of application money will be separately specified by each Placing Bank in accordance with its operational procedures.

OVERSUBSCRIPTIONS

We intend to allocate at least one Retail Note to everyone who applies. The remaining Retail Notes will then be allocated to investors approximately in proportion to the number of Retail Notes for which each investor applied. If the Retail Notes are so over-subscribed that we cannot even allocate one Retail Note to each applicant, we will choose by ballot through the Principal Paying and Transfer Agent. All allocations will be done for each Class of Retail Notes separately.

The HKMC, the Arranger, the Joint Underwriters, the Placing Banks and their related entities may subscribe for Retail Notes if they want to do so.

A table of multiples of Retail Notes and payments of application amounts is set out on the next page.

SECTION 1. HOW TO INVEST

**TABLE OF MULTIPLES OF RETAIL NOTES AND
PAYMENTS OF APPLICATION AMOUNTS FOR THE RETAIL NOTES**

Number of Retail Notes applied for	Principal amount of Retail Notes applied for (HK\$)	Application Amounts
		(Application Price of 102% of principal amount plus 0.15% of Application Price) (HK\$)
1	50,000	51,076.50
2	100,000	102,153.00
3	150,000	153,229.50
4	200,000	204,306.00
5	250,000	255,382.50
6	300,000	306,459.00
7	350,000	357,535.50
8	400,000	408,612.00
9	450,000	459,688.50
10	500,000	510,765.00
11	550,000	561,841.50
12	600,000	612,918.00
13	650,000	663,994.50
14	700,000	715,071.00
15	750,000	766,147.50
16	800,000	817,224.00
17	850,000	868,300.50
18	900,000	919,377.00
19	950,000	970,453.50
20*	1,000,000*	1,021,530.00

* (After this number, in increments of 1 Retail Note or HK\$50,000 principal amount.)

SECTION 1. HOW TO INVEST

HOW THE SUBSCRIPTION PRICE OF THE RETAIL NOTES WILL BE FIXED

We will calculate and pay interest on the Retail Notes by reference to 100% of the principal amount of the Retail Notes. Annual interest on the Retail Notes is paid every six months, which means that your effective annualised yield is in fact a little higher than the stated interest rate on your Retail Notes. This is because you receive half the annual interest on your Retail Notes after six months.

However, to calculate your real investment return to the Repayment Date of your Retail Notes, you must take into account the fact that the Subscription Price for your Retail Notes may be more or less than the principal amount of your Retail Notes. If the Subscription Price is more than 100%, your investment return will be less than the stated interest rate on your Retail Notes; if the Subscription Price is less than 100%, your investment return will be more than the stated interest rate on your Retail Notes.

We will fix the Subscription Price at an amount which means that the annualised yield to maturity on your investment will be equal

to the yield on an identified issue of an Exchange Fund Bill (EFB) or Exchange Fund Note (EFN) of similar maturity plus a specified margin. The EFB or EFN yield will be as quoted by the Hong Kong Monetary Authority on Reuters page HKEFBNMIDFIX at about 11.30am on the Price-fixing Date.

Remember also to take into account the fees you will incur in ordering the Retail Notes and in setting up and maintaining a securities or investment account at a bank to hold your Retail Notes.

The following table sets out an example of the annualised yields to repayment for each Class of Retail Notes and for a range of Subscription Prices.

Subscription Price (as a percentage of the principal amount of the Retail Notes)	Class A Notes	Class B Notes	Class C Notes
	Interest rate 1.70% per annum, (payable semi-annually)	Interest rate 2.65% per annum, (payable semi-annually)	Interest rate 3.05% per annum, (payable semi-annually)
	Annualised Yield (%)	Annualised Yield (%)	Annualised Yield (%)
98.00	3.780	3.385	3.623
98.10	3.675	3.348	3.595
98.20	3.569	3.312	3.567
98.30	3.464	3.276	3.540
98.40	3.359	3.240	3.512
98.50	3.254	3.203	3.484
98.60	3.150	3.167	3.457
98.70	3.045	3.131	3.429
98.80	2.941	3.095	3.401
98.90	2.837	3.059	3.374
99.00	2.733	3.024	3.346
99.10	2.630	2.988	3.319
99.20	2.526	2.952	3.291
99.30	2.423	2.916	3.264
99.40	2.320	2.881	3.237
99.50	2.218	2.845	3.209
99.60	2.115	2.809	3.182
99.70	2.013	2.774	3.155
99.80	1.911	2.738	3.128
99.90	1.809	2.703	3.100
100.00	1.707	2.668	3.073
100.10	1.606	2.632	3.046
100.20	1.504	2.597	3.019
100.30	1.403	2.562	2.992

SECTION 1. HOW TO INVEST

Subscription Price (as a percentage of the principal amount of the Retail Notes)	Class A Notes	Class B Notes	Class C Notes
	Interest rate 1.70% per annum, (payable semi-annually)	Interest rate 2.65% per annum, (payable semi-annually)	Interest rate 3.05% per annum, (payable semi-annually)
	Annualised Yield (%)	Annualised Yield (%)	Annualised Yield (%)
100.40	1.302	2.527	2.965
100.50	1.202	2.491	2.938
100.60	1.101	2.456	2.911
100.70	1.001	2.421	2.884
100.80	0.901	2.386	2.857
100.90	0.801	2.351	2.830
101.00	0.701	2.316	2.804
101.10	0.602	2.282	2.777
101.20	0.503	2.247	2.750
101.30	0.404	2.212	2.723
101.40	0.305	2.177	2.697
101.50	0.206	2.143	2.670
101.60	0.107	2.108	2.644
101.70	0.009	2.073	2.617
101.80	N.A.	2.039	2.590
101.90	N.A.	2.004	2.564
102.00	N.A.	1.970	2.537
102.10	N.A.	1.935	2.511
102.20	N.A.	1.901	2.485
102.30	N.A.	1.867	2.458
102.40	N.A.	1.833	2.432
102.50	N.A.	1.798	2.406
102.60	N.A.	1.764	2.379
102.70	N.A.	1.730	2.353
102.80	N.A.	1.696	2.327
102.90	N.A.	1.662	2.301
103.00	N.A.	1.628	2.275

Notes

(1): The Subscription Price fixed for each Class of Retail Notes may not be the same as any of the prices set out in the above table.

(2): The information shown in this table is for reference only. The Subscription Price for each Class of Retail Notes will be determined on the Price-fixing Date so that the annualised yield of each Class of Retail Notes will be as set out in The Offer at a glance - ("Annualised yield").

SECTION 2. THE ISSUER - BAUHINIA MBS LIMITED

INTRODUCTION

Bauhinia MBS Limited is the issuer of the Retail Notes. We are a company incorporated in the Cayman Islands. Our purpose is to issue notes and to acquire pools of mortgages from the Seller. We cannot engage in any business that is not related to this purpose.

Further information about us is set out in Section 7 ("*Information about Bauhinia and our Retail Note issue*").

PARTIES INVOLVED IN THE ISSUE

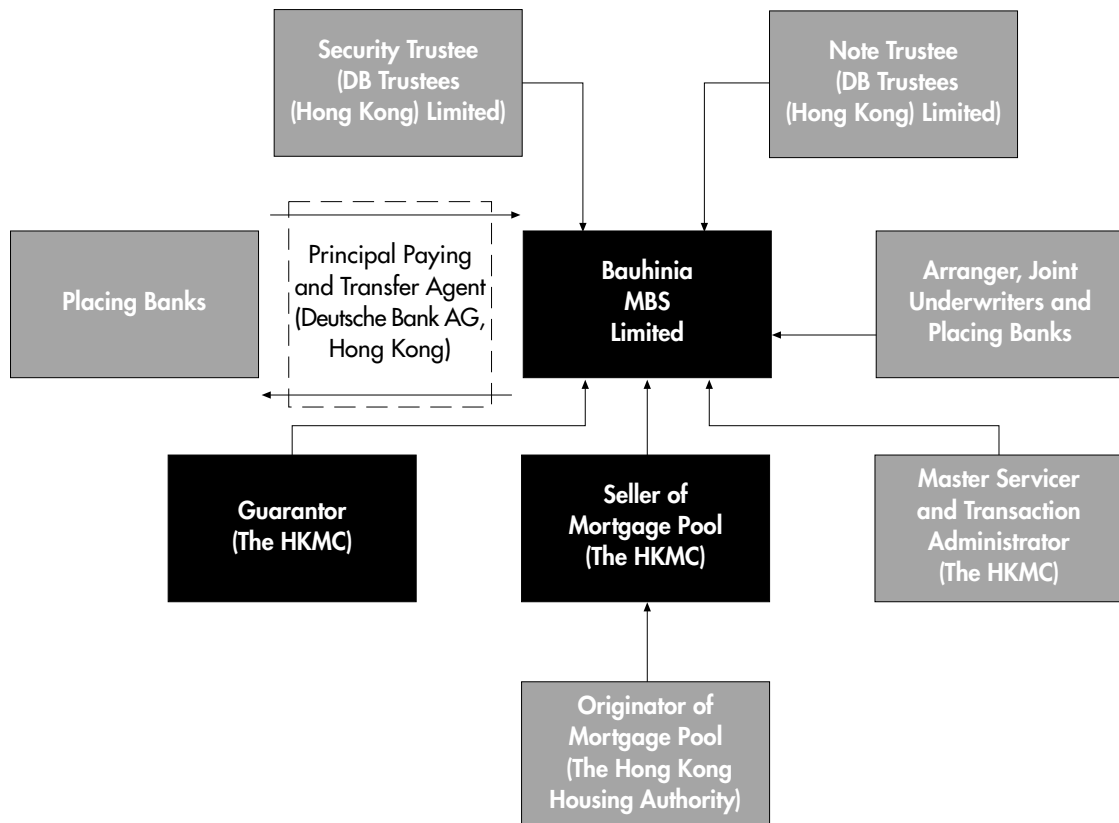
We have entered into arrangements for the ongoing management of Bauhinia and for the administration of notes issued by us, including the Retail Notes and the Professional Notes. A brief summary of the role of each main service provider is set out below. A summary of material contracts, including some of the arrangements with the main service providers, is set out in Section 8 ("*Information about key agreements*").

Party	Role
The Hongkong and Shanghai Banking Corporation Limited	◀ As Arranger: The Hongkong and Shanghai Banking Corporation Limited is responsible for arranging the initial issue of the Retail Notes and the Professional Notes.
	◀ As Joint Underwriter of the Retail Notes: The Hongkong and Shanghai Banking Corporation Limited has agreed to underwrite up to HK\$450 million of the Retail Notes.
Standard Chartered Bank (Hong Kong) Limited	◀ As Joint Underwriter of the Retail Notes: Standard Chartered Bank (Hong Kong) Limited has agreed to underwrite up to HK\$450 million of the Retail Notes.
The Hong Kong Mortgage Corporation Limited	◀ As Guarantor: the HKMC is guaranteeing the principal and interest payments on the Retail Notes and the Professional Notes.
	◀ As Seller: the HKMC will sell its interest in the Mortgage Pool to us.
	◀ As Master Servicer: the HKMC is responsible for servicing all Mortgages purchased by us from the HKMC, including the Mortgage Pool.
	◀ As Transaction Administrator: the HKMC provides certain administrative services in respect of our mortgage-backed securitisation programme.
The Hong Kong Housing Authority	◀ As Originator: The Hong Kong Housing Authority sells interests in the Mortgages in the Mortgage Pool to the Seller before they are sold to us.
	◀ As Delegate Servicer: The Hong Kong Housing Authority is responsible for servicing the Mortgage Pool on behalf of the Master Servicer.
DB Trustees (Hong Kong) Limited	◀ As Note Trustee: DB Trustees (Hong Kong) Limited holds on trust for the benefit of Noteholders the right to enforce our obligations under the Retail Notes and the Professional Notes. The Note Trustee also holds the benefit of the Guarantee on behalf of Noteholders.
	◀ As Security Trustee: DB Trustees (Hong Kong) Limited acts as trustee for each Series 2004-2 Secured Party including the Retail Noteholders. The Security Trustee is authorised to enforce the Security on behalf of the Series 2004-2 Secured Parties. The Security Trustee is responsible for keeping the benefit of the Security relating to each Series of notes separate. As a result, your rights in relation to Retail Notes should be unaffected by prior or future issues of notes under our mortgage-backed securitisation programme.

SECTION 2. THE ISSUER - BAUHINIA MBS LIMITED

Party	Role
Deutsche Bank AG, Hong Kong Branch	◀ As Principal Paying and Transfer Agent: Deutsche Bank AG, Hong Kong Branch will provide Note reference agent services under the Agency Agreement (including making determinations and calculations as required under the Terms and Conditions) as well as paying and transfer agent services.
The Placing Banks	◀ The Placing Banks are responsible for selling the Retail Notes.

BAUHINIA SERVICE PROVIDERS



SECTION 3. THE GUARANTEE AND THE SERIES ASSETS

DESCRIPTION OF THE GUARANTEE

The terms of the Guarantee are contained in the Trust Deed.

Under the Trust Deed, the Guarantor irrevocably and unconditionally guarantees to the Note Trustee the due and punctual repayment of the principal, and payment of interest, under the Notes of this Series 2004-2. This includes the Retail Notes.

The effect of the Guarantee is that you should always receive full payment of the principal and interest under your Retail Notes. If we do not have enough money from the Series Assets to meet payments on your Retail Notes, the Guarantee requires the Guarantor to pay in full or to make up the difference.

Important features of the Guarantee are summarised in Section 8.3 (*"The Guarantee"*).

USE OF PROCEEDS AND SERIES ASSETS

We will use the net proceeds from the sale of the Notes to purchase the Mortgage Pool. The Series Assets for this Series 2004-2 are:

- ◀ the Mortgage Pool;
- ◀ amounts on deposit in the accounts established for this Series 2004-2, including the Series 2004-2 Collection Account, the Principal Accumulation Account and any Eligible Investments;

- ◀ our rights under the Transaction Documents, to the extent to which they relate to this Series 2004-2;
- ◀ our rights under the Guarantee; and
- ◀ our rights to receive payments under the Payment Deed.

Important features of these arrangements are summarised in Section 8 (*"Information about key agreements"*).

The Retail Notes are backed by, and secured over, the Series Assets. This provides, in addition to the Guarantee, another source of payment for Retail Noteholders so that Retail Noteholders can turn to the Series Assets for payment of principal and interest on the Retail Notes even if the Guarantor does not meet its obligations under the Guarantee.

THE PROVISIONAL POOL AND POOL CRITERIA

Subject to the paragraph immediately following the table below, the Mortgage Pool sold to us on the Issue Date was selected by the Seller from a provisional pool of Mortgages (the Provisional Pool) based on information as at the Settlement Cut-Off Date. The Provisional Pool consists of not more than 4,373 Mortgages that had an aggregate outstanding principal balance as at the Settlement Cut-Off Date of not less than HK\$2 billion.

The information in the table below sets out various details relating to the Provisional Pool as at 30 June 2004. The information has been provided to us by the Seller. All amounts have been rounded to the nearest Hong Kong dollar. The sum in any column may not equal the total indicated due to rounding.

	Provisional Pool Information (as at 30 June 2004)		Pool Criteria	
			Minimum	Maximum
Number of Mortgages	4,373		n/a	n/a
Aggregate outstanding principal balance	\$2,099,354,719	\$2,000,000,000		n/a
Average outstanding principal balance	\$ 480,072	\$ 456,068	\$ 504,076	
Maximum outstanding principal balance	\$ 585,474		n/a	\$ 800,000
Minimum outstanding principal balance	\$ 116,099		n/a	n/a
Maximum remaining term to maturity (in months)	102		n/a	240
Minimum remaining term to maturity (in months)	90		12	n/a
Weighted average original term to maturity (in months)	157		149	165
Weighted average remaining term to maturity (in months)	96		91	101

SECTION 3. THE GUARANTEE AND THE SERIES ASSETS

The statistical information in the column headed "Provisional Pool Information" in the table above may not reflect the actual Mortgage Pool which is sold to us on the Issue Date because the Seller may substitute Mortgages from the Provisional Pool with interests in other eligible Mortgages. The Seller may do this if, for example, the Mortgages of the Provisional Pool are fully repaid before the Issue Date.

Structure of Housing Authority Mortgages

The Hong Kong Housing Authority provides an interest-free loan, and the Scheme Bank provides an interest-bearing loan, to the Mortgagor. The Mortgagor grants a mortgage in favour of the Scheme Bank (for itself and also as agent for The Hong Kong Housing Authority) to secure both the loan from The Hong Kong Housing Authority and the loan from the Scheme Bank. If payments by Mortgagors are less than scheduled, the amount received is applied first in payment of the Scheme Bank's interest, then in payment of default interest, which is shared *pari passu* between the Scheme Bank and The Hong Kong Housing Authority. The Scheme Bank and The Hong Kong Housing Authority rank equally under the mortgage for payments of principal.

The Hong Kong Housing Authority's "interest" in each mortgage granted under the Home Loan Scheme is called a "Housing Authority Mortgage". The Hong Kong Housing Authority has sold Housing Authority Mortgages to the Seller.

Our acquisition of Housing Authority Mortgages

All of the Mortgages in the Mortgage Pool sold to us on the Issue Date have been acquired by the Seller from The Hong Kong Housing Authority. The Hong Kong Housing Authority and Scheme Banks participate in the Home Loan Scheme. After The Hong Kong Housing Authority determines that its mortgages (and related loans) meet the Eligibility Criteria, it may offer to sell to the Seller all its interests in a pool of those mortgages and related loans. The Seller may then accept or reject the offer from The Hong Kong Housing Authority.

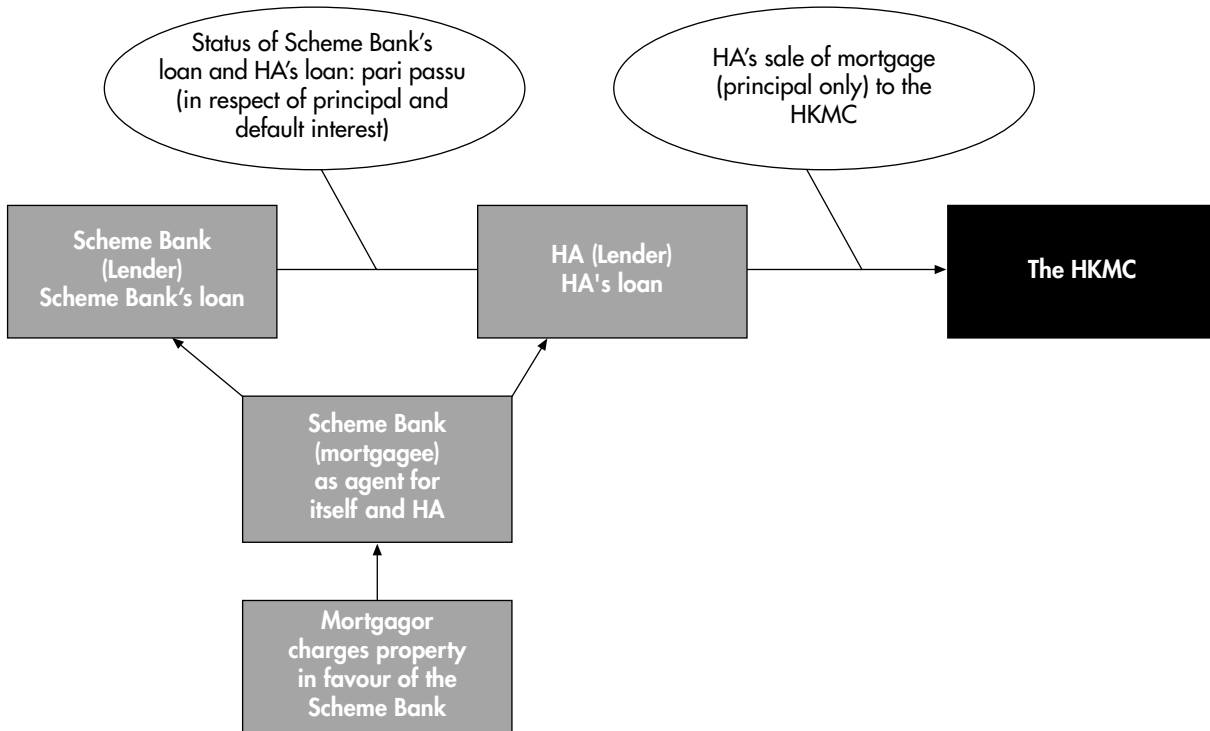
Amounts other than principal payable under the Mortgages (such as default interest) are retained by The Hong Kong Housing Authority and are not transferred to the Seller.

The Seller undertakes a validation process to ensure that the loans and mortgages conform to the Eligibility Criteria. If the Seller determines that an interest in a loan or mortgage which it has accepted did not conform to the offer, its acceptance or to the Eligibility Criteria, the Seller need not purchase that interest in that loan or mortgage and may require The Hong Kong Housing Authority to repurchase the interest in the non-conforming loan and mortgage.

If the Seller accepts the offer, the sale and purchase is effected by a deed of transfer. Following settlement, the Seller lodges the transfers for registration at the relevant Land Registry in Hong Kong.

SECTION 3. THE GUARANTEE AND THE SERIES ASSETS

A diagram of the Housing Authority Mortgages is set out below.



HA - The Hong Kong Housing Authority

Servicing of Housing Authority Mortgages

Housing Authority Mortgages are serviced by The Hong Kong Housing Authority. Under the Home Loan Scheme, The Hong Kong Housing Authority has appointed the relevant Scheme Bank to be its agent to service the Housing Authority Mortgages.

Duties and standards of Mortgage servicing

After purchase by the Seller, The Hong Kong Housing Authority agrees to service the Mortgage Pool on behalf of the Seller in accordance with the master mortgage servicing administration agreement between The Hong Kong Housing Authority and the Seller. The Mortgage Servicing Manual sets out the main servicing duties and standards required of The Hong Kong Housing Authority. Some of the key ones are summarised in Section 8.5 (*"Mortgage servicing arrangements"*).

Payments by Seller

A Mortgage secures an interest-free loan provided by The Hong Kong Housing Authority. Default interest will be payable by the Mortgagor to The Hong Kong Housing Authority in the event of default but no right to such default interest has been transferred to the Seller. However, the Seller agrees to make certain regular payments to us under the Payment Deed on a floating rate as determined by the inter-bank offered rate for deposits in Hong

Kong Dollars plus a specified margin. These payments will enable us to meet our obligations to pay interest and other costs and expenses of this Series 2004-2, but do not cover any principal payments under the Notes.

Repurchase of Mortgages by the Seller

The Master Mortgage Sale and Purchase Agreement requires the Seller to repurchase Mortgages in certain circumstances, such as when the Mortgages fail to meet the Eligibility Criteria or Pool Criteria as at the Settlement Cut-Off Date.

In certain circumstances, the Seller must repurchase a Mortgage if:

- ◀ the Mortgagor requests for a change in the persons named as Mortgagors in the mortgage deed and such request is approved by The Hong Kong Housing Authority and the Scheme Bank; or
- ◀ the Mortgagor is prosecuted for the provision of any false information in connection with his application for the loan from The Hong Kong Housing Authority; or

SECTION 3. THE GUARANTEE AND THE SERIES ASSETS

- ◀ the Mortgagor applies to The Hong Kong Housing Authority or the Seller to redeem the Mortgage earlier than as provided in the Mortgage for the refinancing of such Mortgage and such application is approved for that purpose by The Hong Kong Housing Authority or the Seller; or

- ◀ the Mortgagor requests for a further advance of moneys secured on the Mortgage and The Hong Kong Housing Authority or the Seller has agreed to make such advance.

The Seller may choose to repurchase a Mortgage if the Mortgage is in default. A Mortgage is treated as being in default if any amount owing under the Mortgage has been overdue for 120 days or more or any of the events of default as provided in the Mortgage has occurred.

Any Mortgage repurchased by the Seller must be purchased for a price equal to Bauhinia's interest in the outstanding principal balance on the date of repurchase.

SECTION 4. COLLECTIONS AND CASHFLOWS

COLLECTIONS

Payments under the Mortgages and payments made by the Seller under the Payment Deed will be received by us each month.

Collections include all of the following amounts received by us:

- ◀ from our interests in the Mortgages during a Collection Period:
 - ◀ repayments of principal (whether scheduled or otherwise) under the Mortgages; and
 - ◀ proceeds from enforcement of the Mortgages and the Mortgage Related Rights; and
- ◀ from the Seller on or before the relevant Interest Payment Date:
 - ◀ amounts received from the Seller because it is required, or chooses, to repurchase a Mortgage; and
 - ◀ payments under the Payment Deed.

Payments under the Mortgages

Payments under the Mortgages will be made to the Scheme Bank as agent for The Hong Kong Housing Authority. Under the terms of the agreement by which The Hong Kong Housing Authority is appointed as Delegate Servicer by the Master Servicer, The Hong Kong Housing Authority must pay to the Master Servicer an amount which it estimates is equal to the collections relating to principal repayments made under the Mortgages in a Collection Period. These estimated amounts must be paid on a specified date, usually on the first Business Day of the calendar month after such Collection Period. Adjustments will be made to subsequent payments to reflect the difference between amounts actually collected and the amounts paid as estimated collections. The Hong Kong Housing Authority must pay such adjustments to the Master Servicer on the first Business Day of the third month after such Collection Period. The Master Servicer will then pay these collections to us by crediting the Series 2004-2 Collection Account, after deducting any servicing fees due to the Master Servicer.

The Series 2004-2 Collection Account for this Series will be established and maintained by us with a bank that satisfies certain eligibility criteria under the Trust Deed.

Floating Rate to Fixed Rate Payments

Interest on the Retail Notes and the Class A-1 Professional Notes is paid at a fixed rate. The payments we receive under the Payment Deed are calculated on a floating rate determined by the inter-bank offered rate for deposits in Hong Kong Dollars plus a specified margin. We will hedge this mismatch through an Interest Rate Swap with a bank selected by us.

Under the Interest Rate Swap, we will exchange floating rate payments for fixed rate payments. The fixed rate payments we receive under the Interest Rate Swap enable us to make payments of interest under the Retail Notes and the Class A-1 Professional Notes.

CASHFLOWS

Each month calculations are made to determine Total Available Income and Available Principal Collections in respect of the Collection Period for the relevant Determination Date.

Determination of Total Available Income for this Series 2004-2

Interest payment on the Notes is made from Total Available Income.

Total Available Income for a Determination Date is the aggregate of the following amounts received or to be received on or before the relevant Interest Payment Date:

- ◀ interest earned on the Application Amounts; and
- ◀ amounts received by us from the Seller under the Payment Deed as described in Section 3 (*"The Guarantee and the Series Assets - Payments by Seller"*); and
- ◀ interest received on Eligible Investments and any other income received by us; and
- ◀ any amounts received by us as a Guarantor Advance on account of interest due on the Retail Notes on the relevant Interest Payment Date; and
- ◀ any net payments due to be received by us under the Interest Rate Swap; and
- ◀ any other amounts that the Transaction Administrator determines should be included in Total Available Income.

SECTION 4. COLLECTIONS AND CASHFLOWS

If there is a shortfall between:

- ◀ the amount of the Total Available Income for a Determination Date; and
- ◀ the amount of interest due on the Retail Notes on the relevant Interest Payment Date, taking into account other payments due to be made on the Interest Payment Date in priority to, or equally with, the Retail Notes in accordance with the Cash Flow Allocation,

then the amount of the shortfall is an Income Shortfall.

Under the terms of the Guarantee, the Guarantor must, if it receives notice of an Income Shortfall, pay the amount of the Income Shortfall to the Principal Paying and Transfer Agent for distribution to the Noteholders. See Section 8.3 (*"The Guarantee"*).

Determination of Available Principal Collections

Repayments of principal on the Notes are made from Available Principal Collections for the Determination Date with respect to the relevant Repayment Date or Amortisation Payment Date.

Available Principal Collections for a Determination Date is the aggregate of:

- ◀ the amount of Collections on account of principal received for the Collection Period prior to such Determination Date;
- ◀ if the relevant Interest Payment Date with respect to that Determination Date is a Repayment Date or an Amortisation Payment Date, the money in the Principal Accumulation Account;
- ◀ any amounts received by us as a Guarantor Advance on account of principal due under the Notes on the relevant Repayment Date or Amortisation Payment Date; and
- ◀ any other amounts that the Transaction Administrator determines should be included in Available Principal Collections.

