Consolidated Income Statement

For the year ended 31 December 2005

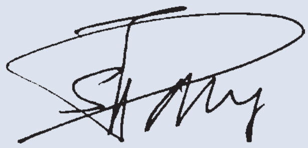
	Notes	2005 HK$'000	2004 HK$'000
Interest income	5	**1,584,531**	1,021,874
Interest expense	6	**(963,898)**	(210,165)
Net interest income		**620,633**	811,709
Other income, net	7	**165,261**	159,801
Operating income		**785,894**	971,510
Operating expenses	8	**(114,632)**	(118,661)
Operating profit before impairment losses		**671,262**	852,849
Write-back of impairment losses on loans/ (provisions) for bad and doubtful loans	9	**18,639**	(89,437)
Profit before taxation		**689,901**	763,412
Taxation	10(a)	**(89,270)**	(99,397)
Net profit for the year	12	**600,631**	664,015
Proposed dividend	13	**250,000**	250,000

Consolidated Balance Sheet

As at 31 December 2005

	Notes	2005 HK$'000	2004 HK$'000
ASSETS			
Cash and short-term funds	14	2,476,532	5,338,017
Interest and remittance receivables	15	349,922	331,776
Prepayments, deposits and other assets	16	47,410	192,644
Deferred expense, net	17	–	8,951
Tax recoverable	10(b)	5,056	–
Derivative financial instruments	18	85,266	–
Mortgage portfolio, net	19	29,475,662	34,938,580
Investment securities:			
– available-for-sale	20(a)	1,989,973	–
– held-to-maturity	20(b)	4,524,894	4,093,253
Fixed assets	21	22,158	23,452
Reinsurance assets	24	429,178	331,179
Deferred tax assets	10(b)	–	8,629
		39,406,051	45,266,481
LIABILITIES			
Interest payable		237,103	228,534
Accounts payable, accrued expenses and other liabilities	23	5,480,716	4,825,066
Derivative financial instruments	18	308,915	–
Tax payable	10(b)	–	47,229
Deferred tax liabilities	10(b)	21,691	–
Insurance liabilities	24	684,212	508,981
Debt securities	25	27,995,867	35,494,740
		34,728,504	41,104,550
SHAREHOLDERS' EQUITY			
Share capital	27	2,000,000	2,000,000
Retained profits		2,271,883	1,870,261
Contingency reserve		61,725	41,670
Other reserve	28	93,939	–
Proposed dividend		250,000	250,000
		4,677,547	4,161,931
		39,406,051	45,266,481

Yam Chi Kwong, Joseph
Deputy Chairman



Pang Sing Tong, Peter
Executive Director

Balance Sheet

As at 31 December 2005

	Notes	2005 HK$'000	2004 HK$'000
ASSETS			
Cash and short-term funds	14	2,474,338	5,338,007
Interest and remittance receivables	15	349,687	331,609
Prepayments, deposits and other assets	16	47,410	192,644
Deferred expense, net	17	–	8,951
Tax recoverable	10(b)	4,994	–
Derivative financial instruments	18	85,266	–
Mortgage portfolio, net	19	29,417,710	34,829,101
Investment securities:			
– available-for-sale	20(a)	1,989,973	–
– held-to-maturity	20(b)	4,524,894	4,093,253
Investment in a subsidiary	22	60,960	109,447
Fixed assets	21	22,158	23,452
Reinsurance assets	24	429,178	331,179
Deferred tax assets	10(b)	–	8,609
		39,406,568	45,266,252
LIABILITIES			
Interest payable		237,103	228,534
Accounts payable, accrued expenses and other liabilities	23	5,480,687	4,825,045
Derivative financial instruments	18	308,915	–
Tax payable	10(b)	–	47,167
Deferred tax liabilities	10(b)	21,824	–
Insurance liabilities	24	684,212	508,981
Debt securities	25	27,995,867	35,494,740
		34,728,608	41,104,467
SHAREHOLDERS' EQUITY			
Share capital	27	2,000,000	2,000,000
Retained profits		2,272,296	1,870,115
Contingency reserve		61,725	41,670
Other reserve	28	93,939	–
Proposed dividend		250,000	250,000
		4,677,960	4,161,785
		39,406,568	45,266,252