If there is a shortfall between:

- ◀ the amount of the Available Principal Collections for a Determination Date; and
- ◀ the amount of principal due to be repaid on the Notes on a Repayment Date or an Amortisation Payment Date, taking into account other payments due to be made on the Repayment Date or Amortisation Payment Date in priority to, or equally with, the Notes in accordance with the Cash Flow Allocation,

then the amount of the shortfall is a Principal Shortfall.

Under the terms of the Guarantee, the Guarantor must, if it receives notice of a Principal Shortfall, pay the amount of the Principal Shortfall to the Principal Paying and Transfer Agent for distribution to the Noteholders. See Section 8.3 (*"The Guarantee"*).

The Transaction Administrator's role

On each Determination Date the Transaction Administrator will determine the Total Available Income and the Available Principal Collections for the next relevant Interest Payment Date, Repayment Date or Amortisation Payment Date.

The order of payments to be made will differ depending upon whether or not the Security has been enforced. For further details of the Cash Flow Allocation (both before and after enforcement) see Section 8.7 (*"Pre and post-enforcement cashflows"*).

SECTION 5. INVESTMENT RISKS

INTRODUCTION

Before applying for any Retail Notes, you should consider whether the Retail Notes are suitable for you in light of your own financial condition and investment objectives. You should be aware that there are risks associated with investing in the Retail Notes. In particular, you should carefully consider each of the following risks, as well as the other information in this Prospectus.

Some of the following risks apply generally to investments, while others are specific to the Retail Notes. Many of these risks are outside the control of Bauhinia, the Guarantor, the Arranger and the Joint Underwriters.

In all circumstances except where withholding tax or other deductions are required to be made by us on payments made to Retail Noteholders, if we do not have enough money to pay principal and interest on the Retail Notes, the Retail Noteholders will have recourse under the Guarantee.

Political and economic situation in Hong Kong and PRC

Our revenue is generated mainly from mortgages in Hong Kong. Accordingly, our operations and performance may be affected by the general political and economic circumstances of Hong Kong and the People's Republic of China. Future political or economic instability or a sustained slowdown in domestic economic activities, especially in relation to real property, will adversely affect our business if it leads to an increase in mortgage loan payment defaults.

Liquidity risk

The Retail Notes are not listed and cannot be traded on any stock exchange.

Price risk

The trading price of the Retail Notes will fluctuate depending on factors such as market interest rate movements and the market's view of the credit quality of the Retail Notes or the credit quality of the Guarantor. Also, the price could be affected if there are few potential buyers in the market.

If you try to sell your Retail Notes before their Repayment Date, you may receive an offer which is less than the amount you invested or you may not be able to sell your Retail Notes. We have designed the Retail Notes for investors who intend to hold them to their Repayment Date.

Bank or intermediary default

As the Retail Notes are not listed, you are not covered by the Investor Compensation Fund (being the compensation fund established under section 236 of the Securities and Futures Ordinance) if your bank or another intermediary defaults.

Hong Kong residential property risk

The Mortgage Pool is backed by residential property in Hong Kong. Real property investments are subject to varying degrees of risk. Property values are affected by changes in the general economic and political climate and local conditions. Hong Kong property values are particularly sensitive to such factors, resulting in rapid, substantial increases and decreases in valuation levels.

SECTION 5. INVESTMENT RISKS

Government Lease/Government Grant

Some of the mortgaged properties in the Mortgage Pool may be subject to a Government Grant and not a Government Lease. A Government Grant is, in law, not a lease (which gives the lessee a legal estate in land), but only an agreement by the Hong Kong Government to lease the land to the purchaser once the purchaser has complied with certain conditions.

If the purchaser fails to comply with the conditions this will be a breach of contract by the purchaser and it entitles the Hong Kong Government to re-enter and to take back possession of the property. If this happens all rights of the purchaser under the Government Grant cease. As a result, such mortgaged properties will no longer be part of the Mortgage Pool and the Available Principal Collections will decrease.

Investing in Mortgages

Our interest in the Mortgages and Mortgage Related Rights only entitles us to a share of principal repayments under the Mortgages and not to any other money paid by Mortgagors or guarantors of the Mortgages (such as default interest).

Withholding and deductions

If any law requires us to withhold or deduct taxes, duties or other charges from payments of principal or interest on the Notes of this Series 2004-2, then we will make the withholding or deduction and pay it to the tax authorities. You will therefore receive payments under the Retail Notes net of any required withholding or deduction. This withholding or deduction is not covered by the Guarantee. However, currently there is no requirement for us to make any such withholding or deduction.

If any law requires the Guarantor to withhold or deduct taxes, duties or other charges from payments under the Guarantee, the Guarantor is required to pay additional amounts to ensure that the payments under the Guarantee will effectively be made free and clear of any such withholding or deduction.

Source of payments to Noteholders

The only source of payment for the Notes is the Series Assets. The cashflow from the Series Assets may not be enough to pay the principal of, and interest on, the Notes.

Limited recourse

All Notes issued by us (and each other contract we enter into) are subject to limited recourse provisions. This means that if the actual amount available for distribution to Noteholders under the Terms and Conditions, the Trust Deed and the Security is less than the amount owing to Noteholders, the payment of the amount available completely discharges our liability to Noteholders. In such a case, Noteholders have no further claim or entitlement against Bauhinia, the Arranger, the Joint Underwriters, the Note Trustee or the Security Trustee (or any other person) to be paid the difference between the amount owing and the amount available for distribution.

However, the limited recourse provisions do not limit the Guarantor's obligations under the Guarantee.

SECTION 5. INVESTMENT RISKS

Performance of contractual obligations

The Retail Notes are not the responsibility of, or guaranteed by, any person other than Bauhinia and (under the Guarantee) the Guarantor.

Our ability to make payments in respect of this Series 2004-2 (including principal and interest on the Retail Notes) may depend on the performance by other parties to the Transaction Documents. None of these parties (apart from the Guarantor under the Guarantee) is responsible for, or has any obligations, under the Retail Notes.

Insufficient enforcement proceeds

If the Security Trustee enforces the security over the Series Assets after an Event of Default, the value of the Series Assets may not be enough to repay outstanding principal and interest due on the Retail Notes. The Security Trustee may not be able to realise the full value of these Series Assets.

Payments due to various parties to the Transaction Documents rank ahead or equally with payments to be made under the Retail Notes.

As a result, after an Event of Default there may not be enough money to repay the principal of, and pay interest on, the Retail Notes in full. See Section 8.7 ("*Pre and post-enforcement cashflows*").

Commingling of Collections and assets of servicers

Before the Master Servicer pays Collections to the Series 2004-2 Collection Account, the Collections may be commingled with the other assets of the Master Servicer. If the Master Servicer becomes insolvent, we may only be able to claim those Collections as an unsecured creditor. The same is true with respect to any money held by a Delegate Servicer before it is paid to the Master Servicer. This could lead to a failure to receive the Collections, or delays in receiving the Collections.

Mortgagor default risk

If a sufficient number of Mortgagors fail to make principal payments when due under the Mortgages, we may not have enough money to pay interest and principal on the Retail Notes in full or on time.

There may also be a timing delay between default by a Mortgagor and receipt by us of the proceeds of sale of the relevant mortgaged property. The failure of the Mortgagors to make principal payments when due under the Mortgages will not remove our obligations generally to pay principal and interest on the Retail Notes.

Enforcement of Mortgages

Enforcement of the Mortgages, including the sale of one or more of the mortgaged properties, could lead to delays in recovery by us of amounts we are owed under the Mortgages. We may not recover all money owed to us when rights under the Mortgages are enforced. As a result we may not have enough money to pay interest and principal on the Retail Notes in full or on time.

SECTION 5. INVESTMENT RISKS

No notice of transfers

Until a Perfection Trigger Event occurs, we will not notify the Mortgagors or any guarantors of the Mortgages that The Hong Kong Housing Authority's interest in the Mortgages and the Mortgage Related Rights has been transferred to us.

After any Perfection Trigger Event occurs, the Seller must (on notice from the Security Trustee), take the action the Security Trustee requires to protect Bauhinia's and the Security Trustee's interest in, the Mortgages and the Mortgage Related Rights.

The fact that notice of the transfer of Mortgages and the Mortgage Related Rights is not given until a Perfection Trigger Event occurs creates some additional risks. For example, until notice is given, Mortgagors may be entitled to claim a right of set-off (see "set-off" below).

Registration

The documents transferring the Mortgages to us and the Security are documents which can be registered at the relevant Land Registries in Hong Kong under the Land Registration Ordinance (Cap. 128) of the Laws of Hong Kong.

There is no legal requirement that documents relating to land be registered, but the Land Registration Ordinance gives priority according to the dates of registration of such documents. If they are registered within one month of signature, priority of these documents will relate back to the date of signature. If we do not register these documents they will still bind the parties to them, but they will not be able to be enforced against a subsequent buyer or mortgagee of the Mortgages who makes payment in good faith and whose interest is properly registered.

Some Government Leases and the conditions of some Government Grants require the registration of any assignment or transfer of any interest in the underlying property within a certain time period. Breach of the terms of these types of Government Lease or Government Grant could entitle the Hong Kong Government to re-enter and take possession of the land subject to the lessee's right to apply for relief against re-entry.

Generally Government Leases and Government Grants do not set a deadline for registration of assignments or transfers. Therefore, if it becomes apparent that the documents transferring the Mortgages to us or the Security need to be registered at the relevant Land Registries, such registration could be done at that time, without causing a breach of the Government Lease or Government Grant.

Master Servicer and Transaction Administrator risk

The appointment of the Master Servicer under the Master Servicing Agreement and the appointment of the Transaction Administrator under the Transaction Administration Agreement may be terminated in certain circumstances.

It may not be possible to find a substitute Master Servicer or Transaction Administrator who is willing to perform these roles.

The ability of any substitute Master Servicer to perform the services under the Master Servicing Agreement will depend, amongst other things, on the information and records then available to it.

SECTION 5. INVESTMENT RISKS

Risks in bankruptcy or insolvency

In the Transaction Documents we agree to restrict our business to the ownership and management of mortgages, activities related to or incidental to that business, and such other activities not inconsistent with the provisions of the Transaction Documents. We can only borrow money and incur debts as permitted by the Transaction Documents.

Although the transaction structure is designed to minimise the likelihood of our bankruptcy or insolvency, it is possible that we could become insolvent or the subject of a winding-up or liquidation order or proceedings.

No representation or warranty as to Eligibility Criteria or Pool Criteria

The Seller will not represent and warrant to us that the Mortgages satisfy the Eligibility Criteria at the time of their sale to us (or at any other time) or that the Pool Criteria are satisfied at any such time.

No investigations, searches or other actions

None of Bauhinia, the Note Trustee or the Security Trustee have undertaken, or will undertake, any investigations, searches or other actions which would normally be undertaken by a lender in respect of purchasers of owner-occupied residential property in Hong Kong. Instead, we, the Note Trustee and the Security Trustee will rely on our rights under the Master Mortgage Sale and Purchase Agreement to require the Seller to repurchase any Mortgage not satisfying the Eligibility Criteria or the Pool Criteria as at the Settlement Cut-Off Date.

Uninsured loss

The terms of the Mortgages generally require the Mortgagors to carry fire and other insurance over the mortgaged properties. There are, however, certain types of losses which may be either uninsurable or not economically insurable or are not covered by the required insurance policies. If an uninsured or uninsurable loss occurs, there may not be enough money to make all required payments under a Mortgage.

Set-off

The Seller has agreed in the Master Mortgage Sale and Purchase Agreement not to make any further advances to Mortgagors other than the making of certain payments under the Master Servicing Agreement. However, either the Seller, The Hong Kong Housing Authority or a Scheme Bank may make or have outstanding advances or facilities to Mortgagors, whether or not secured.

If a Mortgagor is owed an amount by, or has money in an account with, the Seller, The Hong Kong Housing Authority or a Scheme Bank, that Mortgagor may have rights to require that money to be set off against money due under their Mortgage. The effect of this will be that the Mortgagor may pay less than the amount then due under the Mortgage. If the Seller, The Hong Kong Housing Authority or a Scheme Bank becomes insolvent after a valid notice has been given to them of the transfer of the Mortgages, it can be expected that Mortgagors will exercise their rights of set off to a significant degree and that enforcement of the obligations to pay sums to us will be subject to the insolvency of the Seller, The Hong Kong Housing Authority or a Scheme Bank.

Withdrawal or downgrade of rating of the Retail Notes

The rating of the Retail Notes is based on factors which may include the adequacy of the value of the Series Assets and the Guarantee. It reflects the rating agency's assessment of how likely it is that holders of the Retail Notes will receive the payments to which they are entitled. A rating is not an assessment of how likely it is that principal prepayments on the Mortgages will be made, the degree to which the rate of prepayments might differ from that originally anticipated, or the likelihood that the Retail Notes will be redeemed early.

A rating is not a recommendation to purchase, hold or sell the Retail Notes because it does not address the market price of the Retail Notes or the suitability of the Retail Notes for any particular investor.

A rating may not remain in place for any given period of time and a rating agency could lower, qualify or withdraw a rating entirely in the future. For example, the rating agency could lower, qualify or withdraw its rating of the Retail Notes due to:

- ◀ a decrease in the adequacy of the value of the Series Assets; or
- ◀ an adverse change in the financial or other condition of the HKMC as Master Servicer or as Guarantor.

A reduction in any rating of the Retail Notes is likely to reduce the market value of the Retail Notes and may affect your ability to sell them.

Risks associated with Bauhinia

If we default under the Notes, the Security Trustee can enforce the Security only over the assets relating to this Series 2004-2. The Security Trustee will then use any proceeds recovered to repay the Retail Notes and the Professional Notes and the amounts owing in the order described in Section 8.7 ("*Pre and post-enforcement cashflows*").

Noteholders (including Retail Noteholders) cannot take direct action against us. Rights available against us in respect of the Notes (including the Retail Notes) are exercisable only by the Note Trustee on behalf of the Noteholders (including Retail Noteholders). You will have to rely on your bank in its capacity as Retail Noteholder to request the Note Trustee to take action on your behalf.

SECTION 5. INVESTMENT RISKS

Risks associated with the HKMC

Although non-payment under the Guarantee by the HKMC is a minimal risk, you should understand that the risks described in this Section 5 would be real risks in the event of non-payment under the Payment Deed or Guarantee.

If we are unable to repay amounts owing on the Retail Notes, you are then exposed to the credit risk of the HKMC, as the HKMC (as Guarantor) has guaranteed repayment of principal and payment of interest on the Retail Notes as well as on the Professional Notes. At the date of this Prospectus, the HKMC has the same credit rating as the current credit rating of the Hong Kong Government.

Although the HKMC is wholly-owned by the Hong Kong Government, the Hong Kong Government does not provide any form of guarantee of the HKMC's borrowings or other obligations, including its obligations under the Guarantee. If the HKMC is partly or fully privatised, the HKMC's credit standing could be adversely affected.

Basis Risk

Each Housing Authority Mortgage is secured over an interest-free loan. Under the terms of the Payment Deed, the HKMC has agreed to make certain contractual payments, which are calculated to take the place of interest and are designed to provide us with enough funds to meet our obligations to make interest payments in respect of the Notes. These payments are calculated by reference to HIBOR plus a specified margin. Our payment obligations on the Retail Notes are fixed rate. We will hedge this mismatch through the Interest Rate Swap. If there is a difference between the payments made by the HKMC under the Payment Deed and our payment obligations, we may not have enough money to pay interest on the Notes.

Interest Rate Swap

If the Interest Rate Swap is wholly or partially terminated, or if the interest rate swap provider fails to perform its obligations under the Interest Rate Swap, Retail Noteholders will be exposed to the risk that the fixed rate of interest payable on the Retail Notes will be greater than the floating rate amounts received by us under the Payment Deed. Accordingly, we may not have sufficient money to make payments due on the Retail Notes.

If the Interest Rate Swap is wholly or partially terminated before its scheduled termination date, a termination payment may be payable. A termination payment could be substantial. Any termination payment owed by us to the Interest Rate Swap provider will be payable out of the Series Assets. Accordingly, we may not have sufficient money to make payments due on the Notes.

SECTION 6. HONG KONG TAXATION OF NOTES

We have based this summary of Hong Kong tax on current law and practice. It is intended to give you an overview of what Hong Kong tax you might have to pay if you hold Retail Notes. It is not complete and we are not giving you any tax advice. You should consult your own tax adviser about the tax consequences of investing in Retail Notes, particularly if you are subject to special tax rules (for example, if you are a bank, dealer, insurance company or a tax-exempt entity).

WITHHOLDING TAX

Under current law we do not have to make any withholding on account of Hong Kong tax from payments under the Retail Notes.

CAPITAL GAINS TAX

No capital gains tax is payable in Hong Kong on any capital gains arising from resale of the Retail Notes.

PROFITS TAX

Profits tax is charged on every person carrying on a trade, profession or business in Hong Kong in respect of assessable profits arising in or derived from Hong Kong from such trade, profession or business.

Under the Inland Revenue Ordinance (Cap. 112) of the Laws of Hong Kong as it is currently applied, interest on the Retail Notes is subject to Hong Kong profits tax where the interest is received by or accrued to:

- ◀ a financial institution (as defined in the Inland Revenue Ordinance) and the interest arises through or from the carrying on by the financial institution of its business in Hong Kong; or

- ◀ a corporation carrying on a trade, profession or business in Hong Kong and such interest is derived from Hong Kong; or
- ◀ a person, other than a corporation, carrying on a trade, profession or business in Hong Kong and such interest is derived from Hong Kong and is in respect of the funds of the trade, profession or business.

Notes of a particular Series may be “qualifying debt instruments”. Qualifying debt instruments may entitle the holder to relief from all or part of any profits tax chargeable on payments of interest, depending on the maturity and other features of the notes.

In addition, Hong Kong profits tax also may be charged on profits arising on the sale, disposal or redemption of the Retail Notes where the sale, disposal or redemption is or forms part of a trade, profession or business carried on in Hong Kong.

ESTATE DUTY

The Retail Notes are Hong Kong property for the purposes of Hong Kong estate duty. Accordingly, Hong Kong estate duty may be payable in respect of Retail Notes on the death of the beneficial owner of Retail Notes (regardless of the place of the owner’s residence, citizenship or domicile) or, where the Retail Noteholder is a privately controlled company for these purposes, on the death of a person who transferred Retail Notes to the company within three years of his or her death.

STAMP DUTY

The Retail Notes are not subject to Hong Kong stamp duty or bearer instrument duty either when issued or on any subsequent transfer.

SECTION 7. INFORMATION ABOUT BAUHINIA AND THE RETAIL NOTE ISSUE

GENERAL

Bauhinia was incorporated as an exempted company with limited liability in the Cayman Islands (with registered number CR-113375) on 15 October 2001. Our authorised share capital is US\$50,000 divided into 50,000 ordinary shares of US\$1.00 each, of which 1,000 have been issued at par, are fully paid and are held by Walkers SPV Limited as trustee for charitable purposes. The registered office of Bauhinia is Walker House, Mary Street, P.O. Box 265GT, George Town, Grand Cayman, Cayman Islands.

DIRECTORS

Our directors are:

David Egglisshaw
John Cullinane
Derrie Boggess

None of them is an employee of Bauhinia or the HKMC.

The business address of each director is Walker House, Mary Street, P.O. Box 265GT, George Town, Grand Cayman, Cayman Islands.

BUSINESS

Since our date of incorporation, we have not, and will not in the future, carry on any business other than the purchase of mortgages, the issue of notes under our mortgage-backed securitisation programme, the entry into and performance of the Transaction Documents and the other transactions and agreements described in this Prospectus. We do not have any subsidiaries or employees.

Since 15 October 2001, we have entered into the following contracts:

- ◀ the Programme Agreement;
- ◀ the Trust Deed;
- ◀ the Agency Agreement;
- ◀ the Transaction Administration Agreement;
- ◀ the Deed Poll;

- ◀ the Master Mortgage Sale and Purchase Agreement (Authorized Institution Loans);
- ◀ the Master Servicing Agreement (Authorized Institution Loans);
- ◀ the Master Definitions Schedule;
- ◀ the Deed of Charge;
- ◀ the contracts and documents under which the guaranteed mortgage-backed floating-rate notes Series 2002-1 with a total issue size of HK\$2,000,000,000 were issued on 13 March 2002;
- ◀ the contracts and documents under which the guaranteed mortgage-backed floating-rate notes Series 2003-1 with a total issue size of HK\$3,000,000,000 were issued on 4 November 2003;
- ◀ the contracts and documents under which the guaranteed mortgage-backed floating-rate notes Series 2004-1 with a total issue size of HK\$400,000,000 were issued on 29 June 2004; and
- ◀ the contracts and documents for this Series 2004-2.

No shares or debentures have been issued or have been agreed to be issued as fully or partly paid up otherwise than in cash.

As at the date of this Prospectus, we have no hire purchase commitments, guarantees or other material contingent liabilities.

FINANCIAL STATEMENTS

The auditors' report and our financial statements for the year ended 31 December 2003 and our unaudited interim financial statements for the six months ended 30 June 2004 are set out respectively in Appendices P-1 and P-2.

Our unaudited capitalisation details are set out in Appendix P-3 ("*Capitalisation of Bauhinia*").

AUTHORISATIONS

We have obtained all necessary consents, approvals and authorisations in connection with the execution of the Transaction

SECTION 7. INFORMATION ABOUT BAUHINIA AND THE RETAIL NOTE ISSUE

Documents and the issue and performance of our obligations under the Notes. This issue of Notes has been authorised by resolutions of the board of directors passed on 12 October 2004.

NO MATERIAL CHANGE

There has been no material adverse change in our financial or trading position since 30 June 2004.

EXEMPTIONS

We are exempted from complying in this Prospectus with paragraphs 4, 5, 6 (we have not included our directors' residential addresses), 12(1)(a), 12(1)(b), 13, 14, 15, 16, 19, 22, 26(b), 31 and 45 of the Third Schedule to the Companies Ordinance. These exemptions are allowed by Sections 8(2) and (3) of the Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice (Cap. 32L). SFC has also granted us conditional exemption from complying with section 342(1)(b) of the Companies Ordinance (in respect of the requirement for the Prospectus to contain a Chinese translation).

LITIGATION

We are not and have not been involved in any legal or arbitration proceedings which may have, or have had, a significant effect on our financial position nor, so far as we are aware, are any such proceedings pending or threatened. Also, there is no litigation, nor are there any claims, of material importance pending or, to our knowledge, threatened against us.

NO OPTION

No person has, or is entitled to, an option to subscribe for any of our shares or debentures.

AUDITORS' CONSENT

PricewaterhouseCoopers, independent accountants and our auditors for the year ended 31 December 2003, have given and have not withdrawn their written consent to the inclusion in this Prospectus of their report dated 1 April 2004 (which relates to our 2002 and 2003 financial statements). Their report was not prepared exclusively for incorporation in this Prospectus.

As our independent auditors, PricewaterhouseCoopers do not have any shareholding in Bauhinia nor do they have the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for any of our securities.

OUR DIRECTORS TAKE RESPONSIBILITY FOR THIS PROSPECTUS

Our directors collectively and individually accept full responsibility for the truth and accuracy of the information contained in this Prospectus and confirm, having made all reasonable enquiries, that this Prospectus contains all information which is material to an investment in the Retail Notes. They confirm, having made all reasonable enquiries, that to the best of their knowledge and belief, there are no other facts the omission of which would make any statement in this Prospectus misleading in any material way.

This Prospectus is accurate at the date of its issue (19 October 2004). You must not assume that information in this Prospectus is accurate at any time after that date.

None of the Arranger, the Joint Underwriters, the Note Trustee, the Security Trustee or the Placing Banks is responsible in any way to ensure the accuracy of this Prospectus.

WHERE YOU CAN READ COPIES OF THE LEGAL DOCUMENTATION FOR THE RETAIL NOTES

This Prospectus contains only a summary description of our mortgage-backed securitisation programme.

To find out more, you can read copies of the documents listed below by going to the office of the Transaction Administrator at 80th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong or to the office of Deutsche Bank AG, Hong Kong Branch, our Principal Paying and Transfer Agent, at 55th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

In Section 8 ("*Information about key agreements*") we have summarised certain key agreements mentioned in this Prospectus, but which are not listed below. We believe these summaries contain sufficient information for an investor in the context of making a decision as to whether or not to invest in the Retail Notes and we do not believe that there is any need for investors to read those agreements in order to make a decision as to whether or not to invest in the Retail Notes. They are therefore not listed below.

These offices are open only during normal business hours and not on Saturdays, Sundays or public holidays.

These are the documents, copies of which we will keep on display while any of the Retail Notes are outstanding:

◀ this Prospectus;

SECTION 7. INFORMATION ABOUT BAUHINIA AND THE RETAIL NOTE ISSUE

- ◀ a letter from Bauhinia's and the HKMC's auditors, PricewaterhouseCoopers, consenting to the issue of this Prospectus with their audit reports in it;
- ◀ a summary of the exemption (which the SFC gave us for this Prospectus) from full compliance with the Companies Ordinance, including the grounds on which we asked for it and the conditions which the SFC attached in giving it;

SECTION 7. INFORMATION ABOUT BAUHINIA AND THE RETAIL NOTE ISSUE

- ◀ the Trust Deed: the Trust Deed includes the form of the Notes (including the Retail Notes), the Terms and Conditions and the Guarantee;
- ◀ the Deed of Charge;
- ◀ the Deed of Joinder;
- ◀ the Agency Agreement;
- ◀ the terms of our contracts with the banks appointed as market makers for the Retail Notes;
- ◀ our up-to-date memorandum and articles of association;
- ◀ our most recently published audited annual report and accounts and a copy of our most recently published unaudited interim accounts;
- ◀ Master Definitions Schedule;
- ◀ any notices given by us under the Terms and Conditions; and
- ◀ latest audited accounts and latest unaudited interim accounts of the HKMC.

Our Retail Agreement will also be on display during the offer period for the Retail Notes.

You may take photocopies of any of the documents listed above upon paying a reasonable photocopying fee.

NO OTHER INFORMATION AUTHORISED

We have not authorised anyone to give you any information about the Retail Notes other than the information in this Prospectus. You should not rely on any other information (including information available on the HKMC's website).

ENGLISH AND CHINESE VERSIONS AVAILABLE

This Prospectus is available in both the English and Chinese languages. Separate copies of both the Chinese and English language versions of this Prospectus will be available.

LEGAL DOCUMENTATION

The legal documentation has been prepared by our lawyers, Mallesons Stephen Jaques.

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

This Section contains a summary of the key agreements entered into by us with the Note Trustee, the Security Trustee, the HKMC (as Seller, Master Servicer, Transaction Administrator and Guarantor), the Principal Paying and Transfer Agent, the Arranger, the Joint Underwriters and the Placing Banks in respect of the Retail Notes. This summary is not a complete summary of those agreements. The documents listed in Section 7 ("*Information about Bauhinia and our Retail Note issue*" – "*Where you can read copies of the legal documentation for the Retail Notes*") contain important information about the issue of the Retail Notes. These documents can be read and copied by you by following the procedures as set out on pages 34 and 35 of this Prospectus. Some of those documents (such as the Trust Deed, the Terms and Conditions and the Security) are summarised below. The other key agreements that we have summarised in this section are not available to be read and copied by you, but we have described them in this section so that you have a better understanding of how our mortgage-backed securitisation programme operates.

Section 10 ("*Glossary*") contains additional definitions applicable to this Section.

8.1 TERMS AND CONDITIONS OF THE RETAIL NOTES

The terms and conditions of the Retail Notes are contained in the Trust Deed. In this Section 8.1, we describe the main provisions of the terms and conditions which apply to all the notes we issue as well as the specific provisions that apply to the Retail Notes.

Form of the Retail Notes - the Retail Notes are secured, guaranteed, limited recourse debt securities of Bauhinia. The Retail Notes are constituted by the Trust Deed and are represented by the global notes which will be lodged with the CMU.

Status of the Retail Notes - the Retail Notes rank equally with each other and with the Professional Notes. This means that if we become insolvent, Noteholders will rank for payment equally with each other, but ahead of all our other creditors whose claims are not preferred by law. Creditors whose claims are preferred by law include unpaid employees for their wages, the Hong Kong Inland Revenue Department for unpaid taxes, and others whose claims are secured on our assets.

Series - together, the Retail Notes and the Professional Notes form a "Series" of Notes ("Series 2004-2") which share the benefit of, and have rights limited to, the Series Assets. We have given security over these Series Assets to the Security Trustee - see Section 8.4 ("*Security arrangements*").

Undertaking to pay - we have undertaken to the Note Trustee that we will pay principal and interest on the Retail Notes in accordance with the Trust Deed. The Note Trustee holds this undertaking on trust for the Noteholders (including the Retail Noteholders) who are the beneficiaries of the trust created under the Trust Deed. Until an Event of Default occurs, amounts due and payable under a Retail Note will be paid to the Retail Noteholder of the relevant Class. After an Event of Default, we can meet our obligation to make payment of an amount due under a Retail Note by paying the Note Trustee or the Security Trustee instead of a Retail Noteholder.

Events of Default - Events of Default for this Series 2004-2 are:

- ◀ any failure to pay principal, interest or other amounts due on our Series 2004-2 Notes for more than 7 days after the due date;
- ◀ failure by us to perform any of our other obligations under the Series 2004-2 Notes, the Trust Deed, the Deed of Charge or the Deed of Joinder if the Note Trustee certifies that 30 days have passed since we were given written notice to correct the situation and we have not done so;
- ◀ certain specified events of insolvency which affect us;
- ◀ the Security ceases to be a first ranking charge over the Series Assets or becomes void or unenforceable; and
- ◀ certain specified events that might adversely affect the Guarantor (including events such as its insolvency) and its ability to perform its obligations under the Guarantee.

An event of default under any other Series does not, of itself, create an Event of Default under the Notes of this Series 2004-2.

Repayment on the Repayment Date - the principal amount of each Retail Note is HK\$50,000. We agree to repay 100% of this amount to Retail Noteholders on the relevant Repayment Date for their Retail Notes.

Calculations - calculations and determination of amounts under the Retail Notes are made by the Transaction Administrator. Its determination is final and binding on Noteholders, unless there is manifest error.

Noteholders bound - each Noteholder is bound by the Trust Deed.

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

Meetings of Noteholders - the Trust Deed contains provisions for calling and holding meetings of Noteholders to consider any matter affecting their interests. A meeting could be convened, for example, if we want to propose a change to an important term of the Retail Notes or the Professional Notes or if we want to get approval for a waiver of a breach by us of a term of the Notes.

There are detailed provisions in Schedule 6 to the Trust Deed about how meetings will be conducted if a meeting is ever called. A meeting may be called by us, the Guarantor or the Note Trustee in accordance with Schedule 6 to the Trust Deed. The Terms and Conditions also describe the meeting provisions.

A resolution passed at a meeting of Noteholders (including Retail Noteholders) will be binding on all Noteholders (including Retail Noteholders), whether or not they were present at the meeting.

8.2 THE TRUST DEED

Noteholders have the benefit of the Trust Deed. The Trust Deed was entered into by us on 22 February 2002 with DB Trustees (Hong Kong) Limited as Note Trustee and the HKMC as Guarantor. The Trust Deed establishes the trust for Noteholders (and holders of notes of other Series) and contains the Terms and Conditions and the Guarantee.

The Trust - the Trust Deed establishes a separate trust for noteholders of each Series, including this Series 2004-2. It contains the Terms and Conditions and the Guarantee.

The Note Trustee - the major functions of the Note Trustee are to:

- ◀ hold on trust for Noteholders the benefit of our undertakings, including our promise to repay principal and pay interest;
- ◀ if necessary, take action against us to enforce our undertakings;
- ◀ if necessary, take action to enforce the Guarantor's obligations under the Trust Deed and under the Guarantee;
- ◀ hold the bank account into which amounts owing to Noteholders are paid;
- ◀ hold any amounts that the Note Trustee receives for the Noteholders under the Transaction Documents relevant for this Series 2004-2;

- ◀ hold any security rights which the Note Trustee acquires under the Security which are in respect of amounts owing under the Retail Notes; and
- ◀ hold the right to enforce any of our other duties or obligations under the Notes, the Trust Deed or to the Noteholders (including Retail Noteholders) under the Transaction Documents relevant for this Series 2004-2.

Amendments - the Note Trustee also has power to agree, without consent of the Noteholders, to modifications to the Notes which are minor, technical, or made to correct obvious mistakes.

Our undertakings - we give undertakings in the Trust Deed to support the Note Trustee's role. For example, we agree to:

- ◀ provide the Note Trustee with copies of our financial information and other notices to Noteholders;
- ◀ tell the Note Trustee if we breach any of our undertakings or if there is an Event of Default.

Removal and retirement of Note Trustee - the Trust Deed contains provisions for the removal and retirement of the Note Trustee. If the Note Trustee retires or is removed in respect of one Series, it is required to retire or be removed for all Series. However, if the Note Trustee retires or is removed, we must appoint a replacement Note Trustee who has been approved by an extraordinary resolution of the Noteholders of the relevant Series prior to the retirement or removal becoming effective.

Note Trustee fees - for this Series 2004-2, we have agreed to pay a fee to the Note Trustee and to reimburse the Note Trustee for all its costs and expenses properly incurred in acting as Note Trustee. These fees, costs and expenses are payable in accordance with the Cash Flow Allocation - see Section 8.7 ("*Pre and post-enforcement cashflows*"). We do not have to reimburse the Note Trustee for costs and expenses where it has acted negligently or if it has breached its obligations as Note Trustee.

Limited recourse against the Note Trustee - the Trust Deed contains a limited recourse provision. This limits the responsibility and liability of the Note Trustee to the amounts available to it as note trustee. However, this limit does not apply if it has acted negligently or if it has breached its obligations as Note Trustee.

Governing law - The Trust Deed is governed by English law.

8.3 THE GUARANTEE

Payment of shortfall - if there is an Income Shortfall or a Principal Shortfall on an Interest Payment Date or Repayment Date (for the

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

Retail Notes) or Amortisation Payment Date (for the Professional Notes), the Note Trustee must make a claim for the shortfall amount from the Guarantor. On receipt of a claim, the Guarantor must pay the amount of the shortfall to the Principal Paying and Transfer Agent for distribution to the Noteholders.

Guarantor Advances - the Guarantor (at its discretion) may make a Guarantor Advance to us on or before an Interest Payment Date, a Repayment Date or an Amortisation Payment Date. The making of a Guarantor Advance will not reduce or affect the Guarantor's obligation to make further payments under the Guarantee if, despite the Guarantor Advance, there is an Income Shortfall or a Principal Shortfall on the relevant Interest Payment Date, Repayment Date or Amortisation Payment Date.

Guarantor reimburses payments set aside - the Guarantee also covers any payment received by the Noteholders which is subsequently avoided or set aside under applicable law. If this occurs, the Guarantor agrees to reimburse Noteholders the amount of the payment avoided or set aside.

Guarantor's rights against us - if the Guarantor makes any payments under the Guarantee, it will then have rights against us to recover those amounts to the extent that we have funds available to do so at any time. However, the Guarantor has agreed that it cannot recover these amounts until after the Noteholders have received all payments of principal and interest under the Notes.

Status of Guarantee - claims under the Guarantee are direct, unsecured and unsubordinated obligations of the Guarantor ranking equally with other unsecured and unsubordinated indebtedness of the Guarantor. The Guarantee may not be cancelled or revoked before payment in full of all guaranteed payments under the Notes of this Series 2004-2.

8.4 SECURITY ARRANGEMENTS

To provide security for our obligations under the notes of each Series and our obligations under other Transaction Documents, we have entered into the Deed of Charge with the Security Trustee and the Note Trustee. For this Series 2004-2, we will also enter into the Deed of Joinder.

Security Trustee - DB Trustees (Hong Kong) Limited has been appointed as the Security Trustee under the Security. The Security Trustee has certain duties and obligations in connection with holding the Security.

Undertaking to pay - under the Trust Deed we agree to pay all amounts due to each Series 2004-2 Secured Party (including Retail Noteholders).

Deed of Charge - under this document we grant the following security to be held by the Security Trustee for itself and on trust for each Series 2004-2 Secured Party:

- ◀ a first fixed charge over our rights in the Series Assets;
- ◀ a first fixed security over our rights under the Transaction Documents to which we are a party;
- ◀ a first fixed security over our rights and money in the Series 2004-2 Collection Account and the Principal Accumulation Account;
- ◀ a first fixed charge over our rights in all investments (and income from them) made by us in respect of this Series 2004-2; and
- ◀ a first floating charge over all of our property and assets in respect of this Series 2004-2 which is not otherwise subject to the fixed charges or fixed security (as described above), except for any property we have which is located in the Cayman Islands.

Any property we own that is located in the Cayman Islands is not subject to the Deed of Charge.

Nature of the Security

The security created by the Deed of Charge operates as a fixed charge over certain assets and a floating charge over other assets. A floating charge over assets is different to a fixed charge over assets.

We cannot deal with any assets over which we have granted a fixed charge without the consent of the Security Trustee.

A floating charge does not attach to specific assets but instead "floats" over a class of assets which may change from time to time. We can deal with those assets and can give third parties title to those assets free from any encumbrance, provided such dealings and transfers of title are in the ordinary course of our business. We have agreed not to dispose of or create interests in the Series Assets except as allowed under the security documents. The Transaction Administrator has agreed not to direct us to take any such actions.

The floating charge granted over the Series Assets will "crystallise", which means it becomes a fixed charge, if specific

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

events set out in the Deed of Charge occur, including an Event of Default. On crystallisation of a floating charge, we must not deal with the Series Assets without the consent of the Security Trustee.

If a floating charge has crystallised, the Security Trustee may release any asset from a fixed charge by notice to us. Following that release, the asset will again be subject to the floating charge.

Deed of Joinder - this document:

- ◀ identifies the obligations secured under this Series 2004-2;
- ◀ specifies who are the Series 2004-2 Secured Parties; and
- ◀ describes the Series Assets for this Series 2004-2.

Events of Default - if an Event of Default occurs, the Security Trustee must, if directed to do so by the Note Trustee, serve an enforcement notice on us for this Series 2004-2. As a result, the Security will be immediately enforceable. The Security Trustee, at the direction of the Note Trustee, must take possession of, or take such other action in relation to, the Secured Property, including appointing a receiver to the Secured Property.

Note Trustee's Rights - the Note Trustee is the only person who has power to control, direct and veto the actions of the Security Trustee for this Series 2004-2. Noteholders have no power to direct the Security Trustee or to take action in respect of the Secured Property. Noteholders can direct the Note Trustee to enforce the Notes and the Guarantee.

The Security Trustee must take all actions with respect to the Secured Property as the Note Trustee directs be taken. The Security Trustee must also give any directions to us (or any other relevant person) that the Note Trustee directs be given. The Security Trustee must not act with respect to the Secured Property and the Transaction Documents without the prior written consent or direction of the Note Trustee. The Security Trustee is not liable for any act taken (or not taken) at the direction of the Note Trustee.

When acting on the direction of the Note Trustee (acting on behalf of the Noteholders) the Security Trustee does not have to consider the interests of any other Series 2004-2 Secured Party.

Enforcement only by Security Trustee - under the Deed of Charge, other than the Note Trustee acting on behalf of the Noteholders,

only the Security Trustee may enforce the Security. The Note Trustee will not take steps directly against us to recover amounts owing to it by us, unless the Security Trustee has become bound to enforce the Security, but has failed to do so within a reasonable period of becoming bound.

Pre-enforcement and post-enforcement priority of payments - the Deed of Joinder sets out the order of priority for the application of cash by the Transaction Administrator (on behalf of us) before the service of an enforcement notice in relation to this Series 2004-2. This payment order of priority is referred to in this Prospectus as the "Pre-enforcement cash flow allocation". See Section 8.7 ("*Pre and post-enforcement cashflows*").

The Deed of Joinder also sets out the order of priority, following service of an enforcement notice in relation to this Series 2004-2, of amounts received or recovered by the Security Trustee or a receiver appointed on its behalf. This payment order of priority is referred to in this Prospectus as the "Post-enforcement cash flow allocation". See Section 8.7 ("*Pre and post-enforcement cashflows*").

Additional provisions of the Deed of Charge - the Deed of Charge contains a range of provisions regulating the scope of the Security Trustee's duties and liabilities. These include that the Security Trustee:

- ◀ is not responsible for:
 - ◀ the maintenance of any insurance in respect of any Secured Property;
 - ◀ the monitoring and supervision of the Master Servicer; or
 - ◀ the genuineness, validity or effectiveness of any Transaction Document;
- ◀ is entitled to assume that Bauhinia and the Guarantor are in compliance with their obligations under the Transaction Documents to which they are respectively a party;
- ◀ may, with the consent of the Note Trustee, delegate some or all of its duties and powers to any person or persons;
- ◀ is entitled to make any contract or enter into any transaction in the ordinary course of business with us; and

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

- ◀ is not liable for any failure, omission or defect in perfecting the security constituted under the Trust Deed or the Security.

Governing Law - the Deed of Charge and the Deed of Joinder are governed by Hong Kong law.

Security Trustee's fees and expenses - in respect of this Series 2004-2, we have agreed to pay a fee to the Security Trustee and to reimburse the Security Trustee for all costs and expenses it incurs. These fees, costs and expenses are payable in accordance with the Cash Flow Allocation. We are not required to reimburse the Security Trustee for costs and expenses where it has acted negligently or where it has breached its obligations.

Limited recourse against the Security Trustee - the Deed of Charge also limits the responsibility and liability of the Security Trustee to the amounts available to it as security trustee, except in circumstances where it has acted negligently or where there has been a breach of its obligations as Security Trustee.

Retirement and Removal of the Security Trustee - the Deed of Charge contains provisions in relation to the removal and retirement of the Security Trustee. The removal or retirement of the Security Trustee does not take effect until a replacement Security Trustee approved by the Note Trustee has been appointed.

8.5 MORTGAGE SERVICING ARRANGEMENTS

We have entered into a Master Servicing Agreement with the Master Servicer, the Transaction Administrator and the Security Trustee. The Master Servicing Agreement for this Series 2004-2 relates only to the Mortgage Pool.

Under the Master Servicing Agreement, the Master Servicer has agreed to provide to us and the Security Trustee certain administrative and other services in relation to the Mortgages and Mortgage Related Rights purchased by us from the Seller and charged by us in favour of the Security Trustee.

Obligations on Master Servicer - the Master Servicer has agreed to manage the Mortgage Pool in accordance with all applicable laws and in accordance with the provisions of the Master Servicing Agreement (including the Mortgage Servicing Manual which applies to Housing Authority Mortgages) in the same manner as the Master Servicer manages its own mortgages. The same obligations apply to the Delegate Servicer.

Mortgages must also be identified in such a manner as will distinguish the Mortgages from other mortgages serviced by the Master Servicer.

Sub-contracting and delegation - under the Master Servicing Agreement, the Master Servicer can delegate some or all of its obligations to a Delegate Servicer. Bauhinia and the Security Trustee are not liable for any costs, charges or expenses payable to or incurred by any Delegate Servicer. If the Master Servicer does delegate some or all of its obligations:

- ◀ the Master Servicer remains responsible to Bauhinia for the performance of its obligations under the Master Servicing Agreement as if it had not delegated its obligations; and
- ◀ any breach in the performance of the Mortgage servicing function by a Delegate Servicer is treated as a breach by the Master Servicer.

We have consented to the obligations of the Master Servicer under the Master Servicing Agreement being delegated to The Hong Kong Housing Authority as Delegate Servicer and are aware that The Hong Kong Housing Authority has appointed the Scheme Bank to be its agent to service the Housing Authority Mortgages.

Undertakings by the Master Servicer - under the Master Servicing Agreement, the Master Servicer undertakes, among other things, the following:

- ◀ it will not knowingly fail to comply with any legal requirements in the performance of its obligations under the Master Servicing Agreement;
- ◀ it will make all payments required to be made by it under the Master Servicing Agreement on the due date for payment for value without set-off or counterclaim;
- ◀ it will not dispose of any interest in, or create, or permit to exist any further interest in, any Mortgage or property secured under a Mortgage other than as contemplated by any of the Transaction Documents; and
- ◀ if terms of a Mortgage are breached, it will promptly notify us and use its reasonable endeavours to protect and preserve our interest under a Mortgage.

Collections from Mortgagors - the Master Servicer is, under the terms of the Master Servicing Agreement, required to use all reasonable endeavours to collect all payments due under or in connection with the Mortgages and has agreed (on behalf of Bauhinia and the Security Trustee) to enforce all covenants and obligations of the Mortgagors and guarantors of Mortgages owing to us.

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

The Master Servicer must transfer the Collections which are received under the Mortgages during a particular Collection Period either by itself, or the Delegate Servicer on its behalf, to us in accordance with the terms of the Master Servicing Agreement.

The Master Servicer may retain the Collections received under the Mortgages between the time they are received from the Delegate Servicer and the time the Master Servicer is required to pay those Collections to Bauhinia. The Master Servicer may also retain for its own account (such that the amount does not need to be transferred to us and hence we will not receive) any interest and other income derived from those Collections during the period they are held by the Master Servicer or the Delegate Servicer before being paid to the Master Servicer.

Costs and expenses - until a Servicer Termination Event occurs (as defined in the Master Servicing Agreement) in respect of this Series 2004-2, the Master Servicer is, in the performance of its obligations as Master Servicer, authorised to incur out of pocket costs, expenses and liabilities to third parties, including those which must necessarily be incurred in the enforcement of a Mortgage and the Mortgage Related Rights or the rights and remedies of Bauhinia or the Security Trustee under a Mortgage.

Every month the Master Servicer is entitled to be reimbursed for any of these costs, expenses and liabilities. Any servicing fees payable by the Master Servicer to a Delegate Servicer are not recoverable by the Master Servicer from us, although this does not stop the Master Servicer from charging the servicing fee (as described below) to which it is entitled for performing its duties as Master Servicer.

Servicing Fee - the Master Servicer is entitled to receive a servicing fee for performing its obligations under the Master Servicing Agreement. The servicing fee is payable in arrears each month. The servicing fee payable to the Master Servicer in respect of the Mortgage Pool represents the aggregate of separate servicing fees that the Master Servicer is entitled to receive in respect of each Mortgage. The servicing fee includes all of the handling or arrangement fees and late payment fees collected by or on behalf of the Master Servicer or the Delegate Servicer.

Our obligation to pay the servicing fee (if any) to the Master Servicer is reduced to the extent to which the Master Servicer deducts an amount representing all or part of the servicing fee from Collections received under the Mortgages.

Excess Servicing Receipt - in addition to the servicing fee, each month the Master Servicer is entitled to be paid an amount known as the Excess Servicing Receipt (as defined in the Master Definitions Schedule). This is the amount (if any) that is available

to us from the Total Available Income after paying all of our costs and expenses (including interest on the Notes) on the relevant date that the Excess Servicing Receipt is due to be paid.

Title deeds and other documents - the Master Servicer will keep all the documents relating to the Mortgages and the Mortgage Related Rights which are in its possession in a safe place and in such a manner that they are readily identifiable from similar documents relating to other mortgages of which the Master Servicer is mortgagee. The Delegate Servicer is subject to the same obligations. The Master Servicer has no beneficial interest in any of these documents and waives any rights which it might have to them.

Indemnity - the Master Servicer has agreed to indemnify each of us and the Security Trustee from and against all liabilities, losses, damages, actions, proceedings, demands, claims, costs and expenses which may be brought against, suffered or incurred by us or the Security Trustee (as applicable) by reason of any act of wilful default, fraud, negligence or breach of duty of or by the Master Servicer in the performance of its duties under the Master Servicing Agreement.

Servicer Termination Event - the Security Trustee may, by notice to the Master Servicer, terminate the Master Servicing Agreement in respect of this Series 2004-2 if any of a range of events occur in respect of this Series 2004-2. These events include non-payment of money due to us from the Master Servicer, misrepresentation by the Master Servicer, the insolvency of the Master Servicer and change of control of the Master Servicer. These events are described in detail in the Master Servicing Agreement.

Resignation by the Master Servicer - the Master Servicer may resign as Master Servicer in respect of one or all Series of which it is the Master Servicer by giving not less than three months' written notice of termination to us and the Security Trustee. However, it can only resign if a substitute Master Servicer is appointed and enters into an agreement on substantially the same terms as the Master Servicing Agreement.

Limited Recourse - the Master Servicer also agrees to limit its recourse against us under the Master Servicing Agreement in the same way as described in relation to Noteholders in Section 5 ("*Investment Risks*" - "*Limited recourse*"). The Master Servicer also agrees that it will not petition a court for, or take any other action or commence any proceedings for, the liquidation or winding up of Bauhinia until the expiry of two years and one day after the earlier of the repayment in full of the last Series of notes to be repaid and the latest repayment date of all Series of notes.

Governing Law - the Master Servicing Agreement is governed by Hong Kong law.

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

8.6 MORTGAGE ELIGIBILITY CRITERIA

Eligibility Criteria - for this Series 2004-2 are that each Mortgage, as at the Settlement Cut-Off Date:

- ◀ is secured by a first legal charge or equitable mortgage made in favour of a Scheme Bank (as mortgagee on its behalf and as agent for and on behalf of The Hong Kong Housing Authority), on residential properties which are owner-occupied and in respect of which the Seller and the Scheme Bank have not granted any consent to the creation of any tenancy nor received any actual notice in respect of any tenancy or third party interests;
- ◀ has been made on the terms of, and in accordance with, the then current forms of certain documents (such as the deed of mortgage and related loan agreement) which are prescribed or approved by The Hong Kong Housing Authority;
- ◀ is in Hong Kong Dollars;
- ◀ under which the outstanding principal balance of the related loan at origination does not exceed HK\$800,000;
- ◀ has a maximum original mortgage term of 20 years (which term may be changed by The Hong Kong Housing Authority under the Home Loan Scheme);
- ◀ has a combined loan-to-value ratio at origination of the mortgage loan by the Scheme Bank and The Hong Kong Housing Authority of not more than 100% based on the purchase price of the property as stipulated in the relevant formal sale and purchase agreement;
- ◀ is fully drawn;
- ◀ is to secure a mortgage loan borrowed by an individual person(s) and not by any other legal entities such as a corporation;
- ◀ has no payment of principal which is more than 30 days overdue during the six months immediately preceding the Settlement Cut-Off Date;
- ◀ under which the only obligation secured is the advance made by The Hong Kong Housing Authority and the Scheme Bank to finance the purchase of the relevant mortgaged property or the refinancing of such mortgaged property (other than any other obligation ranking after such advance);
- ◀ is secured by property and buildings which are not more than 30 years old at origination of the mortgage loan;
- ◀ can be dealt with by the Seller as contemplated in the Master Mortgage Sale and Purchase Agreement, and the terms under which the Mortgage is sold to us;
- ◀ the Mortgagor of which has good title to the property and the property is free from any prior encumbrance which would affect that title (and the relevant Mortgagor has obtained a certificate of eligibility issued by The Hong Kong Housing Authority certifying that the Mortgagor is an eligible applicant approved by The Hong Kong Housing Authority to the Home Loan Scheme);
- ◀ is due from a Mortgagor who, to The Hong Kong Housing Authority's actual knowledge, is neither dead, nor bankrupt, nor in breach of the terms of the mortgage deed, loan agreement, loan application forms or any ancillary documents;
- ◀ is related to a property which is covered for loss or damage by fire and other risks as considered appropriate by the Scheme Bank;
- ◀ is free of encumbrances and ranks first in priority;
- ◀ complies with all restrictions of Government Leases and Government Grants for creation and transfers of mortgages;
- ◀ is a mortgage in respect of which there has been no variation to any of the mortgage origination documents without the Seller's approval;
- ◀ is a mortgage in respect of which The Hong Kong Housing Authority has no notice of any litigation or dispute or complaint affecting the Mortgages, any bankruptcy of the Mortgagors, any breach of the terms of the Mortgages or other mortgage origination documents or any non-payment of government taxes, rents, rates, management fees or other expenses in relation to the mortgaged properties;
- ◀ is not subject to set-off rights in favour of the Mortgagors;
- ◀ is a mortgage in respect of which the insurance policy for the property is assignable without the consent of the relevant insurer;
- ◀ is a mortgage in respect of which The Hong Kong Housing Authority, when it made the advance to the Mortgagor,

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

had made or taken, by itself or someone on its behalf, all investigations, searches and other actions that The Hong Kong Housing Authority normally would undertake when assessing the eligibility of the Mortgagors under the Home Loan Scheme for the purchase of the property;

- ◀ is a mortgage in respect of which The Hong Kong Housing Authority has, since the grant of the loan, kept proper accounts, books and records showing clearly all transactions, payments, receipts and proceedings relating to each related loan and all such accounts, books and records are up to date and held by or on behalf of The Hong Kong Housing Authority;
- ◀ is a mortgage in respect of which all the loan agreements, the loan application forms and any ancillary documents are held by, or on behalf of, The Hong Kong Housing Authority;
- ◀ is a mortgage in respect of which all of the principal, interest and other amounts from time to time due and owing to the Seller and the Scheme Bank are secured against the property; and
- ◀ has been registered with the appropriate Land Registry.

Principal Accumulation Account - under the terms of the Transaction Administration Agreement, the Principal Accumulation Account must be established and maintained with a bank that satisfies certain eligibility criteria in the Trust Deed and must not be changed to any other type of financial institution unless we and the Security Trustee have given our consent. The Transaction Administrator may invest the money in the Principal Accumulation Account on our behalf, subject to certain restrictions. During the Principal Accumulation Period and the Amortisation Period, we will apply specific amounts of Available Principal Collections to the credit of the Principal Accumulation Account. During the Principal Accumulation Period, the amount of principal paid into the Principal Accumulation Account and the Series 2004-2 Collection Account will be determined by the Transaction Administrator as the amount that will allow us to repay Retail Notes on their Repayment Dates and Class A-1 Professional Notes on their Amortisation Payment Date.

The money in the Principal Accumulation Account will be applied by us:

- ◀ on each Repayment Date during the Principal Accumulation Period, towards repaying the relevant maturing Class of Retail Notes; and

- ◀ on each Amortisation Payment Date during the Amortisation Period, towards repaying the Amortisation Amount of the Class A-1 Professional Notes.

Any amount of principal collected in excess of the amount so determined by the Transaction Administrator will be paid to the holders of Class A-2 Professional Notes as repayment of the principal on the Class A-2 Professional Notes.

If the Security is enforced during the Principal Accumulation Period or the Amortisation Period, the money in the Principal Accumulation Account will be distributed in the order of priority set out in Section 8.7 ("*Pre and post-enforcement cashflows*").

8.7 PRE AND POST-ENFORCEMENT CASHFLOWS

Pre-enforcement cashflow allocation - each month the Transaction Administrator is required to calculate the Total Available Income and Available Principal Collections and to distribute that income in accordance with a specified order of priority. Set out below is how the Total Available Income and the Available Principal Collections will be distributed pre-enforcement for this Series 2004-2 on each Interest Payment Date and on each Repayment Date.