Yam Chi Kwong, Joseph
Deputy Chairman

Pang Sing Tong, Peter
Executive Director

Consolidated Statement of Changes in Equity

For the year ended 31 December 2005

	Notes	Share capital HK$'000	Contingency reserve HK$'000	Retained profits HK$'000	Other reserve HK$'000	Total HK$'000
Balance as at 1 January 2004		**2,000,000**	**28,657**	**1,469,259**	**–**	**3,497,916**
Net profit for the year		–	–	664,015	–	664,015
Transfer of 50% of net risk premium earned from retained profits to contingency reserve		–	13,013	(13,013)	–	–
Balance as at 31 December 2004		**2,000,000**	**41,670**	**2,120,261**	**–**	**4,161,931**
Effect of adopting HKAS 39	2.1(a)	–	–	71,046	–	71,046
Balance as at 1 January 2005		**2,000,000**	**41,670**	**2,191,307**	**–**	**4,232,977**
Fair value gains, net of tax – available-for-sale securities	28	–	–	–	93,939	93,939
Net profit for the year		–	–	600,631	–	600,631
Transfer of 50% of net risk premium earned from retained profits to contingency reserve		–	20,055	(20,055)	–	–
Dividend paid	13	–	–	(250,000)	–	(250,000)
Balance as at 31 December 2005		**2,000,000**	**61,725**	**2,521,883**	**93,939**	**4,677,547**

Consolidated Cash Flow Statement

For the year ended 31 December 2005

	Notes	2005 HK$'000	2004 HK$'000
Cash flows from operating activities			
Profit before taxation		689,901	763,412
Adjustment for:			
Depreciation		10,952	16,224
Amortisation of discount of debt securities		2,708	8,451
(Write-back) of impairment losses on loans/provisions for bad and doubtful loans		(18,639)	89,437
Mortgage portfolio written off net of recoveries		(58,595)	(53,963)
Amortisation of (discount)/premium of investment securities		(10,086)	7,617
Net loss on disposal of available-for-sale securities		6,989	–
Change in fair value of derivatives and debt securities		14,461	–
		637,691	831,178
Increase in interest and remittance receivables		(18,146)	(33,934)
(Increase)/decrease in prepayments, deposits and other assets		(10,060)	12,784
Decrease/(increase) in mortgage portfolio		5,739,076	(388,613)
Increase/(decrease) in interest payable		8,569	(29,129)
Increase in accounts payable, accrued expenses and other liabilities		666,309	4,436,995
Increase in insurance liabilities, net/unearned premiums, net		77,232	70,904
Exchange differences		9,490	(1,766)
Cash generated from operation		7,110,161	4,898,419
Hong Kong profits tax paid		(146,011)	(69,275)
Net cash from operating activities		6,964,150	4,829,144
Cash flows from investing activities			
Purchase of fixed assets	21	(9,658)	(20,588)
Purchase of available-for-sale securities	20	(4,094,763)	–
Purchase of held-to-maturity securities	20	(6,054,641)	(1,741,749)
Proceeds from sale and redemption of available-for-sale securities	20	2,217,499	–
Proceeds from redemption of held-to-maturity securities	20	5,617,764	1,178,170
Net cash used in investing activities		(2,323,799)	(584,167)
Net cash inflows before financing		4,640,351	4,244,977
Cash flows from financing activities			
Proceeds from issue of debt securities	25	5,095,964	11,407,744
Redemption of debt securities	25	(12,347,800)	(12,534,050)
Dividend paid	13	(250,000)	–
Net cash used in financing activities		(7,501,836)	(1,126,306)
Net (decrease)/increase in cash and cash equivalents		(2,861,485)	3,118,671
Beginning cash and cash equivalents		5,338,017	2,219,346
Ending cash and cash equivalents	14	2,476,532	5,338,017

Notes to the Consolidated Financial Statements

1. Basis of preparation

The consolidated financial statements of The Hong Kong Mortgage Corporation Limited (the "Company") and its subsidiary, HKMC Mortgage Management Limited (collectively the "Group") have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs" which is a collective term including all applicable individual Hong Kong Financial Reporting Standards ("HKFRS"), Hong Kong Accounting Standards ("HKASs") and Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale investment securities, financial assets and financial liabilities (including derivative financial instruments) at fair value through profit or loss.

The accounting policies and methods of computation used in the preparation of these consolidated financial statements are consistently applied to all the years presented, except that the Group has changed certain of its accounting policies following its adoption of new/revised HKFRSs which are effective for accounting periods commencing on or after 1 January 2005.

The changes to the Group's accounting policies and the effect of adopting these new policies are set out in Note 2 below.

The preparation of financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

2. Principal accounting policies

2.1. Adoption of HKFRSs

In 2005, the Group adopted the new/revised HKFRSs below, which are relevant to its operations. The 2004 comparatives have been amended as required, in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 12	Income Taxes
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures

HKAS 27	Consolidated and Separate Financial Statements
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 (Amendment)	The Fair Value Option
HKAS 39 (Amendment)	Financial Guarantee Contracts
HKAS-Int 12	Consolidation – Special Purpose Entities
HKFRS 4	Insurance contracts

(a) Effect of adopting new HKFRSs

Other than HKAS 32, 39 and HKFRS 4, there were no material effects for the current year and prior year from the adoption of HKFRSs. All relevant changes in the accounting policies have been made in accordance with the provisions of the respective standards, which require retrospective application to prior year comparatives other than HKAS 39.

The adoption of HKAS 39 has resulted in a change in the accounting policy relating to the measurement of financial assets, the classification of financial assets at fair value through profit or loss and available-for-sale financial assets. It has also resulted in the recognition of derivative financial instruments at fair value and the change in the recognition and measurement of hedging activities. The adoption of HKAS 32 has affected the disclosure and presentation of financial instruments.

The early adoption of HKAS 39 (Amendment) Fair Value Option has resulted in a recognition of financial assets and liabilities designated as at fair value through profit or loss. The designation results in more relevant information because it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

The early adoption of HKAS 39 (Amendment) Financial Guarantee Contracts has resulted in a change in the accounting policy for the financial guarantee contracts. Financial guarantee contracts issued are initially recognised at fair value and subsequently measured at the higher of (i) the amount recognised under HKAS 37, Provisions, Contingent Liabilities and Contingent Assets, and (ii) the amount initially recognised less, where appropriate, cumulative amortisation recognised over the life of the guarantee on a time-apportionment basis.

HKAS 39 does not permit recognition, derecognition and measurement of financial assets and liabilities in accordance with this standard on a retrospective basis. The Group therefore adopted HKAS 39 as from 1 January 2005. The adjustments required for the adoption of HKAS 39 as at 1 January 2005 resulted in increase in the opening equity by HK$71 million.

The adoption of HKFRS 4 has resulted in presentation of insurance assets and the related insurance liabilities separately on the balance sheet. This did not have any impact on the Group's results or the Group's equity. HKFRS 4 has also affected the disclosures with respect to insurance contracts issued and reinsurance contracts held.

Estimated effect of changes in the accounting polices on consolidated balance sheet items

The Group	HKAS 32, HKAS 39 and HKAS 39 (Amendment) HK$'000	HKFRS 4 HK$'000	Total HK$'000
Increase/(decrease) in assets as at 31 December 2005			
Mortgage portfolio, net	851,501	–	851,501
Non-trading securities	(1,989,973)	–	(1,989,973)
Available-for-sale securities	1,989,973	–	1,989,973
Derivative financial instruments	85,266	–	85,266
Prepayments, deposits and other assets	35,560	(2,175)	33,385
Reinsurance assets	–	429,178	429,178
	972,327	427,003	1,399,330
(Increase)/decrease in liabilities as at 31 December 2005			
Accounts payable, accrued expenses and other liabilities	(862,516)	2,743	(859,773)
Deferred tax liabilities	(4,295)	–	(4,295)
Tax payable	(3,000)	–	(3,000)
Debt securities	240,794	–	240,794
Derivative financial instruments	(308,915)	–	(308,915)
Insurance liabilities	–	(429,746)	(429,746)
	(937,932)	(427,003)	(1,364,935)
Increase in equity as at 31 December 2005			
Retained profits	34,395	–	34,395