Total Available Income for this Series 2004-2 will be distributed pre-enforcement by the Transaction Administrator on our behalf on each Payment Date in the following order of priority:

- ◀ **first**, to the payment of the servicing fee payable by us to the Master Servicer in respect of the related Collection Period (although the amount payable will be reduced by the amount of its servicing fee which the Master Servicer has deducted from Collections paid to us);
- ◀ **secondly**, to the payment, equally according to their respective amounts, of:
 - (a) the fees and other amounts payable to the Security Trustee;
 - (b) the fees and other amounts payable to the Note Trustee;
 - (c) the fees and other amounts payable to the Agents;
 - (d) the fees and other amounts payable to the Transaction Administrator;

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

- (e) the fees and other amounts payable to Walkers SPV Limited as corporate services provider; and
 - (f) any other amounts due or overdue from us as a primary liability to third parties under obligations incurred in the course of our business (including taxes and amounts payable to the CMU), other than amounts paid under paragraphs (a) to (e) above, as the Transaction Administrator may specify as attributable to this Series 2004-2;
- ◀ **thirdly**, any net amount (including break costs) payable by us under the Interest Rate Swap;
 - ◀ **fourthly**, to the payment of the guarantee fee payable by us to the Guarantor in respect of the related Interest Period;
 - ◀ **fifthly**, if that Payment Date is an Interest Payment Date, to the payment (equally according to their respective amounts) of interest due in respect of the Notes on that Interest Payment Date;
 - ◀ **sixthly**, to the repayment of any Guarantor Advances made by the Guarantor and reimbursement of amounts paid by the Guarantor under the Guarantee (together with interest on such advances and amounts) on account of a previous Income Shortfall and which have not been repaid or reimbursed (as the case may be) as at that Payment Date;
 - ◀ **seventhly**, to the payment of any amounts payable to the Master Servicer under the Master Servicing Agreement, other than the servicing fee and the Excess Servicing Receipt;
 - ◀ **eighthly**, in or towards satisfaction of the Excess Servicing Receipt (if any) payable by us to the Master Servicer in respect of the Notes under the Master Servicing Agreement; and
 - ◀ **ninthly**, the surplus (if any) to us.
- We will only make a payment under any of the items above, to the extent that any Total Available Income remains from which to make the payment after amounts with priority to that amount have been paid and distributed.
- Distribution of Available Principal Collections** - Available Principal Collections for this Series 2004-2 will be distributed pre-enforcement by the Transaction Administrator on our behalf on each Payment Date in the following order of priority:
- ◀ **first**, to the payment of the Accrued Principal Adjustment payable to the Seller in respect of interests in the Mortgages purchased by us from the Seller on the Issue Date;
 - ◀ **secondly**, any net amounts (including break costs) payable by us under the Interest Rate Swap to the extent any such amount remains unpaid out of the Total Available Income;
 - ◀ **thirdly**, during the Principal Accumulation Period:
 - (a) on a specified date of each month to pay a specified amount of principal into the Principal Accumulation Account; and
 - (b) on the relevant Repayment Date, to make principal repayment of the relevant Retail Notes;
 - ◀ **fourthly**, during the Amortisation Period:
 - (a) on a specified date of each month to pay specified amounts of principal into the Principal Accumulation Account; and
 - (b) on the relevant Amortisation Payment Date, to make principal repayment of the Class A-1 Professional Notes;
 - ◀ **fifthly**, to the holders of the Class A-2 Professional Notes in repayment of principal in respect of such Notes until the principal amount outstanding under the Class A-2 Professional Notes has been reduced to zero;
 - ◀ **sixthly**, to repayment of any Guarantor Advances made by the Guarantor and reimbursement of amounts paid by the Guarantor under the Guarantee (together with interest on such advances and amounts) on account of a Principal Shortfall in previous months and which have not been repaid or reimbursed as at the current month; and
 - ◀ **seventhly**, the surplus (if any) to us to be invested by the Transaction Administrator on our behalf in accordance with the terms of the Transaction Administration Agreement.

We will only make a payment under any of the items above to the extent that any Available Principal Collections remain from which to make the payment after amounts with priority to that amount have been paid and distributed.

SECTION 8. INFORMATION ABOUT KEY AGREEMENTS

Post-enforcement cashflow allocation - the cash in the Principal Accumulation Account, Series 2004-2 Collection Account and any other bank accounts designated for this Series, in respect of the Notes from and including the time (if ever) when the Security Trustee serves an enforcement notice in respect of the Notes on us and any proceeds from enforcement of the security held by the Security Trustee over the Secured Property will be applied by the Security Trustee in accordance with the order of priority set out in the Deed of Joinder as follows (to the extent such amounts have not already been paid by deduction from Collections paid to us by the Master Servicer):

- ◀ **first**, to pay any unpaid amount of the servicing fee payable by us to the Master Servicer under the Master Servicing Agreement;
- ◀ **secondly**, to pay the fees or other remuneration and indemnity payments (if any) payable to the Security Trustee and any receiver appointed by the Security Trustee and any costs, charges, liabilities and expenses incurred by the Security Trustee and any receiver appointed by the Security Trustee under the Deed of Charge and any other relevant Transaction Documents in relation to the Notes, together with interest on such amounts;
- ◀ **thirdly**, to pay, pro rata according to the respective amounts owing:
 - ◀ the fees or other remuneration and indemnity payments (if any) payable to the Note Trustee, the Agents and the Transaction Administrator and any costs, charges, liabilities and expenses incurred by any of those parties under the provisions of the Trust Deed, the Agency Agreement, the Transaction Administration Agreement and other relevant Transaction Documents in relation to this Series 2004-2, together with interest on such amounts; and
 - ◀ the fees payable to the CMU in respect of this Series 2004-2 and such amount of the fees payable to Walkers SPV Limited as corporate services provider as the Transaction Administrator (with the prior written consent of the Security Trustee) may specify as attributable to the Notes;
- ◀ **fourthly**, to pay all outstanding amounts (including break costs) due and payable by us under the Interest Rate Swap;
- ◀ **fifthly**, to pay all amounts of interest due but unpaid under the Notes;
- ◀ **sixthly**, to pay all amounts of principal outstanding under the Notes;
- ◀ **seventhly**, to pay the amount of any Accrued Principal Adjustment payable to the Seller in respect of the Notes;
- ◀ **eighthly**, to pay all amounts payable to the Guarantor in respect of any due but unpaid guarantee fee, repayment of Guarantor Advances made and reimbursement of amounts paid under the Guarantee on account of either an Income Shortfall or a Principal Shortfall, under the Trust Deed in respect of the Notes;
- ◀ **ninthly**, to pay any sums due or overdue from us as a primary liability to third parties under obligations incurred in the course of our business, other than amounts paid under the preceding paragraphs, as the Transaction Administrator (with the prior written consent of the Security Trustee) may specify as attributable to the Notes;
- ◀ **tenthly**, to pay any amounts payable to the Master Servicer under the Master Servicing Agreement, other than the servicing fee and the Excess Servicing Receipt;
- ◀ **eleventhly**, in or towards satisfaction of the Excess Servicing Receipt (if any) payable by us to the Master Servicer in respect of the Notes under the Master Servicing Agreement; and
- ◀ **twelfthly**, the surplus (if any) to us.

SECTION 9. THE GUARANTOR - THE HONG KONG MORTGAGE CORPORATION LIMITED

The following information on The Hong Kong Mortgage Corporation Limited has been provided as the HKMC is guaranteeing payment of both interest and principal on the Retail Notes.

The HKMC also has key roles in the management of the Bauhinia Mortgage-Backed Securitisation Programme. It is also Master Servicer of the Mortgage Pool.

THE HKMC'S BUSINESS

General Profile

The HKMC has been in business since 1997. Although it is wholly owned by the Hong Kong Government, none of the HKMC's obligations are guaranteed by the Hong Kong Government.

The HKMC's current corporate credit ratings are as below. As at the date of this Prospectus, they are the same as the credit ratings of the Hong Kong Government.

	Standard & Poor's		Moody's	
	Short-term	Long-term	Short-term	Long-term
Foreign currency (Outlook)	A-1 (stable)	A+ (stable)	P-1 (stable)	A1 (stable)
Local currency (Outlook)	A-1+ (stable)	AA- (stable)	P-1 (stable)	Aa3 (stable)

These ratings reflect only the views of the credit rating agencies. They are not recommendations to buy, sell or hold securities and are subject to change, update or withdrawal at any time.

Strategic mission

The HKMC's mission is to:

- ◀ promote the development of the secondary mortgage market in Hong Kong;
- ◀ improve banking and monetary stability;
- ◀ facilitate the development of the local debt market; and
- ◀ promote wider home ownership.

The HKMC's Directors take responsibility for this Prospectus

The HKMC's directors collectively and individually accept full responsibility for the truth and accuracy of the information contained in this Prospectus and confirm, having made all reasonable enquiries, that this Prospectus contains all information which is material to an investment in the Retail Notes. They confirm, having made all reasonable enquiries, that to the best of their knowledge and belief, there are no other facts the omission of which would make any statement in this Prospectus misleading in any material way.

Principal activities

The HKMC's major businesses are:

- ◀ buying mortgage loans secured by residential properties located in Hong Kong from banks, the Hong Kong Government, Government housing agencies and property developers;
- ◀ raising money to pay for the HKMC's purchases of mortgage loans through the issuance of debt securities in the capital markets;
- ◀ securitising mortgage portfolios by issuing mortgage-backed securities to investors; and
- ◀ providing mortgage insurance to banks to cover them against the risk of default by their borrowers.

The HKMC is a public sector entity

The HKMC is recognised as a "public sector entity" under the Banking Ordinance (Cap. 155) of the Laws of Hong Kong.

The HKMC is an authorized insurer

The HKMC has been approved by the Insurance Authority of Hong Kong as an "authorized insurer" under the Insurance Companies Ordinance (Cap. 41) of the Laws of Hong Kong.

Accordingly, its mortgage insurance business is subject to the regulatory requirements of the Insurance Companies Ordinance (Cap. 41) of the Laws of Hong Kong and the prudential supervision of the Insurance Authority.

Credit line from the Exchange Fund

The Exchange Fund through the Hong Kong Monetary Authority provides the HKMC with a HK\$10 billion credit line. This means the HKMC can borrow short-term funding of up to HK\$10 billion to allow the HKMC to bridge any time gap between the purchase of mortgage loans and the issuance of debt securities to raise the money to pay for those mortgages.

Shareholding Structure

The HKMC has an authorized share capital of HK\$3 billion, divided into 3 billion shares of HK\$1 each, of which HK\$2 billion has been subscribed and paid up. All of the issued shares are beneficially owned by the Financial Secretary of Hong Kong as Controller of the Exchange Fund.

Subsidiary

On 21 August 2002, the HKMC set up the HKMC Mortgage Management Limited as a wholly-owned subsidiary to assist in its business of acquiring and servicing mortgage loans. This subsidiary has an authorized capital of HK\$5 million of which HK\$1 million has been paid-up.

SECTION 9. THE GUARANTOR - THE HONG KONG MORTGAGE CORPORATION LIMITED

THE HKMC'S BOARD OF DIRECTORS AND SENIOR MANAGEMENT

The Chairman of the HKMC is The Financial Secretary of Hong Kong. The members of the HKMC's board of directors at the date of this Prospectus are:

Name and Business Address	Outside Interests	Interests in the HKMC's transactions - see the notes on page 50
Chairman and Executive Director		
The Honourable Henry TANG Ying Yen, GBS, JP 12th Floor, West Wing Central Government Offices Lower Albert Road, Hong Kong	Financial Secretary of Hong Kong	(1) (3) (8)
Deputy Chairman and Executive Director		
Joseph YAM Chi Kwong, GBS, JP 55th Floor Two International Finance Centre 8 Finance Street Central Hong Kong	Chief Executive of the Hong Kong Monetary Authority	(1) (3) (8)
Executive Directors		
Norman CHAN Tak Lam, SBS, JP 55th Floor Two International Finance Centre 8 Finance Street Central Hong Kong	Deputy Chief Executive of the Hong Kong Monetary Authority	(1) (3) (8)
Peter PANG Sing Tong, JP 55th Floor Two International Finance Centre 8 Finance Street Central Hong Kong	Deputy Chief Executive of the Hong Kong Monetary Authority	(1) (3) (8)
Directors		
Ronald Joseph ARCULLI, GBS, JP Room 2012 Hutchison House 10 Harcourt Road, Central Hong Kong	Managing Partner of Arculli and Associates Director of Sino Land Company Limited	(4)
Professor Andrew CHAN Chi Fai, Ph. D. 22nd Floor K. Wah Centre 191 Java Road North Point Hong Kong	Chairman of Consumer Council	

SECTION 9. THE GUARANTOR - THE HONG KONG MORTGAGE CORPORATION LIMITED

Name and Business Address	Outside Interests	Interests in the HKMC's transactions - see the notes on page 50
The Honourable Bernard Charnwut CHAN, JP 16th Floor, Worldwide House 19 Des Voeux Road Central Hong Kong	President of Asia Insurance Company, Limited Director of Asia Commercial Bank Limited	(5)
The Honourable CHAN Kam Lam, JP Room 523F, 5th Floor, West Wing Central Government Offices 11 Ice House Street Central Hong Kong	Legislative Councillor Member of The Hong Kong Housing Authority	(2)
Clifford Rowland FORSTER Suites 3901-04, 39th Floor Two Exchange Square Central Hong Kong	Regional Director of Lloyds TSB Bank plc.	
Anita FUNG Yuen Mei Level 16 1 Queen's Road Central Hong Kong	Treasurer, Co-Head of Global Markets, Asia Pacific of The Hongkong and Shanghai Banking Corporation Limited	(5) (6)
Andy HON Hak Keung 18th Floor, Standard Chartered Tower 388 Kwun Tong Road, Kwun Tong Hong Kong	General Manager, Mortgages & Auto, Consumer Banking of Standard Chartered Bank (Hong Kong) Limited	(5) (6)
Ambrose LAU Hon Chuen, GBS, JP 2nd Floor The Chinese General Chamber of Commerce Building 24-25 Connaught Road Central Hong Kong	Senior Partner of Chu & Lau, Solicitors & Notaries Director of Nanyang Commercial Bank, Limited Director of Wing Hang Bank, Ltd.	(5) (6)
Dr. the Honourable David LI Kwok Po, GBS, ILLD (Cantab), JP 22nd Floor, 10 Des Voeux Road Central, Hong Kong	Chairman and Chief Executive of The Bank of East Asia, Limited Director of Tricor Holdings Limited	(5) (6) (7)

Name and Business Address	Outside Interests	Interests in the HKMC's transactions - see the notes on page 50
The Honourable Frederick MA Si Hang, JP 8th Floor, West Wing Central Government Offices Lower Albert Road Hong Kong	Secretary for Financial Services and the Treasury Member of The Hong Kong Housing Authority	(1) (2)
The Honourable SIN Chung Kai Room 410, West Wing Central Government Offices, 11 Ice House Street, Central, Hong Kong	Legislative Councillor Member of The Hong Kong Housing Authority	(2) (5) (6)
The Honourable Michael SUEN Ming Yeung, GBS, JP 8th Floor, West Wing Central Government Offices Lower Albert Road Hong Kong	Secretary for Housing, Planning and Lands Member of The Hong Kong Housing Authority	(1) (2)
David SUN Tak Kei 15th Floor Hutchison House 10 Harcourt Road, Central Hong Kong	Chairman, Assurance & Advisory Business Services of Ernst & Young	

Directors' Interests in Transactions and Contracts

A number of the HKMC's directors have interests in the HKMC's contracts and transactions because of their positions and activities in the Government or in business. Interests which may be considered significant to the HKMC's business are noted as follows:

- (1) Up to 30 June 2004, the HKMC has purchased about HK\$20.3 billion of mortgage loans from the Government.
- (2) Up to 30 June 2004, the HKMC has purchased about HK\$20.6 billion of mortgage loans from The Hong Kong Housing Authority.
- (3) The HKMC is a member of CMU, which is run by the Hong Kong Monetary Authority. The Exchange Fund through the Hong Kong Monetary Authority provides the HKMC with a HK\$10 billion revolving credit facility.
- (4) Up to 30 June 2004, the HKMC has bought about HK\$767 million of mortgage loans from the Sino Land group.
- (5) Director of, or employed by, a financial institution or an organisation which participates in the HKMC's mortgage purchase programme or mortgage insurance programme.
- (6) Director of, or employed by, a financial institution which has participated as placing bank, underwriter or arranger/dealer in one or more of the HKMC's debt securities issues.
- (7) Tricor Holdings Limited is the ultimate holding company of Tengis Limited, the corporate services provider to the HKMC Funding Corporation (1) Limited.
- (8) On 21 April 2004, the HKMC entered into a lease for a period of 6 years commencing on 1 January 2005 with The Financial Secretary Incorporated under which The Financial Secretary Incorporated let to the HKMC Suite 7902 on 79th Floor and the whole of the 80th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. At the direction of The Financial Secretary Incorporated, the HKMC pays the rental to the Hong Kong Monetary Authority. The HKMC has an option to renew the lease for the office premises for a term of three years at the then prevailing open market rent upon expiration of the lease on 31 December 2010. Before expiry of the renewed term, the HKMC has a further option to renew the lease for a further period of three years at the then prevailing open market rent.

Senior Management of the HKMC

Members of the HKMC's senior management are:

Chief Executive Officer

Senior Vice President (Finance)

Senior Vice President (Operations)

General Counsel and Company Secretary

James Henry LAU Jr., JP

Philip LI Wing Kuen

Kenny FOK Tsz Chun

Susie CHEUNG Sau Fun

FURTHER INFORMATION ABOUT THE HKMC

Further Information

There has been no material adverse change in the HKMC's financial or trading position since 30 June 2004.

There is no litigation, nor are there any claims, of material importance pending or, to the HKMC's knowledge, threatened against the HKMC.

The HKMC is incorporated in Hong Kong as a public company with limited liability under the Companies Ordinance. Its company registration number is 596648.

No person has, or is entitled to, an option to subscribe for the HKMC's shares or debentures.

None of the HKMC's shares or debentures have been issued, nor has the HKMC agreed to issue any, as fully or partly paid up otherwise than in cash within the last three years.

Financial information about the HKMC

The HKMC publishes its audited annual report and accounts following the end of each of its financial years and it publishes its unaudited interim financial statements following the end of each of its semi-annual interim financial periods. The HKMC's financial year end is 31 December.

PricewaterhouseCoopers, independent accountants and the HKMC's auditors for the year ended 31 December 2003, have given and have not withdrawn their written consent to the inclusion in this Prospectus of their report dated 1 April 2004 (which relates to the HKMC's 2002 and 2003 financial statements) in the form and context in which it is included. Their report was not prepared exclusively for incorporation in this Prospectus.

As independent auditors of the HKMC, PricewaterhouseCoopers do not have any shareholding in the HKMC or any of its subsidiaries, nor do they have the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for any of its securities or any securities of its subsidiaries.

Financial Statements

The auditors' report and financial statements of the HKMC for the year ended 31 December 2003 and the unaudited interim financial statements for the six months ended 30 June 2004 are set out respectively in Appendices P-4 and P-5.

SECTION 9. THE GUARANTOR - THE HONG KONG MORTGAGE CORPORATION LIMITED

SUMMARY TABLE OF THE HKMC'S KEY BUSINESS INFORMATION (AS AT 31 JULY 2004, UNLESS OTHERWISE SPECIFIED)

THE HKMC'S RETAINED MORTGAGE PORTFOLIO PLUS MORTGAGE LOANS WHICH IT HAS GUARANTEED

Number of mortgage loans in its portfolio	96,965 [#]
Total outstanding principal balance	HK\$44,442 million [#]
Loan-to-Value ratio at origination	66.1%*
Debt-to-Income ratio at origination	39.0%*

* Figures exclude mortgage loans with co-financing arrangements and special arrangements and mortgage loans purchased from the Housing Authority, Housing Society, property developers and the Government

PERFORMANCE OF THE HKMC'S MORTGAGE PORTFOLIO

Combined delinquency (payments more than 90 days overdue) and charge-off ratio	0.67% [#]
Industry combined delinquency and rescheduled loan ratio	1.04%*

* Source: Hong Kong Monetary Authority

[#] Provisional

THE HKMC'S MORTGAGE INSURANCE PROGRAMME

Number of applications approved since inception	30,615
Total amount of mortgage loans covered (drawdown)	HK\$37,214 million
Total gross risk-in-force (at issue)	HK\$ 8,156 million

THE HKMC'S OUTSTANDING DEBT SECURITIES

	<u>HK\$'000</u>
Short-Term Liabilities	
HK\$ Short-Term Bank Loan	1,251,000
HK\$ Note Issuance Programme Notes due within 1 year	500,000
HK\$ Debt Issuance Programme Notes due within 1 year	6,891,000
HK\$ Over-the-Counter Retail Bond Issuance Notes due within 1 year	2,542,000
Long-Term Liabilities	
HK\$ Note Issuance Programme Notes due after 1 year	1,000,000
HK\$ Debt Issuance Programme Notes due after 1 year	24,486,000
HK\$ Retail Bond Issuance Programme Notes due after 1 year	1,698,550
HK\$ Over-the-Counter Retail Bond Issuance Notes due after 1 year	4,030,340
Total loan capital	42,398,890
Mortgage-backed securities guaranteed by the HKMC under	
Bauhinia MBS Programme	3,934,255
Guaranteed Mortgage-Backed Pass-Through Securitisation Programme	822,463

SECTION 9. THE GUARANTOR - THE HONG KONG MORTGAGE CORPORATION LIMITED

THE HKMC'S PROFITABILITY (FOR THE SIX MONTHS ENDED 30 JUNE 2004 AND THE YEAR ENDED 31 DECEMBER 2003)

	Unaudited 6 months ended 30 June 2004	Audited Year ended 31 December 2003
	HK\$'000	HK\$'000
Audited profit after tax	355,281	379,136
Return on average shareholder's equity	19.1%	11.5%

THE HKMC'S SHAREHOLDERS' EQUITY (AS AT 30 JUNE 2004 AND 31 DECEMBER 2003)

	Unaudited as at 30 June 2004	Audited as at 31 December 2003
	HK\$'000	HK\$'000
Share capital of 2,000,000,000 shares issued and fully paid (authorized 3,000,000,000 shares of HK\$1 each)	2,000,000	2,000,000
Retained profit and contingency reserves	1,853,197	1,497,916
Shareholders' equity	3,853,197	3,497,916
THE HKMC'S CAPITAL-TO-ASSETS RATIO	8.2%	7.7%

SECTION 10. GLOSSARY

Terms defined in this Glossary are to assist you in reading this Prospectus. For detailed definitions of terms used in Transaction Documents, see the Master Definitions Schedule.

Accrued Principal Adjustment	The amount equal to the difference between the aggregate reconciled outstanding principal balance of the Mortgage Pool as at the Settlement Cut-Off Date and the amount paid by us to the Seller on the Issue Date to acquire the Mortgage Pool.
Agent	Each of the Principal Paying and Transfer Agent, the paying and transfer agents and the registration and the reference agent appointed under the Agency Agreement.
Agency Agreement	The Agency Agreement entered into on 22 February 2002 between us, the Principal Paying and Transfer Agent, the Guarantor, the paying and transfer agents, the reference agent, the registrars, the Transaction Administrator and the Note Trustee.
Amortisation Amount	An amount equal to Hong Kong Dollars One Hundred Twelve Million and Five Hundred Thousand (HK\$112,500,000).
Amortisation Payment Date	The dates when principal is scheduled to be repaid on Class A-1 Professional Notes, which means each of 5 May 2009, 5 November 2009, 5 May 2010 and 5 November 2010.
Amortisation Period	The period from (but excluding) the Repayment Date of Retail Notes Class C up to (and including) the final Amortisation Payment Date of Class A-1 Professional Notes.
Application Amount	The total amount of Application Price and the handling fee.
Application Price	For a Retail Note, 102% of the Face Value.
Arranger	The Hongkong and Shanghai Banking Corporation Limited.
Available Principal Collections	Has the meaning set out in Section 4 (" <i>Determination of Available Principal Collections</i> ").
Bauhinia	Bauhinia MBS Limited.
Business Day	A day (excluding a Saturday, Sunday and any public holiday) on which banks are open in Hong Kong.
Cash Flow Allocation	The allocation of Collections as set out in Section 8.7 (" <i>Pre and post-enforcement cashflows</i> ").
Class	Each class of the Notes within Series 2004-2.
Collection Period	The period during which Collections are received by the Master Servicer. The first Collection Period commences on (and includes) the day after the Settlement Cut-Off Date and ends on (and includes) the last day of that calendar month. Every other Collection Period commences on the first day of the calendar month which is 3 months before the related Determination Date and ends on (and includes) the last day of that calendar month.
Collections	Amounts received by or on behalf of the Master Servicer in respect of the Series Assets as set out in Section 4 (" <i>Collections and cashflows</i> ").

SECTION 10. GLOSSARY

Deed of Charge	The Deed of Charge entered into on 22 February 2002 between us, the Security Trustee and the Note Trustee.
Deed of Joinder	The Deed of Joinder to be entered into on 5 November 2004 between a number of parties including us, the Security Trustee, the Note Trustee, the HKMC (as Guarantor, Seller, Master Servicer and Transaction Administrator) and the Principal Paying and Transfer Agent.
Deed Poll	The deed poll dated 22 February 2002 between us and the Guarantor.
Delegate Servicer	The person appointed by the Master Servicer as its delegate to perform some or all of its functions under the Master Servicing Agreement, which for this Series 2004-2 is The Hong Kong Housing Authority.
Determination Date	With respect to a Payment Date, the last Business Day of the calendar month immediately preceding such Payment Date. The first Determination Date will be 30 November 2004. In respect of the Retail Notes, the first Determination Date will be the last Business Day in April 2005.
Eligibility Criteria	The eligibility criteria relating to a Mortgage included in the Mortgage Pool and described in Section 8.6 (" <i>Mortgage eligibility criteria</i> ").
Eligible Investments	<p>Certain permitted investments (in Hong Kong Dollars) which have original maturities of no more than 185 days and which mature or are realised on or before one Business Day before the Repayment Dates (in respect of Retail Notes) or the Amortisation Payment Date (in respect of Class A-1 Professional Notes) which occurs immediately following the date the investment is made and are made with depository institutions or trust companies which either:</p> <ul style="list-style-type: none">◀ have a specified debt rating by an internationally recognised rating agency; or◀ are note-issuing banks within the meaning of the Legal Tender Notes Issue Ordinance (Cap.65) of the Laws of Hong Kong.
Excess Servicing Receipt	The amount to be obtained by the Master Servicer as described in Section 8.5 (" <i>Mortgage Servicing Agreement</i> ").
Events of Default	The events described in Section 8.1 (" <i>Terms and conditions of the Retail Notes</i> " - " <i>Events of Default</i> ").
Face Value	The face value (or principal amount to be repaid) of each Note. This is HK\$50,000 per Retail Note.
Government Grant	The conditions or government lease from the Hong Kong Government under which the property subject to a Mortgage is held and which is subject to certain terms and conditions.
Government Lease	A leasehold interest granted by the Hong Kong Government before 1 July 1997, that continues to be recognised and protected under the Joint Declaration and the Basic Law of Hong Kong.

SECTION 10. GLOSSARY

Guarantee	The guarantee under the Trust Deed by the HKMC of payment of principal and interest on the Notes.
Guarantor	The HKMC.
Guarantor Advance	An advance made by the Guarantor on account of a payment due under the Notes.
HIBOR	The inter-bank offered rate for deposits in Hong Kong Dollars for a relevant interest period as determined in the Terms and Conditions.
Home Loan Scheme	The home purchase loan scheme established by The Hong Kong Housing Authority.
Hong Kong	The Hong Kong Special Administrative Region of the People's Republic of China.
Hong Kong Dollars	The lawful currency of Hong Kong.
Housing Authority Mortgage	The Hong Kong Housing Authority's interest in each first-ranking registered mortgage over Hong Kong residential property created in favour of a Scheme Bank as the mortgagee (for itself and also as agent for The Hong Kong Housing Authority).
Income Shortfall	As set out in Section 4 (" <i>Collections and Cashflows</i> ").
Interest Payment Date	<p>For a Retail Note, means 5th of each May and November or if such day is not a Business Day, the next Business Day.</p> <p>For a Class A-1 Professional Note, means 5th of each February, May, August and November in each of the calendar years 2005 to 2010, commencing on 5 February 2005 or if such day is not a Business Day, the next Business Day.</p> <p>For a Class A-2 Professional Note, means 5th of each month or if such day is not a Business Day, the next Business Day.</p>
Interest Period	In respect of an Interest Payment Date and a Class of Notes, means the period commencing from (and including) the preceding Interest Payment Date for that Class of Notes up to (but excluding) that Interest Payment Date. The first Interest Period for a Class of Notes is the period from (and including) the Issue Date to (but excluding) the first Interest Payment Date for that Class of Notes. The last Interest Period for a Class of Notes is the period from (and including) the Interest Payment Date for that Class of Notes immediately preceding the date upon which the Notes are repaid in full to (but excluding) the date on which the Notes are repaid in full.
Interest Rate	The rate described in The Offer at a glance.
Interest Rate Swap	The swap agreement described in Section 4 (" <i>Collections and Cashflows</i> " - " <i>Floating Rate to Fixed Rate Payments</i> ").
Issue Date	The date of issue of the Retail Notes, which is expected to be 5 November 2004.
Issuer	Bauhinia MBS Limited.
Joint Underwriters	The Hongkong and Shanghai Banking Corporation Limited and Standard Chartered Bank (Hong Kong) Limited.

SECTION 10. GLOSSARY

Master Definitions Schedule	The Master Definitions Schedule entered into on 22 February 2002 between a number of parties including us, the Note Trustee, the Seller, the Master Servicer, the Guarantor, the Transaction Administrator and the Security Trustee.
Master Mortgage Sale and Purchase Agreement	The Master Mortgage Sale and Purchase Agreement entered into on 14 October 2004 between us, the Seller, the Transaction Administrator and the Security Trustee.
Master Servicer	For the Mortgage Pool, the HKMC.
Master Servicing Agreement	The Master Mortgage Servicing Agreement entered into on 14 October 2004 between us, the Master Servicer, the Transaction Administrator and the Security Trustee.
Mortgage	Each Housing Authority Mortgage (including each loan secured by the Housing Authority Mortgage, to the extent it relates to principal), the benefit of which is transferred to us by the Seller.
Mortgage Pool	The pool of Mortgages and Mortgage Related Rights acquired by us from the Seller.
Mortgage Related Rights	Each security granted to further secure a loan secured by a Mortgage, including any guarantee of the Mortgagor's obligations in connection with the Mortgage, each insurance policy and any other associated rights.
Mortgage Servicing Manual	The mortgage servicing manual of the Seller relating to the servicing of Mortgages.
Mortgagor	The mortgagor under a Mortgage.
Notes	Retail Notes and Professional Notes issued as part of this Series 2004-2.
Note Trustee	DB Trustees (Hong Kong) Limited.
Noteholder	Each Retail Noteholder and each Professional Noteholder.
Offer	The offer of Retail Notes under this Prospectus.
Offer Closing Date	29 October 2004 or such other date that is determined by us or the Arranger.
Offer Opening Date	20 October 2004 or such other date as nominated by us or the Arranger.
Payment Date	The 5th of each calendar month or if such day is not a Business Day, the next Business Day.
Payment Deed	The Payment Deed entered into on 14 October 2004 between a number of parties including us, the Security Trustee and the HKMC.
Perfection Trigger Event	Events specified in the Master Mortgage Sale and Purchase Agreement which allow us to terminate that agreement.
Placing Banks	The banks appointed by us as placing banks under the Retail Agreement.
Pool Criteria	The criteria for the Mortgage Pool as set out in Section 3 (<i>"The Guarantee and the Series Assets"</i>).
Price-fixing Date	The date which is three Business Days after the Offer Closing Date and on which the Subscription Price for each Class of Retail Notes is fixed.

SECTION 10. GLOSSARY

Principal Accumulation Account	The bank account of Bauhinia into which certain Available Principal Collections are deposited during the Principal Accumulation Period and the Amortisation Period.
Principal Accumulation Period	The period from the Issue Date up to (and including) the Repayment Date of Retail Notes Class C.
Principal Paying and Transfer Agent	Deutsche Bank AG, Hong Kong Branch.
Principal Shortfall	For a Repayment Date or Amortisation Payment Date, the amount described in Section 4 (" <i>Collections and cashflows</i> " - " <i>Determination of Available Principal Collections</i> ").
Professional Noteholder	The holder of Professional Notes.
Professional Notes	The secured limited recourse notes issued as part of this Series 2004-2 and designated Classes A-1 and A-2 Notes.
Programme Agreement	The agreement entered into on 19 December 2001 between us, the Guarantor, the Seller, Merrill Lynch International and the Dealers in relation to the issue of notes under our mortgage-backed securitisation programme.
Prospectus	This Prospectus relating to the issue of Retail Notes.
Relevant Account Holders	The Placing Banks which hold the Retail Notes for investors in their respective accounts with the CMU.
Repayment Date	For a Retail Note, the date that the Retail Note is due to be repaid as set out in The Offer at a glance.
Retail Agreement	The agreement entered into on 14 October 2004 between us, the Guarantor, the Seller, the Arranger, the Joint Underwriters and the Placing Banks relating to the issue of Retail Notes.
Retail Noteholder	Each holder of interests in a Retail Note.
Retail Notes	The secured limited recourse notes issued under this Prospectus as part of this Series 2004-2 and designated Classes A, B or C Notes.
Scheme Bank	A bank participating in The Hong Kong Housing Authority's Home Loan Scheme and which is named as mortgagee of a Mortgage.
Secured Property	The secured property under the Security.
Security	The security described in Section 8.4 (" <i>Security arrangements</i> ") to the extent it relates to this Series 2004-2.
Security Trustee	DB Trustees (Hong Kong) Limited.
Seller	The HKMC under the Master Mortgage Sale and Purchase Agreement.
Series	Each series of notes issued by us under the Trust Deed.
Series 2004-2	This Series of Notes.
Series 2004-2 Collection Account	The bank account of Bauhinia into which Collections are paid.

SECTION 10. GLOSSARY

Series 2004-2 Secured Party	The parties listed in the Deed of Joinder, including the Master Servicer, the Security Trustee, the Note Trustee, the Transaction Administrator, the Agents, the Guarantor, the Seller, the Noteholders and the Interest Rate Swap provider.
Series Assets	For this Series 2004-2, each of the assets described in Section 3 (<i>"The Guarantee and the Series Assets"</i> - <i>"Use of Proceeds and Series Assets"</i>).
Servicer Termination Event	Events specified in the Master Servicing Agreement which allow us to terminate the appointment of the Master Servicer, including events such as the insolvency of the Master Servicer.
SFC	The Securities and Futures Commission of Hong Kong.
Settlement Cut-Off Date	The close of business on 31 July 2004.
Subscription Price	For this Series 2004-2, the price fixed by us on the Price-fixing Date as the subscription price of the Retail Notes.
Terms and Conditions	The terms and conditions applying to the Retail Notes issued under this Series 2004-2.
the HKMC	The Hong Kong Mortgage Corporation Limited.
The Hong Kong Housing Authority	The Hong Kong Housing Authority, a body corporate established under Section 3 of the Housing Ordinance (Cap.283) of the Laws of Hong Kong.
Total Available Income	The aggregate amount described in Section 4 (<i>"Collections and cashflows"</i> - <i>"Determination of Total Available Income for this Series 2004-2"</i>).
Transaction Administration Agreement	The Transaction Administration Agreement entered into on 22 February 2002 between a number of parties including us, the Transaction Administrator, the Note Trustee and the Principal Paying and Transfer Agent.
Transaction Administrator	The HKMC.

SECTION 10. GLOSSARY

Transaction Documents	<ul style="list-style-type: none">(a) the Master Mortgage Sale and Purchase Agreement;(b) the Master Servicing Agreement;(c) the Agency Agreement;(d) the Transaction Administration Agreement;(e) the Trust Deed;(f) the agreement with Walkers SPV Limited for the provision of corporate services to us;(g) the Deed Poll;(h) the Deed of Charge;(i) the Notes;(j) the Deed of Joinder;(k) the series supplement (which includes the class supplements) relating to the Notes;(l) the offer notice relating to the Mortgages;(m) each acceptance notice relating to the Mortgages;(n) each transfer relating to the Security;(o) the Interest Rate Swap;(p) the power of attorney given by the Seller to us and the Security Trustee and the powers of attorney given by us and the Security Trustee in favour of the Seller; and(q) the Payment Deed.
Trust Deed	The Trust Deed entered into on 22 February 2002 between us, the Guarantor and the Note Trustee.
US person	Has the same meaning as in Regulation S of the United States Securities Act of 1933.
we, our, us	Bauhinia.

SECTION 11. PURCHASER CONFIRMATIONS

Under the SFC Code of Conduct, the Placing Banks, as entities licensed by or registered with the Securities and Futures Commission, are required to ensure that the suitability of the Retail Notes to a prospective investor is reasonable in all circumstances and that the prospective investor understands the nature and risk of investing in the Retail Notes. The Placing Banks have agreed to obtain the following confirmations from prospective investors in the Retail Notes at the time of giving application instructions for the Retail Notes, whether in person, by telephone or through the internet.

"In applying for the Retail Notes, you confirm to Bauhinia and to us that you:

- (i) understand that in respect of each Class of Retail Notes, the Subscription Price has not yet been set and will be set on the Price-fixing Date, as specified in the Prospectus;
- (ii) agree to accept the Retail Notes applied for, or any lesser number allotted to you;
- (iii) agree to pay in full the Subscription Price and the handling fee if the Subscription Price of the Retail Notes is set at more than the Application Price of the Retail Notes;
- (iv) understand that no certificates of title will be available for your Retail Notes and your interest in your Retail Notes is in book-entry form only;
- (v) agree that if you are not allotted any Retail Notes, or if the Subscription Price of any Class of Retail Notes which you have applied for is less than the Application Price of the Retail Notes or if your application is successful only in part or if the Retail Notes of the Class you have applied for are not issued for any reason, the whole or an appropriate portion of the Application Amount will be returned to you without interest and at your own risk and that all interest will be retained for the benefit of Bauhinia;
- (vi) understand that the Retail Notes will be held through the CMU, which means that you will have to rely on the Placing Bank selected by you to credit the account you hold with that Placing Bank with payments credited to it through the CMU, to distribute notices to you which it receives from Bauhinia through the CMU and to take any necessary enforcement action on your behalf;
- (vii) have received a copy of the Prospectus (in your preference of either the Chinese or English versions), have read and understood the Prospectus and have relied on no other information or material relating to the Retail Notes;
- (viii) understand and accept that Bauhinia and the Guarantor accept no responsibility for the provision of bank services (including internet and telephone banking) and custody services by the Placing Banks or for any consequences of, or arising from the use of, the bank account and investment account or custody services of any of the Placing Banks;
- (ix) confirm that you are not located within the United States or Canada and are not a resident of Canada or a U.S. Person within the meaning of Regulation S under the U.S. Securities Act of 1933, as amended, (which includes any person resident in the United States and any partnership or corporation organised or incorporated under the laws of the United States);
- (x) understand that you are deemed to have notice of the terms of the contractual documentation in respect of the issue of the Retail Notes, namely the Trust Deed, copies of which are available for inspection;
- (xi) understand that under the SFC Code of Conduct, the Placing Banks are required to ensure that the Retail Notes are a suitable investment for you and that you understand the nature and risks of investing in the Retail Notes."

APPENDIX P-1 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF BAUHINIA FOR THE YEAR ENDED 31 DECEMBER 2003

AUDITORS' REPORT TO THE SHAREHOLDERS OF BAUHINIA MBS LIMITED (INCORPORATED IN THE CAYMAN ISLANDS WITH LIMITED LIABILITY)

We have audited the financial statements of Bauhinia MBS Limited (the "Company") on pages 63 to 71, which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Hong Kong Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you, as a body, and for no other purpose. We do not assume responsibilities towards or accept liability to any other person for the content of this report.

BASIS OF OPINION

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company, 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 statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company as at 31 December 2003 and of its profit and cash flows for the year then ended.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong,
1 April 2004.

**APPENDIX P-1 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF BAUHINIA
FOR THE YEAR ENDED 31 DECEMBER 2003**

BAUHINIA MBS LIMITED

**PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2003**

	Notes	2003 HK\$'000	From 15 October 2001 (date of incorporation) to 31 December 2002 HK\$'000
Interest income		55,049	42,293
Interest expense		<u>(26,922)</u>	<u>(32,681)</u>
Net interest income		28,127	9,612
Other income, net	3	<u>416</u>	<u>1,043</u>
Operating income		28,543	10,655
Operating expenses	4	<u>(28,535)</u>	<u>(10,629)</u>
Profit before taxation		8	26
Taxation	5	<u>16</u>	<u>(23)</u>
Net profit for the year/period		<u>24</u>	<u>3</u>

**APPENDIX P-1 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF BAUHINIA
FOR THE YEAR ENDED 31 DECEMBER 2003**

BAUHINIA MBS LIMITED

**BALANCE SHEET
AS AT 31 DECEMBER 2003**

	Notes	2003 HK\$'000	2002 HK\$'000
ASSETS			
Interest and remittance receivables	6	134,129	50,437
Prepayments		2,611	32
Tax recoverable	5	5	—
Mortgage portfolio	7	4,119,519	1,642,613
		<u>4,256,264</u>	<u>1,693,082</u>
LIABILITIES			
Interest payable		1,750	2,571
Accounts payable and accrued expenses		30	21
Provisions for taxation	5	—	23
Mortgage-backed securities	8	4,254,449	1,690,456
		<u>4,256,229</u>	<u>1,693,071</u>
SHAREHOLDER'S EQUITY			
Share capital	9,10	8	8
Retained profits	10	27	3
		<u>35</u>	<u>11</u>
		<u>4,256,264</u>	<u>1,693,082</u>

John Henry CULLINANE
Director

Derrie Lynn BOGGESS
Director

**APPENDIX P-1 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF BAUHINIA
FOR THE YEAR ENDED 31 DECEMBER 2003**

BAUHINIA MBS LIMITED

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2003**

	Note	2003 HK\$'000	From 15 October 2001 (date of incorporation) to 31 December 2002 HK\$'000
Total equity as at 1 January 2003/15 October 2001	10	11	—
Issue of ordinary share capital	10	—	8
Net profit for the year/period	10	<u>24</u>	<u>3</u>
Total equity as at 31 December 2003/2002	10	<u><u>35</u></u>	<u><u>11</u></u>

BAUHINIA MBS LIMITED

**CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2003**

	Notes	2003	From 15 October 2001 (date of incorporation) to 31 December 2002
		HK\$'000	HK\$'000
Net cash outflow from operating activities	11	<u>(2,563,993)</u>	<u>(1,690,464)</u>
Financing			
Issue of ordinary share capital		—	8
Proceeds from issue of mortgage-backed securities		3,000,000	2,000,000
Repayment of mortgage-backed securities		<u>(436,007)</u>	<u>(309,544)</u>
Net cash inflow from financing		<u>2,563,993</u>	<u>1,690,464</u>
Decrease in cash and cash equivalents		—	—
Beginning cash and cash equivalents		—	—
Ending cash and cash equivalents		<u>—</u>	<u>—</u>

BAUHINIA MBS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1. Basis of preparation

The financial statements of Bauhinia MBS Limited (the "Company") have been prepared under the historical cost convention, and in accordance with the accounting principles generally accepted in Hong Kong.

2. Principal accounting policies

a. *Adoption of Statements of Standard Accounting Practice ("SSAPs")*

In the current year, the Company has adopted the following SSAPs issued by the Hong Kong Society of Accountants which are effective for accounting periods commencing on or after 1 January 2003:

SSAP 12:	Income taxes
SSAP 34 (revised):	Employee benefits

There were no material effects on net profit and opening balance of retained profits for the current year and prior year from the adoption of the above accounting standards.

b. *Income and expense recognition*

Provided it is probable that the economic benefits associated with a transaction will flow to the Company and the income and costs, if applicable, can be measured reliably, interest income, interest expense and others are recognised on the following bases:

(i) Interest income and expense

Interest income and expense are accrued on a time-apportioned basis on the principal outstanding and at the rate applicable.

(ii) Fee income and expense

Fee income and expense are recognised when earned or incurred.

c. *Foreign currencies*

The books and records are maintained in Hong Kong Dollars. Transactions in other currencies during the period are translated into Hong Kong Dollars at exchange rates prevailing in effect at the time of the transactions. Monetary assets and liabilities denominated in other currencies at the balance sheet date are translated into Hong Kong Dollars at rates of exchange in effect at the balance sheet date. Exchange differences are dealt with in the profit and loss account.

d. *Deferred taxation*

Deferred taxation is recognized in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred tax liabilities are recognized on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not be reversed in the foreseeable future.

In the prior year, deferred taxation was accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset was expected to be payable or recoverable in the foreseeable future. There were no material effects on net profit and opening balance of retained profits for the current year and prior year from the adoption of the new SSAP 12.

APPENDIX P-1 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF BAUHINIA FOR THE YEAR ENDED 31 DECEMBER 2003

e. *Cash and cash equivalents*

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including cash and balances with banks.

3. **Other income, net**

	2003	From 15 October 2001 (Date of incorporation) to 31 December 2002
	HK\$'000	HK\$'000
Early prepayment fees and late charges	805	1,181
Issuance costs of mortgage-backed securities	(389)	(138)
	<u>416</u>	<u>1,043</u>

4. **Operating expenses**

	2003	From 15 October 2001 (Date of incorporation) to 31 December 2002
	HK\$'000	HK\$'000
Auditors' remuneration	30	30
Guarantee fee	7,296	4,474
Master servicing fee	130	56
Excess servicing fee	20,417	5,830
Other operating expenses	662	239
	<u>28,535</u>	<u>10,629</u>

5. **Taxation**

(a) Taxation (credit)/charge in the profit and loss account represents:-

	2003	From 15 October 2001 (Date of incorporation) to 31 December 2002
	HK\$'000	HK\$'000
Hong Kong profits tax		
Provision for the year	1	23
Overprovision in respect of prior year	(17)	—
	<u>(16)</u>	<u>23</u>

APPENDIX P-1 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF BAUHINIA FOR THE YEAR ENDED 31 DECEMBER 2003

Hong Kong profits tax has been provided at the rate of 17.5% (2002: 16%) on the estimated assessable profit for the year. There was no significant unprovided deferred taxation as at 31 December 2003.

The taxation on the Company's profit before taxation differs from the theoretical amount that would arise using the taxation rate of Hong Kong as follows:

	2003	From 15 October 2001 (Date of incorporation) to 31 December 2002
	HK\$'000	HK\$'000
Profit before taxation	8	26
Calculated at a taxation rate of 17.5% (2002:16%)	1	4
Expenses not deductible for taxation purposes	—	19
Overprovision in prior years	(17)	—
	(16)	23

(b) (Tax recoverable)/Provision for taxation in the balance sheet represents:-

	2003	2002
	HK\$'000	HK\$'000
Hong Kong profits tax for the year	—	23
Tax recoverable for Hong Kong profits tax	(5)	—
	(5)	23

6. Interest and remittance receivables

	2003	2002
	HK\$'000	HK\$'000
Interest receivable from mortgage portfolio	17,165	5,999
Loan instalments, in transit	116,964	44,438
	134,129	50,437

7. Mortgage portfolio

	2003	2002
	HK\$'000	HK\$'000
Outstanding principal balance of mortgage portfolio	4,119,519	1,642,613

At 31 December 2003, the mortgage portfolio had a weighted average remaining term of 12 years on a contractual basis, without taking into account any prepayment of the mortgage loans. Final maturity of the mortgage portfolio is in the year 2031.

**APPENDIX P-1 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF BAUHINIA
FOR THE YEAR ENDED 31 DECEMBER 2003**

8. Mortgage-backed securities

	<u>2003</u>	<u>2002</u>
	HK\$'000	HK\$'000
Outstanding security principal balance of notes issued	<u>4,254,449</u>	<u>1,690,456</u>
At 1 January 2003/15 October 2001	1,690,456	—
Issuance for the year/period	3,000,000	2,000,000
Less: Redemption for the year/period	<u>(436,007)</u>	<u>(309,544)</u>
At the end of the year/period	<u>4,254,449</u>	<u>1,690,456</u>

The timely payment of principal and interest in respect of each series of the notes is unconditionally and irrevocably guaranteed by The Hong Kong Mortgage Corporation Limited.

9. Share capital

	<u>2003</u>	<u>2002</u>
	HK\$'000	HK\$'000
Authorized 50,000 ordinary shares of US\$1 each	<u>390</u>	<u>390</u>
Issued and fully paid 1,000 ordinary shares of US\$1 each	<u>8</u>	<u>8</u>

10. Reserves

	<u>Share Capital</u>	<u>Retained profits</u>	<u>Total</u>
	HK\$'000	HK\$'000	HK\$'000
Balance at 15 October 2001	—	—	—
Issue of ordinary share capital	8	—	8
Net profit for the period	<u>—</u>	<u>3</u>	<u>3</u>
Balance at 31 December 2002	8	3	11
Net profit for the year	<u>—</u>	<u>24</u>	<u>24</u>
Balance at 31 December 2003	<u>8</u>	<u>27</u>	<u>35</u>

APPENDIX P-1 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF BAUHINIA FOR THE YEAR ENDED 31 DECEMBER 2003

11. Notes to the cash flow statement

Reconciliation of profit before taxation to net cash outflow from operating activities:

	2003	From 15 October 2001 to 31 December 2002
	HK\$'000	HK\$'000
Profit before taxation	8	26
Purchase of mortgage loans	(3,000,000)	(2,000,000)
Proceeds from mortgage principal repayment	523,094	357,387
Increase in interest and remittance receivables	(83,692)	(50,437)
Increase in prepayments	(2,579)	(32)
(Decrease)/increase in interest payable	(821)	2,571
Increase in accounts payable and accrued expenses	9	21
Net cash outflow from operating activities before taxation	(2,563,981)	(1,690,464)
Hong Kong profits tax paid	(12)	—
Net cash outflow from operating activities	(2,563,993)	(1,690,464)

12. Related party transactions

Mr. David Egglisshaw, Mr. John Cullinane and Ms. Derrie Boggess are currently the directors of Walkers SPV Limited ("Walkers"). In December 2001, the Company entered into a Corporate Services Agreement with Walkers for provision of corporate secretarial and related services to the Company and the Directors may be deemed to be interested in the Corporate Services Agreement.

13. Approval of financial statements

The financial statements were approved by the Board of Directors on 1 April 2004.

**APPENDIX P-2 UNAUDITED INTERIM FINANCIAL STATEMENTS OF BAUHINIA
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

BAUHINIA MBS LIMITED

PROFIT AND LOSS ACCOUNT

	Notes	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
		HK\$'000	HK\$'000
Interest income		58,312	21,477
Interest expense		<u>(11,777)</u>	<u>(14,876)</u>
Net interest income		46,535	6,601
Other income, net	3	<u>486</u>	<u>257</u>
Operating income		47,021	6,858
Operating expenses	4	<u>(47,016)</u>	<u>(6,854)</u>
Profit before taxation		5	4
Taxation		<u>—</u>	<u>—</u>
Net profit for the period		<u><u>5</u></u>	<u><u>4</u></u>

**APPENDIX P-2 UNAUDITED INTERIM FINANCIAL STATEMENTS OF BAUHINIA
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

BAUHINIA MBS LIMITED

BALANCE SHEET

	Notes	Unaudited as at 30 June 2004 HK\$'000	Audited as at 31 December 2003 HK\$'000
ASSETS			
Interest and remittance receivables		220,316	134,129
Prepayments		2,082	2,611
Tax recoverable		5	5
Mortgage portfolio	5	<u>3,843,965</u>	<u>4,119,519</u>
		<u>4,066,368</u>	<u>4,256,264</u>
LIABILITIES			
Interest payable		1,690	1,750
Accounts payable and accrued expenses		18	30
Provisions for taxation		—	—
Mortgage-backed securities	6	<u>4,064,620</u>	<u>4,254,449</u>
		<u>4,066,328</u>	<u>4,256,229</u>
SHAREHOLDER'S EQUITY			
Share capital		8	8
Retained profits	7	<u>32</u>	<u>27</u>
		<u>40</u>	<u>35</u>
		<u>4,066,368</u>	<u>4,256,264</u>

**APPENDIX P-2 UNAUDITED INTERIM FINANCIAL STATEMENTS OF BAUHINIA
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

BAUHINIA MBS LIMITED

STATEMENT OF CHANGES IN EQUITY

	Notes	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
		HK\$'000	HK\$'000
Total equity at 1 January	7	35	11
Net profit for the period	7	<u>5</u>	<u>4</u>
Total equity at 30 June	7	<u><u>40</u></u>	<u><u>15</u></u>

**APPENDIX P-2 UNAUDITED INTERIM FINANCIAL STATEMENTS OF BAUHINIA
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

BAUHINIA MBS LIMITED

CASH FLOW STATEMENT

	Note	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
		HK\$'000	HK\$'000
Net cash inflow from operating activities	8	<u>189,829</u>	<u>179,075</u>
Financing			
Proceeds from issue of mortgage-backed securities		400,000	—
Repayment of mortgage-backed securities		<u>(589,829)</u>	<u>(179,075)</u>
Net cash outflow from financing		<u>(189,829)</u>	<u>(179,075)</u>
Decrease in cash and cash equivalents		—	—
Beginning cash and cash equivalents		<u>—</u>	<u>—</u>
Ending cash and cash equivalents		<u>—</u>	<u>—</u>
Analysis of the balance of cash and cash equivalents			
Cash and short-term funds		<u>—</u>	<u>—</u>

BAUHINIA MBS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1. Basis of Preparation

The financial statements of Bauhinia MBS Limited (the "Company") have been prepared under the historical cost convention, and in accordance with the accounting principles generally accepted in Hong Kong. The accounting policies and basis of preparation used in the preparation of these interim financial statements are consistent with those used in the annual financial statements for the year ended 31 December 2003.

2. Principal accounting policies

a. *Income and expense recognition*

Provided it is probable that the economic benefits associated with a transaction will flow to the Company and the income and costs, if applicable, can be measured reliably, interest income, interest expense and others are recognised on the following bases:

(i) Interest income and expense

Interest income and expense are accrued on a time-apportioned basis on the principal outstanding and at the rate applicable.

(ii) Fee income and expense

Fee income and expense are recognised when earned or incurred.

b. *Foreign currencies*

The books and records are maintained in Hong Kong Dollars. Transactions in other currencies during the period are translated into Hong Kong Dollars at exchange rates prevailing at the time of the transactions. Monetary assets and liabilities denominated in other currencies at the balance sheet date are translated into Hong Kong Dollars at rates of exchange prevailing at the balance sheet date. Exchange differences are dealt with in the profit and loss account.

c. *Deferred taxation*

Deferred taxation is recognised in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred tax liabilities are recognised on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not be reversed in the foreseeable future.

d. *Cash and cash equivalents*

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity.

**APPENDIX P-2 UNAUDITED INTERIM FINANCIAL STATEMENTS OF BAUHINIA
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

3. Other Income, net

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Early prepayment fees and late charges	597	425
Issuance costs of debt securities and MBS	<u>(111)</u>	<u>(168)</u>
	<u>486</u>	<u>257</u>

4. Operating expenses

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Auditors' remuneration	15	15
Guarantee fee	10,032	2,361
Master servicing fee	114	73
Excess servicing fee	36,848	4,404
Other operating expenses	<u>7</u>	<u>1</u>
	<u>47,016</u>	<u>6,854</u>

5. Mortgage portfolio

	Unaudited at 30 June 2004	Audited at 31 December 2003
	HK\$'000	HK\$'000
Outstanding principal balance of mortgage portfolio	<u>3,843,965</u>	<u>4,119,519</u>

At 30 June 2004, the mortgage portfolio had a weighted average remaining term of 11 years on a contractual basis, without taking into account any prepayment of the mortgage loans. Final maturity of the mortgage portfolio is in the year 2032.

6. Mortgage-backed securities

	Unaudited at 30 June 2004	Audited at 31 December 2003
	HK\$'000	HK\$'000
Outstanding security principal balance of notes issued	<u>4,064,620</u>	<u>4,254,449</u>

The timely payment of principal and interest in respect of each series of the notes is unconditionally and irrevocably guaranteed by The Hong Kong Mortgage Corporation Limited.

APPENDIX P-2 UNAUDITED INTERIM FINANCIAL STATEMENTS OF BAUHINIA FOR THE 6 MONTHS ENDED 30 JUNE 2004

7. Reserves

	Share capital	Retained profits	Total
	HK\$'000	HK\$'000	HK\$'000
Balance at 1 January 2003 (Audited)	8	3	11
Net profit for the year	—	24	24
Balance at 31 December 2003 (Audited)	8	27	35
Net profit for the period	—	5	5
Balance at 30 June 2004 (Unaudited)	<u>8</u>	<u>32</u>	<u>40</u>

8. Notes to the cash flow statement

Reconciliation of profit before taxation to net cash inflow from operating activities:

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Profit before taxation	5	4
Purchase of mortgage loans	(400,000)	—
Proceeds from mortgage principal repayment	675,554	181,193
Increase in interest and remittance receivables	(86,187)	(1,551)
Decrease in prepayments	529	24
Decrease in interest payable	(60)	(592)
Decrease in accounts payable and accrued expenses	(12)	(3)
Net cash inflow from operating activities	<u>189,829</u>	<u>179,075</u>

9. Related party transactions

The directors of the Company, Mr. David Egglshaw, Mr. John Cullinane and Ms. Derrie Boggess, are currently also directors of Walkers SPV Limited ("Walkers"). In December 2001, the Company entered into a Corporate Services Agreement with Walkers for the provision of corporate secretarial and related services to the Company. The Directors may be deemed to be interested in the above contract with the Company.