The Company	HKAS 32, HKAS 39 and HKAS 39 (Amendment) HK$'000	HKFRS 4 HK$'000	Total HK$'000
Increase/(decrease) in assets as at 31 December 2005			
Mortgage portfolio, net	851,444	–	851,444
Non-trading securities	(1,989,973)	–	(1,989,973)
Available-for-sale securities	1,989,973	–	1,989,973
Derivative financial instruments	85,266	–	85,266
Prepayments, deposits and other assets	35,560	(2,175)	33,385
Reinsurance assets	–	429,178	429,178
	972,270	427,003	1,399,273
(Increase)/decrease in liabilities as at 31 December 2005			
Accounts payable, accrued expenses and other liabilities	(862,516)	2,743	(859,773)
Deferred tax liabilities	(4,285)	–	(4,285)
Tax payable	(3,000)	–	(3,000)
Debt securities	240,794	–	240,794
Derivative financial instruments	(308,915)	–	(308,915)
Insurance liabilities	–	(429,746)	(429,746)
	(937,922)	(427,003)	(1,364,925)
Increase in equity as at 31 December 2005			
Retained profits	34,348	–	34,348

The Group and the Company	HKFRS 4 HK$'000
Increase/(decrease) in assets as at 31 December 2004	
Prepayments, deposits and other assets	(5,380)
Reinsurance assets	331,179
	325,799
(Increase)/decrease in liabilities as at 31 December 2004	
Accounts payable, accrued expenses and other liabilities	6,235
Insurance liabilities/unearned premiums	(332,034)
	(325,799)

Estimated effect of changes in the accounting polices on consolidated income statement for the year ended 31 December 2005

The Group	HKAS 32 and HKAS 39 HK$'000
Increase/(decrease) in profit for the year	
Fair value of derivatives and debt securities	(14,461)
Impairment losses on loans	(29,744)
Taxation	7,554
	(36,651)

The HKICPA has issued a number of new and revised HKFRSs which are effective for accounting period beginning or after 1 January 2006. The Group has not early adopted the following Amendment and new Standard which are relevant to its operation:

HKAS 1 (Amendment)	Presentation of financial statements: Capital Disclosures
HKFRS 7	Financial Instruments: Disclosures

The Group has already commenced an assessment of the impact of the HKFRS but is not yet in a position to state whether the new HKFRS would have a significant impact on its operation results and financial positions.

The Companies (Amendment) Ordinance 2005 will apply to the Group for the period beginning 1 January 2006. The Group has assessed its impact and set out the proforma consolidated financial statements in Note 30.

(b) New accounting policies

The accounting policies used for the consolidated financial statements for the year ended 31 December 2005 are set out in Notes 2.2 to 2.18 below which supersede the accounting policies set out in Notes 2(a) to 2(q) to the consolidated financial statements for year ended 31 December 2004.

2.2. Consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiary made up to 31 December.

Where the Company, directly or indirectly, otherwise controls an entity, including special purpose entities as described in HKAS – Int 12, by way of having the power to governing its financial and operating policies so that the Group obtains benefits from these activities, such controlled entities are not included in the consolidated financial statements if they do not fall within the definition of subsidiary set out in the Hong Kong Companies Ordinance except by way of disclosure in the notes to the financial statements to show the effect on the consolidated financial statements had such controlled entities been included.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of the subsidiary have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet, the investment in the subsidiary is stated at cost less provision for impairment allowances. The results of the subsidiary are accounted for by the Company on the basis of dividends received and receivable.

2.3. Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Hong Kong dollars, which is the Company's functional and presentation currency.

(b) **Transactions and balances**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges.

Translation differences on non-monetary items held at fair value through profit or loss are reported as part of the fair value gain or loss. Translation differences on non-monetary items classified as available-for-sale financial assets, are included in the fair value reserve in equity.

2.4. Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge); or, (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(a) **Fair value hedge**

Changes in the fair value of derivatives that are designated and qualified as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used, is amortised to profit or loss over the period to maturity.

(b) **Cash flow hedge**

The effective portion of changes in the fair value of derivatives that are designated and qualified as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

(c) **Derivatives that do not qualify for hedge accounting**

Derivative instruments entered into as economic hedges that do not qualify for hedge accounting are held at fair value through profit or loss. Changes in the fair value of any derivative instrument are recognised immediately in the income statement.

2.5. Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

2.6. Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Upfront arrangement fees that are an integral part of the effective interest rate are recognised as an adjustment to the effective interest rate on the mortgage loans.

2.7. Financial assets

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

(a) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated as at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges.

A financial asset is typically classified as fair value through profit or loss at inception if it meets the following criteria:

(i) it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or

(ii) a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the assets and/or liabilities is provided internally on that basis to the entity's key management personnel.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and for which the Group has no intention of trading the loan and receivable.

(c) Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. Were the Group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale.

(d) Available-for-sale

Available-for-sale investments are non-derivative financial investments that are designated as this category and are not classified in any of the other categories. They are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value. Gains and losses arising from changes in fair value are included as a separate component of equity until sale when the cumulative gain or loss is transferred to the income statement. Interest determined using the effective interest method, impairment losses and translation differences on monetary items are recognised in the income statement.

Purchases and sales of financial assets are recognised on settlement date. Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Gains and losses arising from changes in the fair value of the "financial assets at fair value through profit or loss" category are included in the income statement in the year in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity should be recognised in income statement. However, interest calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the entity's right to receive payment is established.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and other valuation techniques commonly used by market participants.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

2.8. Impairment of financial assets

(a) Assets carried at amortised cost

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following loss events:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the Group would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - adverse changes in the payment status of borrowers in the group; or
  - economic conditions that correlate with defaults on the assets in the group.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics which are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period indicative of changes in the probability of losses in the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

When a mortgage loan is uncollectable, it is written off against the related allowance for loan impairment at the discretion of the Credit Committee. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the allowance for loan impairment in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

(b) Assets carried at fair value

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

2.9. Fixed assets

Fixed assets are stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives.

Leasehold improvements	over the unexpired period of the lease
Furniture and fixtures	over the unexpired period of the lease
Computer	3 years
Office equipment	3 years
Motor vehicle	4 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Gain and loss on disposal is determined by comparing proceeds with carrying amount. It is included in the income statement.

2.10. Impairment of assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

2.11. Leases

The leases entered into by the Group are primarily operating leases. Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

2.12. 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.

2.13. Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events where it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

2.14. Employee benefits

(a) 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.

(b) Bonus plans

The Company recognises a liability and an expense for bonuses, based on a formula that takes into consideration the profit after certain adjustments. The Company recognises a provision where contractually obliged or where there is a past practice that has created constructive obligations.

(c) 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 being forfeited by those employees who leave the scheme prior to full vesting of the employer contributions.

(d) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

2.15. Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred income tax is provided on temporary differences arising from investment in the subsidiary, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future.

Income tax payable on profits is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry-forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax related to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

2.16. Debt securities 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 in standalone retail bond issue and under the Retail Bond Issuance Programme ("RBIP") are initially measured at cost, which is the fair value of the consideration received, net of transaction costs incurred. The notes are subsequently stated at amortised costs; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the debt securities using the effective interest method.

The notes (including those issued with embedded derivative instruments) designated as hedged item under fair value hedge and at fair value through profit or loss upon initial recognition are carried at fair value, with changes in fair value being recorded in the income statement.

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 income statement in the period in which the redemption/repurchase takes place.