APPENDIX P-3 CAPITALISATION TABLE OF BAUHINIA

CAPITALISATION OF BAUHINIA

The following table sets out the unaudited capitalisation of Bauhinia MBS Limited as at 31 July 2004:

	<u>HK\$ '000</u>
Short-Term Liability	
Mortgage-backed securities	566,986
Long-Term Liability	
Mortgage-backed securities	<u>3,367,269</u>
Total Loan Capital	<u>3,934,255</u>
Shareholder's Equity	
Share capital 1,000 shares issued and fully paid (authorized 50,000 shares of "US\$1" each)	8
Retained profits	<u>34</u>
Shareholder's equity	<u>42</u>
Total Capitalisation	<u><u>3,934,297</u></u>

Note:

Save as disclosed herein, there has been no material change in the capitalisation of Bauhinia since 31 July 2004.

**AUDITORS' REPORT TO THE SHAREHOLDER OF
THE HONG KONG MORTGAGE CORPORATION LIMITED
(INCORPORATED IN HONG KONG WITH LIMITED LIABILITY)**

We have audited the financial statements on pages 81 to 107, which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Hong Kong Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibilities towards or accept liability to any other person for the content of this report.

BASIS OF OPINION

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, 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 statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2003 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong,
1 April 2004.

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

THE HONG KONG MORTGAGE CORPORATION LIMITED

**CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2003**

	Notes	2003	2002
		HK\$'000	HK\$'000 Restated
Interest income	3	1,006,846	908,495
Interest expense	4	<u>(385,427)</u>	<u>(477,539)</u>
Net interest income		621,419	430,956
Other income, net	5	<u>59,965</u>	<u>57,917</u>
Operating income		681,384	488,873
Operating expenses	6	<u>(120,304)</u>	<u>(113,330)</u>
Operating profit before provisions		561,080	375,543
Provisions for bad and doubtful loans	7	<u>(149,370)</u>	<u>(86,054)</u>
Operating profit		411,710	289,489
Net gain on disposal of investment in debt securities	8	<u>11,348</u>	<u>2,580</u>
Profit before taxation		423,058	292,069
Taxation	9(a)	<u>(43,922)</u>	<u>(24,722)</u>
Net profit for the year	11	<u>379,136</u>	<u>267,347</u>

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

THE HONG KONG MORTGAGE CORPORATION LIMITED

**CONSOLIDATED BALANCE SHEET
AS AT 31 DECEMBER 2003**

	Notes	2003 HK\$'000	2002 HK\$'000 Restated
ASSETS			
Cash and short-term funds	12, 20	2,219,346	212,863
Interest and remittance receivables	13	297,842	310,551
Prepayments, deposits and other assets	14	210,808	110,755
Deferred expense, net	15	26,646	21,876
Mortgage portfolio, net	16	34,581,747	28,257,727
Investment in debt securities	17, 20	3,535,525	3,244,520
Fixed assets	18	19,088	28,323
Deferred tax assets	9(b)	9,300	4,418
		<u>40,900,302</u>	<u>32,191,033</u>
LIABILITIES			
Interest payable	21	257,663	223,122
Accounts payable, accrued expenses and other liabilities	22	390,612	136,079
Tax payable	9(b)	17,778	18,608
Unearned premiums	10	106,043	79,444
Debt securities	20, 23	36,630,290	28,615,000
		<u>37,402,386</u>	<u>29,072,253</u>
SHAREHOLDER'S EQUITY			
Share capital	25	2,000,000	2,000,000
Retained profits	28	1,469,259	1,102,803
Contingency reserve	28	28,657	15,977
		<u>3,497,916</u>	<u>3,118,780</u>
		<u>40,900,302</u>	<u>32,191,033</u>

Yam Chi Kwong, Joseph
Deputy Chairman

Chan Tak Lam, Norman
Executive Director

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

THE HONG KONG MORTGAGE CORPORATION LIMITED

**BALANCE SHEET
AS AT 31 DECEMBER 2003**

	Notes	2003 HK\$'000	2002 HK\$'000 Restated
ASSETS			
Cash and short-term funds	12, 20	2,219,346	212,863
Interest and remittance receivables	13	297,842	310,551
Prepayments, deposits and other assets	14	210,808	110,755
Deferred expense, net	15	26,646	21,876
Mortgage portfolio, net	16	34,581,747	28,257,727
Investment in debt securities	17, 20	3,535,525	3,244,520
Investment in a subsidiary	19	33	30
Fixed assets	18	19,088	28,323
Deferred tax assets	9(b)	9,300	4,418
		40,900,335	32,191,063
LIABILITIES			
Interest payable	21	257,663	223,122
Accounts payable, accrued expenses and other liabilities	22	390,594	136,079
Tax payable	9(b)	17,778	18,608
Unearned premiums	10	106,043	79,444
Debt securities	20, 23	36,630,290	28,615,000
		37,402,368	29,072,253
SHAREHOLDER'S EQUITY			
Share capital	25	2,000,000	2,000,000
Retained profits	28	1,469,310	1,102,833
Contingency reserve	28	28,657	15,977
		3,497,967	3,118,810
		40,900,335	32,191,063

Yam Chi Kwong, Joseph
Deputy Chairman

Chan Tak Lam, Norman
Executive Director

THE HONG KONG MORTGAGE CORPORATION LIMITED

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2003**

	Notes	<u>2003</u>	<u>2002</u>
		HK\$'000	HK\$'000 Restated
Total equity as at 1 January, as previously reported	28	3,109,819	2,846,010
Effect of adopting SSAP 12	2(f)	<u>8,961</u>	<u>5,423</u>
Total equity as at 1 January, as restated		3,118,780	2,851,433
Net profit for the year	28	<u>379,136</u>	<u>267,347</u>
Total equity as at 31 December	28	<u>3,497,916</u>	<u>3,118,780</u>

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

THE HONG KONG MORTGAGE CORPORATION LIMITED

**CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2003**

	Notes	2003	2002
		HK\$'000	HK\$'000
Net cash outflow from operating activities	26	<u>(5,697,395)</u>	<u>(8,058,702)</u>
Investing activities			
Purchase of fixed assets		(5,660)	(10,799)
Purchase of investment in debt securities		(1,551,254)	(2,290,843)
Proceeds from redemption of investment in debt securities		<u>1,261,197</u>	<u>781,334</u>
Net cash outflow from investing activities		<u>(295,717)</u>	<u>(1,520,308)</u>
Net cash outflow before financing		<u>(5,993,112)</u>	<u>(9,579,010)</u>
Financing			
Proceeds from issue of debt securities		10,869,845	14,935,133
Redemption of debt securities		<u>(2,870,250)</u>	<u>(6,400,000)</u>
Net cash inflow from financing		<u>7,999,595</u>	<u>8,535,133</u>
Increase/(decrease) in cash and cash equivalents		2,006,483	(1,043,877)
Beginning cash and cash equivalents		<u>212,863</u>	<u>1,256,740</u>
Ending cash and cash equivalents		<u><u>2,219,346</u></u>	<u><u>212,863</u></u>
Analysis of the balance of cash and cash equivalents			
Cash and short-term funds	12	<u><u>2,219,346</u></u>	<u><u>212,863</u></u>

THE HONG KONG MORTGAGE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1. Basis of Preparation

The financial statements of The Hong Kong Mortgage Corporation Limited (the "Company") and its subsidiary, HKMC Mortgage Management Limited, (collectively the "Group") have been prepared under the historical cost convention, and in accordance with the provisions of the Hong Kong Companies Ordinance and accounting principles generally accepted in Hong Kong.

2. Principal accounting policies

a. *Consolidation*

The consolidated accounts include the accounts of the Company and its subsidiary made up to 31 December. A subsidiary, in accordance with the Hong Kong Companies Ordinance, is a company in which the Company, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or controls the compositions of the Board of Directors. In the Company's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

b. *Adoption of Statements of Standard Accounting Practice ("SSAPs")*

In the current year, the Group has adopted the following SSAPs issued by the Hong Kong Society of Accountants which are effective for accounting periods commencing on or after 1 January 2003:

SSAP 12:	Income taxes
SSAP 34 (revised):	Employee benefits

The effects of adopting the new SSAP 12 has been shown on the respective notes to the accounts. There were no material effects on net profit and opening balance of retained profit for the current year and prior year from the adoption of SSAP 34.

c. *Income and expense recognition*

Provided it is probable that the economic benefits associated with a transaction will flow to the Group and the income and costs, if applicable, can be measured reliably, interest income, interest expense and others are recognised on the following bases:

(i) Interest income and expense

Interest income and expense are accrued on a time-apportioned basis on the principal outstanding and at the rate applicable, except in case of bad and doubtful loans (Note 2(h)).

(ii) Fee income and expense

Fee income and expense are recognised when earned or incurred.

d. *Fixed assets and depreciation*

Fixed assets are stated at cost less accumulated depreciation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the fixed assets have been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the profit and loss account in the year in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of fixed assets, the expenditure is capitalized as an additional cost of the fixed asset.

Depreciation is calculated on a straight-line basis at annual rates estimated to write off the cost of each asset over its expected useful life.

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

The annual rates are as follows:

Leasehold improvements	over the unexpired period of the lease
Furniture and fixtures	over the unexpired period of the lease
Computer and related software	33-1/3%
Office equipment	33-1/3%
Motor vehicle	25%

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that furniture and equipment and other fixed assets are impaired. If any such indication exists, the recoverable amount of the assets is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account.

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant assets, and is recognised in the profit and loss account.

e. *Foreign currencies*

The books and records are maintained in Hong Kong Dollars. Transactions in other currencies during the year are translated into Hong Kong Dollars at exchange rates prevailing in effect at the time of the transactions. Monetary assets and liabilities denominated in other currencies at the balance sheet date are translated into Hong Kong Dollars at rates of exchange in effect at the balance sheet date. Exchange differences are dealt with in the profit and loss account.

f. *Deferred taxation*

Deferred taxation is recognized in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred tax liabilities are recognized on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not be reversed in the foreseeable future.

In the prior year, deferred taxation was accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset was expected to be payable or recoverable in the foreseeable future. The adoption of the new SSAP 12 represents a change in accounting policy, which has been applied retrospectively so that the comparatives presented have been restated to conform to the changed policy.

As detailed in note 28 to the accounts, opening retained earnings at 1st January 2002 and 2003 have been increased by HK\$5,423,000 and HK\$8,961,000 respectively, which represent the unrecognized net deferred tax assets. This change has resulted in an increase in deferred tax assets as at 31st December 2001 and 31st December 2002 by HK\$5,423,000 and HK\$8,961,000 respectively. The profit for the year ended 31st December 2002 has been increased by HK\$3,538,000.

g. *Operating leases*

Leases where substantially all the rewards and risks of ownership remain with the leasing Company are accounted for as operating leases. Rental payments under operating leases are charged to the profit and loss account on a straight-line basis over the period of the relevant leases. Lease income from operating sub-leases is recognised on a straight-line basis over the lease term.

h. *Bad and doubtful loans*

Provisions for bad and doubtful loans are charged to the profit and loss account on a monthly basis in accordance with the guidelines approved by the Board of Directors. General provision relates to exposures not separately identified but known from experience to exist in the mortgage portfolio. Specific provision for bad and doubtful loans generally applies to a mortgage loan that is overdue for more than 90 days and the current market value of the underlying property is less than the outstanding principal balance ("OPB") of the mortgage loan. When there is no longer any realistic prospect of recovery of the OPB of the mortgage loan, it will be written off at the discretion of the Credit Committee.

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

The accrual of interest on mortgage loans is discontinued when they become overdue for 90 days or more. Any previously accrued and uncollected interests on the loans are reversed against current period's interest income. Interest income on the overdue loans is only recognised when all arrears of principal and interest from the borrowers have been cleared and it is probable that the customer is capable of fully servicing his obligations under the terms of the loans for the foreseeable future.

i. *Repossessed assets*

Assets acquired by repossession of collateral for realization are reclassified from "Mortgage portfolio, net" to "Other receivables, net" which are written down to forced sale value of the repossessed properties by setting off related specific provisions against the OPB of the mortgage loans.

j. *Investment in debt securities*

Held-to-maturity investments are investments which the Group has the expressed intention and ability to hold to maturity. They are carried at amortized cost less any provision for impairment in value.

The carrying amounts of held-to-maturity securities are reviewed at each balance sheet date to assess the credit risk and whether the carrying amounts are expected to be recovered. Provisions are made when the carrying amounts are not expected to be recovered and are recognised as an expense in the profit and loss account.

Provision against the carrying value of held-to-maturity securities are reversed to the profit and loss account when the circumstances and events that led to the write-downs or write-offs cease to exist and there is persuasive evidence that the new circumstances and events will persist in the foreseeable future.

Upon disposal or transfer of held-to-maturity securities, any profit and loss thereon is accounted for in the profit and loss account.

k. *Notes issuance*

The notes issued under the Note Issuance Programme ("NIP"), the notes and Transferable Loan Certificates ("TLC") issued under the Debt Issuance Programme ("DIP") and the notes offered to retail investors through the placing banks are stated at par value under debt securities in the balance sheet. Interest on the notes is accrued on a daily basis and charged to the profit and loss account. Discount on the notes is regarded as deferred expense whereas premium is accounted for as deferred income. Discount and premium are amortized over the entire life of the notes on an effective interest rate method and are accounted for as adjustment to the interest expense of the notes. The arranger and custodian fees paid under the NIP and DIP are amortized to the profit and loss account over the life of the notes issued.

On redemption/repurchase of the notes, the resulting gains or losses, being the difference between the redemption/repurchase amount and the carrying amount, are recognised in the profit and loss account in the year in which the redemption/repurchase takes place.

l. *Interest rate swap ("IRS") contracts for hedging purposes*

The IRS contracts are solely entered into as a hedge against interest rate risk on the assets and liabilities.

The net interest payable or receivable arising from the IRS contracts is recorded on an accrual basis and charged against interest income or interest expenses of the underlying assets and liabilities.

Gains and losses on early termination of the IRS contracts are immediately recognised in the profit and loss account when the underlying assets or liabilities are early disposed of or redeemed.

Gains and losses on early termination of the IRS contracts originally accounted for as a hedge to an asset or a liability are amortized over the remaining original life of the IRS contracts when the underlying asset and liability is not early disposed of or redeemed.

m. *Mortgage guarantee business*

The mortgage guarantee business of the Company is accounted for on the annual accounting basis. Under the annual accounting approach, the Company makes provisions based on credible estimates of future income and outgoings to determine the underwriting result for the current accounting period. The underwriting result includes any adjustments arising from the correction of the previous estimates.

Gross premiums represent direct business written through the Authorized Institutions during an accounting period. The gross premiums include the reinsurance premiums to be paid to the approved reinsurers for reinsurance cover. The net premiums received by the Company comprise the risk premiums and servicing fees earned by the Company. The net premiums are recognized as income on a time-apportioned basis when the insurance coverage has been effective.

Unearned premiums represent that portion of net premiums written which are estimated to relate to risks and services subsequent to the balance sheet date.

Provisions are made for outstanding claims, claims incurred but not reported and loss reserve at the end of each year. For risk sharing business, 50% of the net risk premiums earned is set aside as a Contingency Reserve for a reasonable period of time in accordance with relevant regulatory guidelines and considered by directors as appropriate.

n. *Guaranteed mortgage-backed pass-through securitization*

Upon completion of the sale of a mortgage pool to a third party Special Purpose Company ("SPC") under the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme ("MBS Pass-Through Programme") and the US\$3 Billion Mortgage-Backed Securitization Programme ("Bauhinia MBS Programme"), the Company derecognizes the applicable mortgage pool from its balance sheet; recognizes all assets obtained and liabilities incurred in consideration as proceeds of the sale, including cash and contingent liability in respect of the guarantee on timely payment of principal and interest on the MBS; and recognizes in the profit and loss account any gain or loss on the sale.

Where the Company guarantees the collectibility of the mortgage pool, it recognizes a monthly guarantee fee income from the SPC in the profit and loss account on a time-apportioned basis. Since the Company assumes all credit risks arising from the mortgage loans under the MBS Pass-Through Programme and the Bauhinia MBS Programme, it adheres to the loan provisioning guidelines in Note 2(h) approved by the Board of Directors for making necessary provisions in the profit and loss account.

o. *Employee benefits*

(i) *Employee leave entitlements*

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave and long-service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave, maternity or paternity leave are recognised when the absence occurs.

(ii) *Bonus plans*

Liabilities for bonus plans due wholly within twelve months after the balance sheet date are recognised when the Company has a present or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

(iii) *Pension obligations*

The Company offers a mandatory provident fund scheme and a defined contribution scheme, the assets of which are generally held in separate trustee — administered funds. These pension plans are generally funded by payments from employees and by the Company.

The Company's contributions to the mandatory provident fund scheme and defined contribution scheme are expensed as incurred and are reduced by the portion of employer contributions forfeited by those employees who leave the scheme prior to full vesting of the employer contributions.

p. *Contingent liabilities and contingent assets*

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that an outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognised but are disclosed in the notes to the accounts when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognised.

q. *Cash and cash equivalents*

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including cash, balances with banks and other financial institutions, treasury bills, other eligible bills and certificates of deposit.

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

3. Interest income

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Mortgage portfolio	826,459	771,720
Cash and short-term funds	33,851	39,939
Investment in debt securities – listed	51,982	22,838
Investment in debt securities – unlisted	94,554	73,998
	<u>1,006,846</u>	<u>908,495</u>

4. Interest expense

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Bank loans and debt securities wholly repayable within 5 years	375,121	474,842
Debt securities not wholly repayable within 5 years	10,306	2,697
	<u>385,427</u>	<u>477,539</u>

5. Other income, net

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Early prepayment fees and late charges	2,499	3,497
Subletting income of office premises	230	2,760
Net insurance premiums earned (Note 10)	38,277	32,931
Guarantee fee income on MBS	10,635	7,676
Excess servicing receipts on MBS	20,352	6,122
Issuance costs of debt securities and MBS	(4,477)	(3,604)
Others	(7,551)	8,535
	<u>59,965</u>	<u>57,917</u>

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

6. Operating expenses

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Staff costs		
Salaries and benefits	64,584	61,493
Pension costs — defined contribution scheme	3,501	2,867
Premises		
Rental	11,008	11,001
Others	6,535	3,348
Directors' emoluments	—	—
Depreciation	14,895	14,534
Consultancy fees	4,142	7,227
Auditors' remuneration	311	230
Other operating expenses	15,328	12,630
	<u>120,304</u>	<u>113,330</u>

7. Provisions for bad and doubtful loans

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Provisions against mortgage portfolio		
— specific	131,164	63,945
— general	18,206	22,109
	<u>149,370</u>	<u>86,054</u>

8. Net gain on disposal of investment in debt securities

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Net gain on disposal of investment in debt securities	<u>11,348</u>	<u>2,580</u>

During the year, investment in debt securities classified as held-to-maturity amounting to HK\$364,754,000 (2002: HK\$300,000,000) was sold due to the deterioration in the credit ratings of the issuer.

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

9. Taxation

(a) Taxation charge in the profit and loss account represents:

	The Group	
	2003	2002
	HK\$'000	HK\$'000 Restated
Hong Kong profits tax		
Provision for the year	49,637	29,448
Overprovision in respect of prior years	(833)	(849)
	48,804	28,599
Deferred taxation	(4,882)	(3,877)
	43,922	24,722

Hong Kong profits tax has been provided at the rate of 17.5% (2002: 16%) on the estimated assessable profit for the year. In 2003, the Government enacted a change in the profits tax rate from 16% to 17.5% for the fiscal year 2003/2004. Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 17.5% (2002: 16%).

The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the taxation rate of Hong Kong as follows:

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Profit before taxation	423,058	292,069
Calculated at a taxation rate of 17.5% (2002: 16%)	74,035	46,731
Income not subject to taxation	(29,036)	(21,372)
Expenses not deductible for taxation purposes	170	212
Increase in opening net deferred tax assets resulting from		
an increase in tax rates	(414)	—
Overprovision in prior years	(833)	(849)
Taxation charge	43,922	24,722

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

(b) Provisions for taxation in the balance sheet represents:

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Hong Kong profits tax	17,778	18,608
Deferred tax assets	(9,300)	(4,418)
	8,478	14,190

There is no significant unprovided deferred taxation as at and for the year ended 31 December 2003. The major components of deferred tax assets and liabilities recorded in the consolidated balance sheet, and the movements in 2003 showing the impact of the adoption of SSAP 12, are as follows:

	The Group and the Company		
	Accelerated tax depreciation	Provisions	Total
	HK\$'000	HK\$'000	HK\$'000
As at 1 January 2003, as previously reported	4,543	—	4,543
Effect of adoption of SSAP 12	—	(8,961)	(8,961)
As at 1 January 2003, as restated	4,543	(8,961)	(4,418)
Credited to profit and loss account	(856)	(4,026)	(4,882)
As at 31 December 2003	3,687	(12,987)	(9,300)

	The Group and the Company		
	Accelerated tax depreciation	Provisions	Total
	HK\$'000	HK\$'000	HK\$'000
As at 1 January 2002, as previously reported	4,882	—	4,882
Effect of adoption of SSAP 12	—	(5,423)	(5,423)
As at 1 January 2002, as restated	4,882	(5,423)	(541)
Credited to profit and loss account	(339)	(3,538)	(3,877)
As at 31 December 2002	4,543	(8,961)	(4,418)

The amounts shown in the balance sheet include deferred tax assets of HK\$12,987,000 (2002: HK\$ 8,961,000) to be recovered after more than twelve months.

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

10. Revenue account for mortgage guarantee business

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Gross premiums written	194,339	158,025
Reinsurance premiums	<u>(127,225)</u>	<u>(104,041)</u>
Net premiums written	<u>67,114</u>	<u>53,984</u>
Add: unearned premiums brought forward	79,444	60,301
unearned premiums carried forward	<u>(106,043)</u>	<u>(79,444)</u>
Increase in unearned premiums	<u>(26,599)</u>	<u>(19,143)</u>
Net premiums earned before provision	40,515	34,841
Provisions for outstanding claims and loss reserve (Note 24)	<u>(2,238)</u>	<u>(1,910)</u>
Net premiums earned (Note 5)	38,277	32,931
Management expenses	<u>(3,494)</u>	<u>(3,287)</u>
Underwriting gains	<u><u>34,783</u></u>	<u><u>29,644</u></u>

The management expenses formed part of the operating expenses in Note 6.

11. Net profit for the year

The net profit for the year is dealt with in the accounts of the Company to the extent of HK\$379,157,000 (2002: HK\$267,377,000 as restated).

12. Cash and short-term funds

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Cash at banks	2,351	1,042
Time deposits with banks	<u>2,216,995</u>	<u>211,821</u>
	<u><u>2,219,346</u></u>	<u><u>212,863</u></u>

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

13. Interest and remittance receivables

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Interest receivable from mortgage portfolio	44,391	50,753
Interest receivable from interest rate swap contracts	254,024	200,741
Interest receivable from investment in debt securities	44,607	36,559
Interest receivable from time deposits with banks	102	63
Loan instalments, in transit	(45,282)	22,435
	297,842	310,551

14. Prepayments, deposits, and other assets

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Office rental deposit	2,293	2,293
Corporate club debentures	670	670
Other receivables, net	159,732	78,245
Others	48,113	29,547
	210,808	110,755

The Group reclassified mortgage loans from "Mortgage portfolio, net" (Note 16(a)) to "Other receivables, net" when the mortgage loans were overdue for 180 days or more, or the collateral properties were repossessed, or the mortgagors became bankrupt. The net amount represented the forced sale value of the collateral properties after setting off specific provisions of HK\$107,707,000 (2002: HK\$53,022,000) and general provisions of HK\$236,000 (2002: HK\$59,000) against the outstanding principal balance of the mortgage loans of HK\$267,675,000 (2002: HK\$131,326,000).

As at 31 December 2003, the forced sale value of the repossessed properties under "other receivables, net" amounted to HK\$54,079,000 (2002: HK\$32,067,000).

15. Deferred expense, net

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Deferred expenses/(income) arising on issuance of debt securities		
At 1 January	21,876	38,273
Additions for the year		
— deferred expenses	16,000	40,273
— deferred income	(305)	(18,956)
Less: amortization	(10,925)	(37,714)
	26,646	21,876

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

16. Mortgage portfolio, net

(a) *Mortgage portfolio less provisions*

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Outstanding principal balance of mortgage portfolio (Note 20)	34,664,075	28,318,693
Provisions for bad and doubtful loans		
— specific	(13,863)	(9,335)
— general	(68,465)	(51,631)
	34,581,747	28,257,727

At 31 December 2003, the mortgage portfolio had a weighted average remaining term of 11 years on a contractual basis, without taking into account any prepayment of the mortgage loans. Final maturity of the mortgage portfolio is in the year 2038.

(b) *Provisions for bad and doubtful loans*

	The Group and the Company			
	Specific	General	Total	Suspended Interest
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2003	9,335	55,944	65,279	3,563
Amounts written off	(125,179)	(177)	(125,356)	(6,792)
Charge to profit & loss account	131,164	18,206	149,370	—
Interest suspended during the year	—	—	—	8,191
Suspended interest recovered	—	—	—	(1,363)
	15,320	73,973	89,293	3,599

	The Group and the Company			
	Specific	General	Total	Suspended Interest
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2002	2,002	33,894	35,896	4,214
Amounts written off	(56,612)	(59)	(56,671)	(4,500)
Charge to profit & loss account	63,945	22,109	86,054	—
Interest suspended during the year	—	—	—	4,841
Suspended interest recovered	—	—	—	(992)
	9,335	55,944	65,279	3,563

As regards the loan provisioning on the guaranteed mortgage loans under the two MBS programmes, a sum of HK\$1,457,000 specific provision (2002: Nil) and HK\$5,508,000 general provision (2002: HK\$4,313,000) was grouped under "Other provisions" (Note 22).

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

(c) The total mortgage loans on which interest has been placed in suspense or has ceased to accrue are as follows:

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Gross mortgage loans	149,480	88,644
Specific provisions	(11,619)	(8,668)
	137,861	79,976

Specific provisions were made after taking into account the current market value of the collateral of the delinquent loans.

17. Investment in debt securities

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Investment in debt securities		
Listed in Hong Kong	76,835	—
Listed outside Hong Kong	1,047,297	1,047,040
Unlisted	2,411,393	2,197,480
	3,535,525	3,244,520
Market value of listed securities	1,147,555	1,104,215

The investment in debt securities included above are issued by:

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Banks and other financial institutions	2,324,688	2,362,022
Corporate entities	1,196,296	850,949
Others	14,541	31,549
	3,535,525	3,244,520

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

18. Fixed assets

	The Group and the Company					Total
	Leasehold improvements	Furniture and fixtures	Computers & related software	Office equipment	Motor vehicle	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	
Cost						
As at 1 January 2003	11,415	1,783	70,115	2,471	539	86,323
Additions	13	—	5,617	30	—	5,660
Disposal/write-offs	—	—	(767)	—	—	(767)
As at 31 December 2003	11,428	1,783	74,965	2,501	539	91,216
Accumulated depreciation						
As at 1 January 2003	8,383	1,346	45,831	1,901	539	58,000
Charge for the year	1,521	219	12,886	269	—	14,895
Disposal/write-offs	—	—	(767)	—	—	(767)
As at 31 December 2003	9,904	1,565	57,950	2,170	539	72,128
Net book value						
Ending balance as at 31 December 2003	1,524	218	17,015	331	—	19,088
Ending balance as at 31 December 2002	3,032	437	24,284	570	—	28,323

19. Investment in a subsidiary

	The Company	
	2003	2002
	HK\$'000	HK\$'000
Unlisted shares, at cost	1,000	1,000
Due to a subsidiary	(967)	(970)
	33	30

The amount due to a subsidiary is unsecured, interest free and has no fixed term of repayment.

The details of the subsidiary at 31 December 2003 are:

Name	Place of Incorporation	Principal activities	Nominal value of issued capital	Class of shares held	% of ordinary shares directly held
HKMC Mortgage Management Limited	Hong Kong	Mortgage purchases	HK\$1,000,000 of HK\$1 each	Ordinary	100%

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

20. Maturity profile

The Group and the Company						
2003						
Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets						
– Cash and short-term funds	2,219,346	–	–	–	–	2,219,346
– Mortgage portfolio	16,998	1,013,684	2,614,389	12,649,959	18,361,232	34,664,075
– Investment in debt securities	–	269,000	850,000	1,650,718	765,807	3,535,525
	<u>2,236,344</u>	<u>1,282,684</u>	<u>3,464,389</u>	<u>14,300,677</u>	<u>19,127,039</u>	<u>40,418,946</u>
Liabilities						
– Debt securities	–	3,855,400	5,678,650	24,634,640	2,461,600	36,630,290

The Group and the Company						
2002						
Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets						
– Cash and short-term funds	212,863	–	–	–	–	212,863
– Mortgage portfolio	13,509	707,390	1,607,070	9,071,777	16,912,400	28,318,693
– Investment in debt securities	–	454,235	386,359	1,926,145	477,781	3,244,520
	<u>226,372</u>	<u>1,161,625</u>	<u>1,993,429</u>	<u>10,997,922</u>	<u>17,390,181</u>	<u>31,776,076</u>
Liabilities						
– Debt securities	–	130,000	3,127,550	25,257,450	100,000	28,615,000

21. Interest payable

The Group and the Company	
2003	2002
HK\$'000	HK\$'000
Debt securities	
<u>257,663</u>	<u>223,122</u>

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

22. Accounts payable, accrued expenses and other liabilities

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Accounts payable and accrued expenses	376,320	127,015
Other provisions (Note 29)	<u>14,292</u>	<u>9,064</u>
	<u><u>390,612</u></u>	<u><u>136,079</u></u>

	The Company	
	2003	2002
	HK\$'000	HK\$'000
Accounts payable and accrued expenses	376,320	127,015
Other provisions (Note 29)	<u>14,274</u>	<u>9,064</u>
	<u><u>390,594</u></u>	<u><u>136,079</u></u>

23. Debt securities

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
NIP notes	4,000,000	5,000,000
DIP		
(i) notes	22,441,000	17,491,000
(ii) TLC	3,500,000	—
Other notes	<u>6,689,290</u>	<u>6,124,000</u>
	<u><u>36,630,290</u></u>	<u><u>28,615,000</u></u>
At 1 January	28,615,000	20,058,550
Issuance for the year	10,885,540	14,956,450
Less: Redemption for the year	<u>(2,870,250)</u>	<u>(6,400,000)</u>
At the end of the year	<u><u>36,630,290</u></u>	<u><u>28,615,000</u></u>

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

Notes and TLC issued during the year comprise:

	The Group and the Company			Other notes
	NIP	DIP		
	HK\$'000	notes HK\$'000	TLC HK\$'000	
Amount issued	<u>—</u>	<u>6,050,000</u>	<u>3,500,000</u>	<u>1,335,540</u>
Consideration received	<u>—</u>	<u>6,049,980</u>	<u>3,500,000</u>	<u>1,319,865</u>

All the debt securities issued are unsecured obligations of the Group, and are issued for the purposes of providing general working capital and refinancing.

24. Provisions for mortgage guarantee business

Provisions for outstanding claims under the MIP are recorded net of recoveries from the approved reinsurers. For the year ended 31 December 2003, provisions for loss reserve of HK\$888,000 (2002: HK\$403,000) for risk sharing business was charged to profit and loss account of the Group and the gross claim was HK\$8,176,000 (2002: HK\$9,295,000), of which HK\$6,826,000 (2002: HK\$7,788,000) was recovered from the approved reinsurers.

25. Share capital

	2003 & 2002
	HK\$'000
Authorized	
3 billion ordinary shares of HK\$1 each	<u>3,000,000</u>
Issued and fully paid	
2 billion ordinary shares of HK\$1 each	<u>2,000,000</u>

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

26. Note to the consolidated cash flow statement

Reconciliation of profit before taxation to net cash outflow from operating activities:

	The Group	
	2003	2002
	HK\$'000	HK\$'000
Profit before taxation	423,058	292,069
Depreciation	14,895	14,534
Amortization of deferred expenses	10,925	37,714
Provisions for bad and doubtful loans	149,370	86,054
Mortgage portfolio written off net of recoveries	(125,356)	(56,671)
Amortization of investment in debt securities	5,319	3,835
Net gain on disposal of investment in debt securities	(11,348)	(2,580)
	<u>466,863</u>	<u>374,955</u>
Operating cash inflow before changes in operating assets and liabilities	466,863	374,955
Decrease in interest and remittance receivables	12,709	26,625
Increase in prepayments, deposits and other assets	(100,053)	(74,429)
Increase in mortgage portfolio	(6,345,382)	(8,506,240)
Increase in interest payable	34,541	28,906
Increase in accounts payable, accrued expenses and other liabilities	251,881	72,338
Increase in unearned premiums	26,599	19,143
Exchange differences	5,081	—
	<u>(5,647,761)</u>	<u>(8,058,702)</u>
Net cash outflow from operating activities before taxation	(5,647,761)	(8,058,702)
Hong Kong profits tax paid	(60,935)	—
Hong Kong profits tax refunded	11,301	—
	<u>(5,697,395)</u>	<u>(8,058,702)</u>
Net cash outflow from operating activities	<u>(5,697,395)</u>	<u>(8,058,702)</u>

27. Related party transactions

The Company entered into various transactions with the following related parties on a commercial basis.

Mr. Norman Chan is the Deputy Chief Executive of the Hong Kong Monetary Authority. The Company is a member under the Central Moneymarkets Unit (the "CMU") Membership Agreement with the Monetary Authority through the CMU in respect of the Company's HK dollar debt issuance and securities investment.

Mr. Brian Yiu is the Head of Debt Capital Markets, Asian Fixed Income of Standard Chartered Bank, which is (a) a selling group member under the DIP; (b) an Approved Seller/Service under the MPP; (c) an approved Authorized Institution under the MIP; and (d) an approved Authorized Institution under the HOME Programme.

Mr. Paul Thurston is the General Manager Personal Financial Services, Asia Pacific of HSBC. The Hon. Sin Chung Kai is an Assistant IT Project Manager of HSBC. HSBC is (a) a primary dealer under the DIP; (b) an Approved Seller/Service under the MPP; (c) an approved Authorized Institution under the MIP; (d) the underwriting bank and a placing bank in the Company's retail note issuance in November 2003; (e) a dealer in the Company's Bauhinia MBS Programme, and the lead manager and bookrunner of the Series 2003-1 issue of such programme; (f) an approved Authorized Institution under the HOME Programme; and (g) a holder of a TLC under the TLC Sub-Programme.

The Hon. Sin Chung-kai is also a Member of The Hong Kong Housing Authority which is an Approved Seller/Service under the MPP from which the Company has purchased mortgage loans of around HK\$20.6 billion up to 31 December 2003.

The Hon. Ambrose Lau is a director of Nanyang Commercial Bank Limited and a director of Wing Hang Bank, Ltd.. Wing Hang Bank, Ltd. is (a) an Approved Seller/Service under the MPP; (b) an approved Authorized Institution under the MIP; and (c) an approved Authorized Institution under the HOME Programme. Nanyang Commercial Bank Limited is (a) an Approved Seller/Service under the MPP; (b) an approved Authorized Institution under the MIP; (c) a placing bank in the Company's retail note issuances in November 2003; and (d) an approved Authorized Institution under the HOME Programme.

Mr. Lam Yim Nam is the Deputy Chief Executive of Bank of China (Hong Kong) Limited, which during the time of Mr. Lam's term of directorship with the Company, was (a) an Approved Seller/Service under the MPP; (b) an approved Authorized Institution under the MIP and (c) an approved Authorized Institution under the HOME Programme.

**APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC
FOR THE YEAR ENDED 31 DECEMBER 2003**

28. Reserves

	The Group			
	Share capital	Contingency reserve	Retained profits	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Balance at 1 January 2002, as previously reported	2,000,000	5,951	840,059	2,846,010
Effect of adopting SSAP 12	—	—	5,423	5,423
Balance at 1 January 2002, as restated	2,000,000	5,951	845,482	2,851,433
Net profit for the year, as restated	—	—	267,347	267,347
Transfer of 50% of net risk premium earned from retained profits to contingency reserve	—	10,026	(10,026)	—
Balance at 31 December 2002	2,000,000	15,977	1,102,803	3,118,780
Net profit for the year	—	—	379,136	379,136
Transfer of 50% of net risk premium earned from retained profits to contingency reserve	—	12,680	(12,680)	—
Balance at 31 December 2003	<u>2,000,000</u>	<u>28,657</u>	<u>1,469,259</u>	<u>3,497,916</u>

	The Company			
	Share Capital	Contingency reserve	Retained profits	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Balance at 1 January 2002, as previously reported	2,000,000	5,951	840,059	2,846,010
Effect of adopting SSAP 12	—	—	5,423	5,423
Balance at 1 January 2002, as restated	2,000,000	5,951	845,482	2,851,433
Net profit for the year, as restated	—	—	267,377	267,377
Transfer of 50% of net risk premium earned from retained profits to contingency reserve	—	10,026	(10,026)	—
Balance at 31 December 2002	2,000,000	15,977	1,102,833	3,118,810
Net profit for the year	—	—	379,157	379,157
Transfer of 50% of net risk premium earned from retained profits to contingency reserve	—	12,680	(12,680)	—
Balance at 31 December 2003	<u>2,000,000</u>	<u>28,657</u>	<u>1,469,310</u>	<u>3,497,967</u>

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

29. Effects on the consolidated financial statements of special purpose entities

In October 1999, the Company launched the MBS Pass-Through Programme under which the Company, in return for a guarantee fee, guarantees the timely payment of principal and interest in respect of the MBS issued by HKMC Funding Corporation (1) Limited, a special purpose company ("SPC") incorporated in Hong Kong for the purpose of this programme.

In December 2001, the Company also launched the Bauhinia MBS Programme, under which Bauhinia MBS Limited, an SPC incorporated in the Cayman Islands for the purposes of this programme, will from time to time issue mortgage-backed securities. MBS will be issued by Bauhinia MBS Limited in different currencies under different tranches.

The above two SPCs are considered to be bankruptcy remote "orphan" companies. In the context of section 2(4) of the Hong Kong Companies Ordinance, the two SPCs are not construed as the Group's subsidiaries. In accordance with the provisions of paragraph 27 of SSAP 32 "Consolidated financial statements and accounting for investments in subsidiaries", the financial statements of these two SPCs have therefore not been consolidated into the Group's financial statements for the year ended 31 December 2003. With regard to the mortgage loans sold by the Company to the two SPCs, this would be effected by way of a "clean sale" of such mortgage loans to the SPCs. All the mortgage loans sold to the SPCs will no longer be recognised as an asset in the balance sheet of the Group.

Up to 31 December 2003, HKMC Funding Corporation (1) Limited had issued 8 series of MBS totalling HK\$2,837 million and the Company had guaranteed the timely payment of principal and interest of the MBS. At 31 December 2003, the aggregate security principal balance of MBS guaranteed by the Company under the MBS Pass-Through Programme was HK\$1,002.5 million. As regards the Company's loan provisioning on the guaranteed mortgage loans under the MBS Pass-Through Programme, a sum of HK\$1,800,000 (2002: HK\$1,498,000) was grouped under "Other provisions" (Note 22). The loan provision of HK\$302,000 (2002: HK\$171,000) was charged to the profit and loss account of the Group.

Up to 31 December 2003, Bauhinia MBS Limited issued 2 series of MBS totalling HK\$5 billion and the Company had guaranteed the timely payment of principal and interest of the MBS. At 31 December 2003, the aggregate security principal balance of MBS guaranteed by the Company under the Bauhinia MBS Programme was HK\$4,254 million. As regards the Company's loan provisioning on the guaranteed mortgage loans under the Bauhinia MBS Programme, a sum of HK\$5,165,000 (2002: HK\$2,815,000) was grouped under "Other provisions" (Note 22). The loan provision of HK\$2,350,000 (2002: HK\$2,815,000) was charged to the profit and loss account of the Group.

The operating profit after tax and the major assets and liabilities of HKMC Funding Corporation (1) Limited and Bauhinia MBS Limited are set out below:

	HKMC Funding Corporation	
	(1) Limited	Bauhinia MBS Limited
	HK\$'000	HK\$'000
For the year ended 31 December 2003		
Operating profit after tax	23	24
As at 31 December 2003		
Mortgage portfolio, net	991,988	4,119,520
Total Assets	1,004,606	4,256,260
Debt securities	1,002,534	4,254,449
Total Liabilities	1,004,520	4,256,225
Total Shareholders' Equity	86	35

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

In accordance with paragraph 46 of SSAP 32, the Group has set out below the significant items of the pro-forma consolidated profit and loss account and balance sheet of the Group, HKMC Funding Corporation (1) Limited and Bauhinia MBS Limited for the year ended 31 December 2003 and 2002:

	2003	2002
	HK\$'000	HK\$'000
Net interest income for the year	652,955	443,803
Net profit for the year	379,183	263,834
Mortgage portfolio, net	39,686,290	30,516,727
Cash and short-term funds	2,224,181	215,562
Interest and remittance receivables	367,134	336,995
Total Assets	46,081,334	34,474,398
Debt securities	41,887,273	30,931,520
Total Liabilities	42,583,297	31,364,504
Total Shareholder's Equity	3,498,037	3,109,894
Capital-to-Assets ratio	7.3%	8.5%

30. Commitments

(a) Capital

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Authorized and contracted for	—	—
Authorized but not contracted for	25,185	7,025
	25,185	7,025
	25,185	7,025

(b) Operating lease

Total future minimum lease payments under non-cancellable operating leases at the balance sheet date are analysed as follows:

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Office premises		
not later than one year	11,001	11,001
later than one year and not later than five years	—	11,001
	11,001	22,002
	11,001	22,002

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

31. Mortgage guarantee business

The Company offers mortgage insurance which provides cover to the Approved Seller/Service providers for credit loss of up to 20% of the property value of a mortgage loan when the loan amount has exceeded 70% of the property value at origination.

The Company operates its mortgage insurance business on a risk-sharing basis, and retains up to 50% of the risk exposure under its mortgage insurance covers with the remaining risk exposure being ceded to its approved reinsurers.

Under the HOME programme, the Company provides mortgage insurance to cover credit loss in excess of 90% and up to 140% of the property value at the time of refinancing.

At 31 December 2003, the total risk-in-force was approximately HK\$4.14 billion (2002: HK\$3.39 billion) of which HK\$3.05 billion (2002: HK\$2.59 billion) risk for credit loss was ceded to the approved reinsurers and the balance of HK\$1.09 billion (2002: HK\$780 million) was assumed by the Company.

32. Off-balance-sheet exposures

(a) *Contingent liabilities*

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Guarantees under MBS programmes	5,256,983	2,316,520

(b) *Financial contracts*

Interest rate swap contracts are entered into for hedging the interest rate risk of the assets and liabilities.

i) The outstanding contracted notional amount of the interest rate swap contracts is as follows:

	The Group and the Company	
	2003	2002
	HK\$'000	HK\$'000
Interest rate swap contracts	77,749,150	56,734,398

ii) The replacement costs and potential future credit exposure amounts of the interest rate swap contracts are as follows. These amounts do not take into account the effects of bilateral netting arrangements with the counterparties.

	The Group and the Company			
	2003		2002	
	Replacement cost	Potential future credit exposure	Replacement cost	Potential future credit exposure
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Interest rate swap contracts	1,344,668	140,320	1,401,061	123,970

The replacement costs represent the cost of replacing all interest rate swap contracts that have a positive value when marked to market. The potential future credit exposure amounts refer to the amount as computed in accordance with the Capital-to-Assets ratio guidelines (Note 33). The Group has not experienced any non-performance by its counterparties.

APPENDIX P-4 AUDITORS' REPORT AND FINANCIAL STATEMENTS OF THE HKMC FOR THE YEAR ENDED 31 DECEMBER 2003

33. Capital-to-Assets ratio

To ensure that the Company is managed in a prudent manner, the Financial Secretary of the Government of the Hong Kong Special Administrative Region approved the revised guidelines in 2003 in respect of the minimum Capital-to-Assets ratio ("CAR") to be maintained by the Company. The minimum CAR stipulated in the guidelines is still at 5%.

	<u>2003</u>	<u>2002</u>
		Restated
Capital-to-Assets ratio	<u>7.7%</u>	<u>9.0%</u>

The Capital-to-Assets ratio is calculated as a ratio, expressed as a percentage, of the Company's total capital base to the sum of its total on-balance sheet assets and total off-balance sheet exposures.

34. Comparative figures

Due to the adoption of SSAP 12 during the current year, the presentation of certain items and balances in the accounts have been revised to comply with the new requirements. Accordingly, certain comparative amounts have been reclassified to conform to the current year's presentation.

35. Subsequent events

On 15 January 2004, the Company purchased HK\$9.8 billion of mortgage loans under the Home Starter Loan Scheme from the Government.

36. Approval of financial statements

The financial statements were approved by the Board of Directors on 1 April 2004.

**APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

THE HONG KONG MORTGAGE CORPORATION LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Notes	Unaudited 6 months ended 30 June 2004 HK\$'000	Unaudited 6 months ended 30 June 2003 HK\$'000
Interest income	2	477,045	505,192
Interest expense	3	<u>(56,464)</u>	<u>(234,109)</u>
Net interest income		420,581	271,083
Other income, net	4	<u>105,339</u>	<u>26,633</u>
Operating income		525,920	297,716
Operating expenses	5	<u>(57,634)</u>	<u>(55,068)</u>
Operating profit before provisions		468,286	242,648
Provisions for bad and doubtful loans	6	<u>(56,481)</u>	<u>(78,522)</u>
Profit before taxation		411,805	164,126
Taxation	7	<u>(56,524)</u>	<u>(13,180)</u>
Net profit for the period		<u>355,281</u>	<u>150,946</u>

**APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

THE HONG KONG MORTGAGE CORPORATION LIMITED

CONSOLIDATED BALANCE SHEET

	Notes	Unaudited as at 30 June 2004 HK\$'000	Audited as at 31 December 2003 HK\$'000
ASSETS			
Cash and short-term funds	8,12	6,710,286	2,219,346
Interest and remittance receivables		279,398	297,842
Prepayments, deposits and other assets	9	213,635	210,808
Deferred expense, net		11,771	26,646
Mortgage portfolio, net	10	40,666,850	34,581,747
Investment in debt securities	11,12	3,946,991	3,535,525
Fixed assets		22,349	19,088
Deferred tax assets		9,747	9,300
		<u>51,861,027</u>	<u>40,900,302</u>
LIABILITIES			
Short-term bank loans	12	600,000	—
Interest payable		286,815	257,663
Accounts payable, accrued expenses and other liabilities	13	4,876,160	390,612
Tax payable		74,749	17,778
Unearned premiums		123,216	106,043
Debt securities	12,14	42,046,890	36,630,290
		<u>48,007,830</u>	<u>37,402,386</u>
SHAREHOLDERS' EQUITY			
Share capital		2,000,000	2,000,000
Retained profits	15	1,817,973	1,469,259
Contingency reserve	15	35,224	28,657
		<u>3,853,197</u>	<u>3,497,916</u>
		<u>51,861,027</u>	<u>40,900,302</u>

**APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

THE HONG KONG MORTGAGE CORPORATION LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Notes	Unaudited 6 months ended 30 June 2004 HK\$'000	Unaudited 6 months ended 30 June 2003 HK\$'000
Total equity at 1 January, as previously reported	15	3,497,916	3,109,819
Effect of adopting SSAP 12	1(e)	—	8,961
Total equity at 1 January, as restated	15	3,497,916	3,118,780
Net profit for the period		<u>355,281</u>	<u>150,946</u>
Total equity at 30 June	15	<u><u>3,853,197</u></u>	<u><u>3,269,726</u></u>

**APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

THE HONG KONG MORTGAGE CORPORATION LIMITED

CONSOLIDATED CASH FLOW STATEMENT

	Notes	Unaudited 6 months ended 30 June 2004 HK\$'000	Unaudited 6 months ended 30 June 2003 HK\$'000
Net cash outflow from operating activities	16	<u>(1,117,415)</u>	<u>(3,617,791)</u>
Investing activities			
Purchase of fixed assets		(11,071)	(1,876)
Purchase of investment in debt securities		(681,415)	(751,220)
Proceeds from redemption of investment in debt securities		<u>273,863</u>	<u>612,713</u>
Net cash outflow from investing activities		<u>(418,623)</u>	<u>(140,383)</u>
Net cash outflow before financing		<u>(1,536,038)</u>	<u>(3,758,174)</u>
Financing			
Proceeds from issue of debt securities		10,657,878	6,124,980
Redemption of debt securities		<u>(5,230,900)</u>	<u>(1,400,250)</u>
Net cash inflow from financing		<u>5,426,978</u>	<u>4,724,730</u>
Increase in cash and cash equivalents		3,890,940	966,556
Beginning cash and cash equivalents		<u>2,219,346</u>	<u>212,863</u>
Ending cash and cash equivalents		<u><u>6,110,286</u></u>	<u><u>1,179,419</u></u>
Analysis of the balance of cash and cash equivalents			
Cash and short-term funds	8,12	<u>6,710,286</u>	1,181,619
Short-term bank loans	12	<u>(600,000)</u>	<u>(2,200)</u>
		<u><u>6,110,286</u></u>	<u><u>1,179,419</u></u>

THE HONG KONG MORTGAGE CORPORATION LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Preparation and Principal Accounting Policies

The unaudited financial statements of The Hong Kong Mortgage Corporation Limited (the "Company") and its subsidiary, HKMC Mortgage Management Limited ("HMML") (collectively the "Group"), for the period ended 30 June 2004 have been prepared under the historical cost convention, and in accordance with the provisions of the Hong Kong Companies Ordinance and accounting principles generally accepted in Hong Kong. The accounting policies and basis of preparation used in the preparation of these interim financial statements are consistent with those used in the annual financial statements for the year ended 31 December 2003.

a. *Consolidation*

The consolidated accounts include the accounts of the Company and its subsidiary made up to 30 June. A subsidiary, in accordance with the Hong Kong Companies Ordinance, is a company in which the Company, 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. In the Company's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

b. *Income and expense recognition*

Provided it is probable that the economic benefits associated with a transaction will flow to the Group and the income and costs, if applicable, can be measured reliably, interest income, interest expense and others are recognised on the following bases:

(i) Interest income and expense

Interest income and expense are accrued on a time-apportioned basis on the principal outstanding and at the rate applicable, except in case of bad and doubtful loans (Note 1(g)).

(ii) Fee income and expense

Fee income and expense are recognised when earned or incurred.

c. *Fixed assets and depreciation*

Fixed assets are stated at cost less accumulated depreciation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the fixed assets have been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of fixed assets, the expenditure is capitalized as an additional cost of the fixed asset.

Depreciation is calculated on a straight-line basis at annual rates estimated to write off the cost of each asset over its expected useful life.

The annual rates are as follows:

Leasehold improvements	over the unexpired period of the lease
Furniture and fixtures	over the unexpired period of the lease
Computer and related software	33-1/3%
Office equipment	33-1/3%
Motor vehicle	25%

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that furniture and equipment and other fixed assets are impaired. If any such indication exists, the recoverable amount of the assets is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account.

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant assets, and is recognised in the profit and loss account.

d. *Foreign currencies*

The books and records are maintained in Hong Kong Dollars. Transactions in other currencies during the period are translated into Hong Kong Dollars at exchange rates prevailing at the time of the transactions. Monetary assets and liabilities denominated in other currencies at the balance sheet date are translated into Hong Kong Dollars at rates of exchange prevailing at the balance sheet date. Exchange differences are dealt with in the profit and loss account.

e. *Deferred taxation*

Deferred taxation is recognised in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred tax liabilities are recognised on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not be reversed in the foreseeable future.

In 2002, deferred taxation was accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset was expected to be payable or recoverable in the foreseeable future. The adoption of the new SSAP 12 effective in 2003 represented a change in accounting policy, which has been applied retrospectively and resulted in increase in deferred tax assets at 31 December 2002 by HK\$8,961,000. Therefore, as detailed in Note 15, opening retained earnings at 1 January 2003 have been increased by HK\$8,961,000.

f. *Operating leases*

Leases where substantially all the rewards and risks of ownership remain with the leasing company are accounted for as operating leases. Rental payments under operating leases are charged to the profit and loss account on a straight-line basis over the period of the relevant leases. Lease income from operating sub-leases is recognised on a straight-line basis over the lease term.

g. *Bad and doubtful loans*

Provisions for bad and doubtful loans are charged to the profit and loss account on a monthly basis in accordance with the guidelines approved by the Board of Directors. General provision relates to exposures not separately identified but known from experience to exist in the mortgage portfolio. Specific provision for bad and doubtful loans generally applies to a mortgage loan that is overdue for more than 90 days, or in case of a mortgage loan which has been rescheduled under the relief plans, where extension of repayment holiday and/or reduction in repayment amount has been granted to the borrower. The specific provision is based on certain percentages of the difference between the current market value or the forced sale value of the underlying property and the outstanding principal balance ("OPB") of the mortgage loan. The percentages are validated annually with reference to the delinquency migration pattern of the mortgage portfolio. When there is no longer any realistic prospect of recovery of the OPB of the mortgage loan, it will be written off at the discretion of the Credit Committee.

The accrual of interest on mortgage loans is discontinued when they become overdue for 90 days or more. Any previously accrued and uncollected interests on the loans are reversed against current period's interest income. Interest income on the overdue loans is only recognised when all arrears of principal and interest from the borrowers have been cleared and it is probable that the customer is capable of fully servicing his obligations under the terms of the loans for the foreseeable future.

h. *Repossessed assets*

Assets acquired by repossession of collateral for realisation are reclassified from "Mortgage portfolio, net" to "Other receivables, net" which are written down to forced sale value of the repossessed properties by setting off related specific provisions against the OPB of the mortgage loans.

i. *Investment in debt securities*

Held-to-maturity investments are investments which the Group has the expressed intention and ability to hold to maturity. They are carried at amortised cost less any provision for impairment in value.

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

The carrying amounts of held-to-maturity securities are reviewed at each balance sheet date to assess the credit risk and whether the carrying amounts are expected to be recovered. Provisions are made when the carrying amounts are not expected to be recovered and are recognised as an expense in the profit and loss account.

Provision against the carrying value of held-to-maturity securities are reversed to the profit and loss account when the circumstances and events that led to the write-downs or write-offs cease to exist and there is persuasive evidence that the new circumstances and events will persist in the foreseeable future.

Upon disposal or transfer of held-to-maturity securities, any profit and loss thereon is accounted for in the profit and loss account.

j. *Notes issuance*

The notes issued under the Note Issuance Programme ("NIP"), the notes and Transferable Loan Certificates ("TLC") issued under the Debt Issuance Programme ("DIP") and the notes offered to retail investors through the placing banks and Retail Bond Issuance Programme ("RBIP") are stated at par value under debt securities in the balance sheet. Interest on the notes is accrued on a daily basis and charged to the profit and loss account. Discount on the notes is regarded as deferred expense whereas premium is accounted for as deferred income. Discount and premium are amortised over the entire life of the notes on an effective interest rate method and are accounted for as adjustment to the interest expense of the notes. The arranger and custodian fees paid under the NIP and DIP are amortised to the profit and loss account over the life of the notes issued.

On redemption/repurchase of the notes, the resulting gains or losses, being the difference between the redemption/repurchase amount and the carrying amount, are recognised in the profit and loss account in the period in which the redemption/repurchase takes place.

k. *Interest rate swap ("IRS") contracts for hedging purposes*

The IRS contracts are solely entered into as a hedge against interest rate risk on the assets and liabilities.

The net interest payable or receivable arising from the IRS contracts is recorded on an accrual basis and charged against interest income or interest expenses of the underlying assets and liabilities.

Gains and losses on early termination of the IRS contracts are immediately recognised in the profit and loss account when the underlying assets or liabilities are early disposed of or redeemed.

Gains and losses on early termination of the IRS contracts originally accounted for as a hedge to an asset or a liability are amortised over the remaining original life of the IRS contracts when the underlying asset and liability is not early disposed of or redeemed.

l. *Mortgage guarantee business*

The mortgage guarantee business of the Company is accounted for on the annual accounting basis. Under the annual accounting approach, the Company makes provisions based on credible estimates of future income and outgoings to determine the underwriting result for the current accounting period. The underwriting result includes any adjustments arising from the correction of the previous estimates.

Gross premiums represent direct business written through the Authorised Institutions during an accounting period. The gross premiums include the reinsurance premiums to be paid to the approved reinsurers for reinsurance cover. The net premiums received by the Company comprise the risk premiums and servicing fees earned by the Company. The net premiums are recognised as income on a time-apportioned basis when the insurance coverage becomes effective.

Unearned premiums represent that portion of net premiums written which are estimated to relate to risks and services subsequent to the balance sheet date.

Provisions are made for outstanding claims, claims incurred but not reported and loss reserve at the end of each period. For risk sharing business, 50% of the net risk premiums earned is set aside as a Contingency Reserve for a reasonable period of time in accordance with relevant regulatory guidelines and considered by directors as appropriate.

m. *Guaranteed mortgage-backed pass-through securitisation*

Upon completion of the sale of a mortgage pool to a third party Special Purpose Company ("SPC") under the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme ("MBS Pass-Through Programme") and the US\$3 Billion Mortgage-Backed Securitisation Programme ("Bauhinia MBS Programme"), the Company derecognises the applicable mortgage pool from its balance sheet; recognises all assets obtained and liabilities incurred in return for the consideration received as proceeds of the sale, including cash and contingent liability in respect of the guarantee on timely payment of principal and interest on the MBS; and recognises in the profit and loss account any gain or loss on the sale.

Where the Company guarantees the collectibility of the mortgage pool, it recognises a monthly guarantee fee income from the SPC in the profit and loss account on a time-apportioned basis. Since the Company assumes all credit risks arising from the mortgage loans under the MBS Pass-Through Programme and the Bauhinia MBS Programme, it adheres to the loan provisioning guidelines in Note 1(g) approved by the Board of Directors for making necessary provisions in the profit and loss account.

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

n. *Employee benefits*

(i) Employee leave entitlements

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave and long-service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave, maternity or paternity leave are recognised when the absence occurs.

(ii) Bonus plans

Liabilities for bonus plans due wholly within twelve months after the balance sheet date are recognised when the Company has a present or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

(iii) Pension obligations

The Company offers a mandatory provident fund scheme and a defined contribution scheme, the assets of which are generally held in separate trustee — administered funds. These pension plans are generally funded by payments from employees and by the Company.

The Company's contributions to the mandatory provident fund scheme and defined contribution scheme are expensed as incurred and are reduced by the portion of employer contributions forfeited by those employees who leave the scheme prior to full vesting of the employer contributions.

o. *Contingent liabilities and contingent assets*

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that an outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognised but are disclosed in the notes to the accounts when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognised.

p. *Cash and cash equivalents*

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity including cash, balances with banks and other financial institutions, treasury bills, other eligible bills and certificates of deposit.

2. **Interest income**

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Mortgage portfolio	381,501	415,299
Cash and short-term funds	15,746	19,194
Investment in debt securities — listed	31,236	25,488
Investment in debt securities — unlisted	48,562	45,211
	477,045	505,192

**APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

3. Interest expense

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Bank loans, short-term bills and debt securities wholly repayable within 5 years	49,316	231,589
Debt securities not wholly repayable within 5 years	7,148	2,520
	<u>56,464</u>	<u>234,109</u>

4. Other income, net

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Early prepayment fees and late charges	10,266	1,332
Subletting income of office premises	—	230
Net insurance premiums earned	27,672	19,288
Guarantee fees income on MBS (Note 18)	11,784	3,631
Excess servicing receipts on MBS (Note 18)	36,754	4,331
Issuance costs of debt securities and MBS	(2,847)	(2,269)
Others	21,710	90
	<u>105,339</u>	<u>26,633</u>

5. Operating expenses

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Staff costs		
Salaries and benefits	33,669	31,091
Pension costs — defined contribution plans	1,858	1,748
Premises		
Rental	5,500	5,508
Others	1,723	1,705
Directors' emolument	—	—
Depreciation	7,810	7,444
Consultancy fees	929	1,173
Auditors' remuneration	115	115
Other operating expenses	6,030	6,284
	<u>57,634</u>	<u>55,068</u>

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

6. Provisions for bad and doubtful loans

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Provisions against mortgage portfolio		
– specific	55,964	68,013
– general	517	10,509
	56,481	78,522

Of the above specific provision of HK\$55,964,000, HK\$29,700,000 is an additional specific provision for rescheduled loans under the relief plans and loans overdue for more than 90 days.

7. Taxation

Taxation in the profit and loss account represents:

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Hong Kong profits tax		
– Provision for current period	56,971	16,762
– Overprovision in respect of prior years	–	(513)
	56,971	16,249
Deferred taxation		
– Credit for current period	(447)	(2,655)
– Attributable to a change in tax rate	–	(414)
	56,524	13,180

Hong Kong profits tax has been provided at the rate of 17.5% (2003: 17.5%) on the estimated assessable profit for the period.

Deferred taxation for 2003 includes deferred tax credit of HK\$414,000 which arose from recomputing outstanding deferred tax assets carried forward from 2002 using the higher tax rate of 17.5%.

8. Cash and short-term funds

	Unaudited at 30 June 2004	Audited at 31 December 2003
	HK\$'000	HK\$'000
Cash at banks	57,638	2,351
Time deposits with banks	6,652,648	2,216,995
	6,710,286	2,219,346

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

9. Prepayments, deposits, and other assets

	Unaudited at 30 June 2004 HK\$'000	Audited at 31 December 2003 HK\$'000
Office rental deposit	2,293	2,293
Corporate club debentures	670	670
Other receivables, net	170,929	159,732
Others	39,743	48,113
	213,635	210,808

The Group reclassified mortgage loans from "Mortgage portfolio, net" (Note 10(a)) to "Other receivables, net" which were overdue for 180 days or more, or the collateral properties were repossessed, or the mortgagors became bankrupt. The net amount represented the forced sale value of the collateral properties after offsetting specific provisions of HK\$78,752,000 (31 December 2003: HK\$107,707,000) and general provisions of HK\$544,000 (31 December 2003: HK\$236,000) against the outstanding principal balance of the mortgage loans of HK\$250,225,000 (31 December 2003: HK\$267,675,000).

10. Mortgage portfolio, net

(a) Mortgage portfolio less provisions

	Unaudited at 30 June 2004 HK\$'000	Audited at 31 December 2003 HK\$'000
Outstanding principal balance of mortgage portfolio (Note 12)	40,772,104	34,664,075
Provisions for bad and doubtful loans		
— specific	(39,252)	(13,863)
— general	(66,002)	(68,465)
	40,666,850	34,581,747

At 30 June 2004, the mortgage portfolio had a weighted average remaining term of 11 years on a contractual basis, without taking into account any prepayment of the mortgage loans. Final maturity of the mortgage portfolio is in the year 2038.

(b) Provisions for bad and doubtful loans

	Unaudited			Suspended Interest HK\$'000
	Specific HK\$'000	General HK\$'000	Total HK\$'000	
At 1 January 2004	15,320	73,973	89,293	3,599
Amounts written off	(31,401)	(308)	(31,709)	(2,531)
Charge to profit and loss account	55,964	517	56,481	—
Interest suspended during the period	—	—	—	3,839
Suspended interest recovered	—	—	—	(1,701)
At 30 June 2004	39,883	74,182	114,065	3,206

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

	Audited			
	Specific	General	Total	Suspended Interest
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2003	9,335	55,944	65,279	3,563
Amounts written off	(125,179)	(177)	(125,356)	(6,792)
Charge to profit and loss account	131,164	18,206	149,370	–
Interest suspended during the year	–	–	–	8,191
Suspended interest recovered	–	–	–	(1,363)
	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>
At 31 December 2003	<u>15,320</u>	<u>73,973</u>	<u>89,293</u>	<u>3,599</u>

As regards the loan provisioning on the guaranteed mortgage loans under the two MBS programmes, the sums of HK\$8,180,000 of general provision (31 December 2003: HK\$5,508,000) and HK\$631,000 of specific provision (31 December 2003: HK\$1,457,000) were grouped under "Other provisions" (Note 13).

- (c) The total mortgage loans on which interest has been placed in suspense or has ceased to accrue are as follows:

	Unaudited	Audited
	at	at
	30 June 2004	31 December 2003
	HK\$'000	HK\$'000
Gross mortgage loans	122,517	149,480
Specific provision	<u>(12,840)</u>	<u>(11,619)</u>
	<u>109,677</u>	<u>137,861</u>

Specific provisions were made after taking into account the current market value or forced sale value of the collateral of the delinquent loans.

11. Investment in debt securities

	Unaudited	Audited
	at	at
	30 June 2004	31 December 2003
	HK\$'000	HK\$'000
Investment in debt securities		
Listed in Hong Kong	117,820	76,835
Listed outside Hong Kong	1,335,659	1,047,297
Unlisted	<u>2,493,512</u>	<u>2,411,393</u>
	<u>3,946,991</u>	<u>3,535,525</u>

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

12. Maturity profile

	Unaudited At 30 June 2004						
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets							
– Cash and short-term funds	57,638	6,652,648	–	–	–	–	6,710,286
– Mortgage portfolio	–	1,172,554	3,067,193	13,626,133	22,906,224	–	40,772,104
– Investment in debt securities	–	850,000	1,058,858	1,210,420	827,713	–	3,946,991
	<u>57,638</u>	<u>8,675,202</u>	<u>4,126,051</u>	<u>14,836,553</u>	<u>23,733,937</u>	<u>–</u>	<u>51,429,381</u>
Liabilities							
– Short-term bank loans	–	600,000	–	–	–	–	600,000
– Debt securities	–	1,950,000	8,813,000	25,128,940	6,154,950	–	42,046,890
	<u>–</u>	<u>2,550,000</u>	<u>8,813,000</u>	<u>25,128,940</u>	<u>6,154,950</u>	<u>–</u>	<u>42,646,890</u>
Audited At 31 December 2003							
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets							
– Cash and short-term funds	2,351	2,216,995	–	–	–	–	2,219,346
– Mortgage portfolio	16,998	1,013,684	2,614,389	12,649,959	18,361,232	7,813	34,664,075
– Investment in debt securities	–	269,000	850,000	1,650,718	765,807	–	3,535,525
	<u>19,349</u>	<u>3,499,679</u>	<u>3,464,389</u>	<u>14,300,677</u>	<u>19,127,039</u>	<u>7,813</u>	<u>40,418,946</u>
Liabilities							
– Debt securities	–	3,855,400	5,678,650	24,634,640	2,461,600	–	36,630,290

13. Accounts payable, accrued expenses and other liabilities

	Unaudited at 30 June 2004	Audited at 31 December 2003
	HK\$'000	HK\$'000
Accounts payable and accrued expenses	206,736	176,320
Other liabilities	4,655,926	200,000
Other provisions (Note 18)	13,498	14,292
	<u>4,876,160</u>	<u>390,612</u>

Other liabilities referred to the deferred consideration used for credit enhancement on the mortgage loans purchased from the Government of the Hong Kong Special Administrative Region (the "Government") in December 2003 and January 2004.

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

14. Debt securities

	Unaudited at 30 June 2004 HK\$'000	Audited at 31 December 2003 HK\$'000
NIP notes	2,500,000	4,000,000
DIP		
(i) notes	25,276,000	22,441,000
(ii) TLC	6,000,000	3,500,000
RBIP and other notes	8,270,890	6,689,290
	42,046,890	36,630,290
At 1 January	36,630,290	28,615,000
Issuance for the period/year	10,647,500	10,885,540
Less: Redemption for the period/year	(5,230,900)	(2,870,250)
At the end of the period/year	42,046,890	36,630,290

Notes and TLC issued during the period up to 30 June 2004 comprise:

	Unaudited		
	DIP		RBIP and other notes
	Notes	TLC	
	HK\$'000	HK\$'000	HK\$'000
Amount issued	5,245,000	2,500,000	2,902,500
Consideration received	5,244,895	2,500,000	2,912,983

All the debt securities issued are the unsecured obligations of the Group, and are issued for the purposes of providing general working capital and refinancing.

15. Reserves

	Unaudited			
	Share capital	Contingency reserve	Retained Profits	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Balance at 1 January 2004	2,000,000	28,657	1,469,259	3,497,916
Net profit for the period	—	—	355,281	355,281
Transfer of 50% of net risk premium earned from retained profits to contingency reserve	—	6,567	(6,567)	—
Balance at 30 June 2004	2,000,000	35,224	1,817,973	3,853,197

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

	Note	Audited			
		Share capital	Contingency reserve	Retained Profits	Total
		HK\$'000	HK\$'000	HK\$'000	HK\$'000
Balance at 1 January 2003, as previously reported		2,000,000	15,977	1,093,842	3,109,819
Effect of adopting SSAP 12	1 (e)	—	—	8,961	8,961
Balance at 1 January 2003, as restated		2,000,000	15,977	1,102,803	3,118,780
Net profit for the year		—	—	379,136	379,136
Transfer of 50% of net risk premium earned from retained profits to contingency reserve		—	12,680	(12,680)	—
Balance at 31 December 2003		<u>2,000,000</u>	<u>28,657</u>	<u>1,469,259</u>	<u>3,497,916</u>

16. Note to the consolidated cash flow statement

Reconciliation of profit before taxation to net cash outflow from operating activities:

	Unaudited 6 months ended 30 June 2004	Unaudited 6 months ended 30 June 2003
	HK\$'000	HK\$'000
Profit before taxation	411,805	164,126
Depreciation	7,810	7,444
Amortisation of deferred expenses	4,497	4,937
Provisions for bad and doubtful loans	56,481	78,522
Mortgage portfolio written off net of recoveries	(31,709)	(63,753)
Amortisation of investment in debt securities	3,115	2,941
Decrease/(increase) in interest and remittance receivables	18,444	(47,446)
Increase in prepayments, deposits and other assets	(2,827)	(49,961)
Increase in mortgage portfolio	(6,108,029)	(3,774,782)
Increase in interest payable	29,152	50,456
Increase/(decrease) in accounts payable, accrued expenses and other liabilities	4,483,702	(9,981)
Increase in unearned premiums	17,173	8,363
Exchange differences	(7,029)	42
Net cash outflow from operating activities before taxation	(1,117,415)	(3,629,092)
Hong Kong profits tax paid	—	—
Hong Kong profits tax refunded	—	11,301
Net cash outflow from operating activities	<u>(1,117,415)</u>	<u>(3,617,791)</u>

17. Mortgage guarantee business

The Company offers mortgage insurance which provides cover to the Approved Seller/Service providers for credit loss of up to 20% of the property value of a mortgage loan when the loan amount has exceeded 70% of the property value at origination.

The Company operates its mortgage insurance business on a risk-sharing basis, and retains up to 50% of the risk exposure under its mortgage insurance covers with the remaining risk exposure being ceded to its approved reinsurers.

Under the HOME programme, the Company provides mortgage insurance to cover credit loss in excess of 90% and up to 140% of the property value at the time of refinancing.

At 30 June 2004, the total risk-in-force was approximately HK\$4.72 billion (31 December 2003: HK\$4.14 billion) of which HK\$3.41 billion (31 December 2003: HK\$3.05 billion) had been ceded to the approved reinsurers and the balance of HK\$1.31 billion (31 December 2003: HK\$1.09 billion) was retained by the Company.

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

Provisions for outstanding claims under the Mortgage Insurance Programme ("MIP") are recorded net of recoveries from the approved reinsurers. For the six months ended 30 June 2004, provisions for loss reserve of HK\$134,000 (2003: HK\$314,000 was charged) was written back to profit and loss account of the Group and the gross claim was HK\$4,071,000 (2003: HK\$4,011,000), of which HK\$3,108,000 (2003: HK\$3,224,000) was recovered from the approved reinsurers.

18. Effects on the consolidated financial statements of special purpose entities

In October 1999, the Company launched the MBS Pass-Through Programme under which the Company, in return for a guarantee fee, guarantees the timely payment of principal and interest in respect of mortgage-backed securities ("MBS") issued by HKMC Funding Corporation (1) Limited, a special purpose company ("SPC") incorporated in Hong Kong for the purpose of this programme.

In December 2001, the Company also launched the Bauhinia MBS Programme, under which Bauhinia MBS Limited, an SPC incorporated in the Cayman Islands for the purposes of this programme, will from time to time issue MBS. MBS will be issued by Bauhinia MBS Limited in different currencies under different tranches.

The above two SPCs are considered to be bankruptcy remote "orphan" companies. In the context of section 2(4) of the Hong Kong Companies Ordinance, the two SPCs are not construed as the Group's subsidiaries. In accordance with the provisions of paragraph 27 of SSAP 32 "Consolidated financial statements and accounting for investments in subsidiaries", the financial statements of these two SPCs have therefore not been consolidated into the Group's financial statements for the six months ended 30 June 2004. With regard to the mortgage loans sold by the Company to the two SPCs, this would be effected by way of a "clean sale" of such mortgage loans to the SPCs. All the mortgage loans sold to the SPCs will no longer be recognised as an asset in the balance sheet of the Group.

At 30 June 2004, the aggregate security principal balance of MBS guaranteed by the Company under the MBS Pass-Through Programme was HK\$860.9 million. As regards the Company's loan provisioning on the guaranteed mortgage loans under the MBS Pass-Through Programme, a sum of HK\$2,111,000 (31 December 2003: HK\$1,800,000) was grouped under "Other provisions" (Note 13). The loan provision amounting to HK\$311,000 was charged to the profit and loss account of the Group.

At 30 June 2004, the aggregate security principal balance of MBS guaranteed by the Company under the Bauhinia MBS Programme was HK\$4,064.6 million. As regards the Company's loan provisioning on the guaranteed mortgage loans under the Bauhinia MBS Programme, a sum of HK\$6,700,000 (31 December 2003: HK\$5,165,000) was grouped under "Other provisions" (Note 13). The loan provision amounting to HK\$1,535,000 was charged to the profit and loss account of the Group.

The operating profit after tax and the major assets and liabilities of the two SPCs are set out below:

	Unaudited	
	HKMC Funding Corporation (1) Limited HK\$'000	Bauhinia MBS Limited HK\$'000
For the six months ended 30 June 2004		
Guarantee fee expenses	1,752	10,032
Excess servicing (receipts)/fee expenses	(94)	36,848
Master servicing fee expenses	—	114
Operating profit after tax	13	5
At 30 June 2004		
Mortgage portfolio	836,270	3,843,965
Total assets	862,634	4,066,368
Debt securities	860,904	4,064,620
Total liabilities	862,534	4,066,328
Total shareholders' equity	100	40

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

In accordance with paragraph 46 of SSAP 32, the Group has set out below the significant items of the proforma consolidated profit and loss account and balance sheet of the Group, HKMC Funding Corporation (1) Limited and Bauhinia MBS Limited for the following periods:

	Unaudited 6 months ended 30 June 2004 HK\$'000	Unaudited 6 months ended 30 June 2003 HK\$'000
Net interest income for the period	468,868	278,953
Net profit for the period	355,299	150,961
	Unaudited at 30 June 2004 HK\$'000	Audited at 31 December 2003 HK\$'000
Mortgage portfolio, net	45,338,274	39,686,290
Total assets	56,672,618	46,081,334
Debt securities	46,972,414	41,887,273
Total liabilities	52,819,281	42,583,297
Total shareholders' equity	3,853,337	3,498,037
Capital-to-Assets ratio	7.8%	7.3%

19. Related party transactions

The following Directors may be deemed to be interested in any contracts which have been entered, or may be entered, into by the Company for the reasons set out below:

Name	Interests	Related Transactions — see the notes below
The Honourable Henry TANG Ying Yen, GBS, JP	Financial Secretary of Hong Kong Controller of the Exchange Fund	(1) (2) (7)
Joseph YAM Chi Kwong, GBS, JP	Chief Executive of the Hong Kong Monetary Authority	(1) (2) (7)
Norman CHAN Tak Lam, SBS, JP	Deputy Chief Executive of the Hong Kong Monetary Authority	(1) (2) (7)
Ronald Joseph ARCULLI, GBS, JP	Director of Sino Land Company Limited	(3)
The Honourable Bernard Charnwut CHAN	President of Asia Insurance Company, Limited Director of Asia Commercial Bank Limited	(4)
Anita FUNG Yuen Mei (appointed on 1 April 2004)	Treasurer, Co-Head of Global Markets, Asia Pacific of The Hongkong and Shanghai Banking Corporation Limited	(4) (5)
Andy HON Hak Keung (appointed on 1 April 2004)	General Manager, Mortgages and Auto, Consumer Banking of Standard Chartered Bank	(4) (5)
The Honourable Ambrose LAU Hon Chuen, GBS, JP	Director of Nanyang Commercial Bank Limited Director of Wing Hang Bank, Ltd.	(4) (5)

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

Name	Interests	Related Transactions — see the notes below
Dr. the Honourable David LI Kwok Po, GBS, LLD (Cantab), JP	Chairman and Chief Executive of The Bank of East Asia, Limited Director of Tricor Holdings Limited	(4) (5) (6)
The Honourable Frederick MA Si Hang, JP	Secretary for Financial Services and the Treasury	(1)
The Honourable SIN Chung Kai	Assistant IT Project Manager of The Hongkong and Shanghai Banking Corporation Limited	(4) (5)
The Honourable Michael SUEN Ming Yeung, GBS, JP	Secretary for Housing, Planning and Lands	(1)
Paul THURSTON (retired on 1 April 2004)	Assistant General Manager, Head of Personal Financial Services of The Hongkong and Shanghai Banking Corporation Limited	(4) (5)
Brian YIU Chi Pang (retired on 1 April 2004)	Head, Debt Capital Markets, Asian Fixed Income of Standard Chartered Bank	(4) (5)

Directors' Interests in Transactions and Contracts

A number of the Company's directors have interests in the Company's contracts and transactions because of their positions and activities in the Government or in business. For this year up to 30 June 2004 (the "relevant period"), interests which may be considered significant to the Company's business are noted as follows:

- (1) In the relevant period, the Company purchased about HK\$9.8 billion of mortgage loans from the Government.
- (2) The Company is a member of the Central Moneymarkets Unit Service operated by the Hong Kong Monetary Authority (the "HKMA") and which provides custodian and clearing agent services for the Company's DIP. The Exchange Fund through the HKMA has provided the Company with a HK\$10 billion revolving credit facility.
- (3) In the relevant period, the Company purchased about HK\$51.9 million of mortgage loans from affiliated companies of Sino Land Company Limited.
- (4) A Director of, or employed by, a financial institution or an organisation which participates in the Company's Mortgage Purchase Programme or MIP.
- (5) A Director of, or employed by, a financial institution which has participated as placing bank, underwriter, arranger/dealer or co-lead manager/lead manager in one or more of the Company's debt securities issues.
- (6) Tricor Holdings Limited is the ultimate holding company of Tengis Limited, the corporate services provider to HKMC Funding Corporation (1) Limited.
- (7) On 21 April 2004, the Company entered into a lease for a period of six years commencing on 1 January 2005 with The Financial Secretary Incorporated (the "FSI") by which the FSI let to the Company Suite 7902 on 79th Floor and the whole of the 80th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. At the direction of the FSI, the Company pays the rental to the HKMA. The Company has an option to renew the lease for the office premises for a term of three years at the then current open market rent upon expiration of the lease on 31 December 2010. Prior to expiry of the renewed term, the Company has a further option to renew the lease for a further period of three years at the then current open market rent.

**APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC
FOR THE 6 MONTHS ENDED 30 JUNE 2004**

20. Commitments

	Unaudited at 30 June 2004 <u>HK\$'000</u>	Audited at 31 December 2003 <u>HK\$'000</u>
(a) Capital		
Authorised and contracted for	3,183	—
Authorised but not contracted for	<u>10,895</u>	<u>25,185</u>
	<u>14,078</u>	<u>25,185</u>

(b) Operating lease

Total future minimum lease payments under non-cancellable operating leases at the balance sheet date are analysed as follows:

	Unaudited at 30 June 2004 <u>HK\$'000</u>	Audited at 31 December 2003 <u>HK\$'000</u>
Office premises		
not later than one year	7,624	11,001
later than one year and not later than five years	25,471	—
later than five years	<u>10,613</u>	<u>—</u>
	<u>43,708</u>	<u>11,001</u>

21. Off-balance-sheet exposures

(a) Contingent liabilities

	Unaudited at 30 June 2004 <u>HK\$'000</u>	Audited at 31 December 2003 <u>HK\$'000</u>
Guarantees under MBS programmes	<u>4,925,524</u>	<u>5,256,983</u>

APPENDIX P-5 UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE HKMC FOR THE 6 MONTHS ENDED 30 JUNE 2004

(b) *Financial contracts*

Interest rate swap contracts have been entered into for hedging the interest rate risk of the assets and liabilities.

i) The outstanding contracted notional amount of the interest rate swap contracts is as follows:

	Unaudited at 30 June 2004	Audited at 31 December 2003
	HK\$'000	HK\$'000
Interest rate swap contracts	84,432,614	77,749,150

ii) The replacement costs and potential future credit exposure amounts of the interest rate swap contracts are as follows. These amounts do not take into account the effects of bilateral netting arrangements with the counterparties.

	Unaudited at 30 June 2004		Audited at 31 December 2003	
	Replacement cost	Potential future credit exposure	Replacement cost	Potential future credit exposure
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Interest rate swap contracts	860,709	160,438	1,344,668	140,320

The replacement costs represent the cost of replacing all interest rate swap contracts that have a positive value when marked to market. The potential future credit exposure amounts refer to the amount as computed in accordance with the Capital-to-Assets ratio guidelines (Note 22). The Group has not experienced any non-performance by its counterparties under the interest rate swap contracts.

22. Capital-to-Assets ratio

To ensure that the Company is managed in a prudent manner, the Financial Secretary of the Hong Kong Special Administrative Region approved the revised guidelines in 2003 in respect of the minimum Capital-to-Assets ratio ("CAR") to be maintained by the Company. The minimum CAR stipulated in the guidelines is 5%.

	Unaudited at 30 June 2004	Audited at 31 December 2003
Capital-to-Assets ratio	8.2%	7.7%

The Capital-to-Assets ratio is calculated as a ratio, expressed as a percentage, of the Company's total capital base to the sum of its total on-balance sheet assets and total off-balance sheet exposures.

APPENDIX P-6 CAPITALISATION TABLE OF THE HKMC

CAPITALISATION OF THE HKMC

The following table sets out the unaudited capitalisation of the HKMC as at 31 July 2004:

	<u>HK\$ '000</u>
Short-Term Liabilities	
HK\$ Short-term bank loans	1,251,000
HK\$ Note Issuance Programme Notes due within 1 year	500,000
HK\$ Debt Issuance Programme Notes due within 1 year	6,891,000
HK\$ OTC Retail Notes Issuance due within 1 year	2,542,000
Long-Term Liabilities	
HK\$ Note Issuance Programme Notes due after 1 year	1,000,000
HK\$ Debt Issuance Programme Notes due after 1 year	24,486,000
HK\$ Retail Bond Issuance Programme Notes due after 1 year	1,698,550
HK\$ OTC Retail Notes Issuance due after 1 year	4,030,340
Total Loan Capital	<u>42,398,890</u>
Shareholders' Equity	
Share capital 2,000,000,000 shares issued and fully paid (authorized 3,000,000,000 shares of HK\$1 each)	2,000,000
Retained profit and contingency reserves	<u>1,916,436</u>
Shareholders' equity	<u>3,916,436</u>
Total Capitalisation	<u><u>46,315,326</u></u>

Note:

Save as disclosed herein, there has been no material change in the capitalisation of the HKMC since 31 July 2004.

ISSUER

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