2.17. Mortgage insurance contracts

The mortgage insurance business of the Group is accounted for on the annual accounting basis. Under the annual accounting approach, the Group 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 after deduction of discounts, include the reinsurance premiums to be paid to the approved reinsurers, the risk premiums and servicing fees earned by the Group. The net premiums are recognised as income on a time-apportioned basis during the time the insurance coverage is 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 as considered by directors to be appropriate.

Reinsurance contracts refer to contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more insurance contracts issued by the Group. Benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of claims recoverable from reinsurers and receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

2.18. Dividend

Dividend proposed or declared after the balance sheet date is disclosed as a separate component of shareholders' equity.

3. Risk management

3.1. Strategy in using financial instruments

The principal activities of the Group are (i) to purchase portfolios of mortgage loans, secured by residential properties in Hong Kong; (ii) to raise financing for its purchase of assets through issuance of debt securities; (iii) to securitise mortgage portfolios through special purpose entities by way of issuing mortgage-backed securities ("MBS"); and (iv) to provide mortgage insurance cover to Authorized Institutions in respect of mortgage loans originated by such Authorized Institutions and secured by residential properties in Hong Kong.

By their nature, the Group's activities are principally related to the use of financial instruments including cash, mortgage loans, debts and derivatives. The Group hedges a major proportion of its existing interest rate risk of the fixed-rate bond issuance by fair value hedges in the form of interest rate swaps by swapping into floating-rate funding to better match the floating-rate assets. The net fair value losses of such interest rate swaps designated as fair value hedges as at 31 December 2005 was HK$177,261,000 (Note 18(b)).

3.2. Credit risk

The Group's principal financial assets are its mortgage portfolio, investment securities, cash and short-term funds. The credit risk on liquid funds and investment is limited because the counterparties are mainly sovereigns, quasi-sovereign agencies, banks and companies with very high credit ratings.

The Group's credit risk is primarily attributable to its mortgage portfolio, which is the risk that a mortgage borrower will be unable to pay amounts in full when due. Allowance for impairment is provided for losses that have been incurred at the balance sheet date.

Significant changes in the economy and local property market could result in losses that are different from those provided for at the balance sheet date. The Group therefore has a prudent policy for managing its exposure to credit risk.

To maintain the asset quality of the mortgage loan and mortgage insurance portfolios, the Group adheres to a four-pronged approach to (i) select Approved Sellers carefully, (ii) adopt prudent mortgage purchasing criteria and insurance eligibility criteria, (iii) conduct effective due diligence review and (iv) ensure adequate protection for higher-risk mortgages or transactions. The Group has no significant concentration of credit risk. Risk exposure is spread over a large number of customers, counterparties and a diversified geographic distribution of underlying collaterals in Hong Kong.

For financial instruments such as derivatives, exposures are monitored against counterparty risk limits established in accordance with the investment guidelines and credit risk policy of the Group. These counterparty risk limits are subject to regular review by the Credit Committee on a semi-annual basis. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair value is positive), which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall credit limits with counterparties, together with potential exposures from market movements.

3.3. Currency risk

The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rate on its financial position and cash flows. The Board sets allowable currencies for investment. Currently, the Group's foreign currency exposure is limited to US dollar only. The Asset and Liability Committee ("ALCO") sets limits on the currency exposure that may be undertaken, which is monitored daily.

The tables below summarise the Group's exposure to foreign currency exchange rate risk. Included in the tables are the Group's assets and liabilities at carrying amounts, categorised by currency.

The Group	HK$ HK$'000	US$ HK$'000	Total HK$'000
As at 31 December 2005			
Assets			
Cash and short-term funds	1,357,931	1,118,601	2,476,532
Interest and remittance receivables	311,046	38,876	349,922
Prepayments, deposits and other assets	47,410	–	47,410
Tax recoverable	5,056	–	5,056
Derivative financial instruments	85,266	–	85,266
Mortgage portfolio, net	29,475,662	–	29,475,662
Investment securities:			
– available-for-sale	596,461	1,393,512	1,989,973
– held-to-maturity	2,114,492	2,410,402	4,524,894
Fixed assets	22,158	–	22,158
Reinsurance assets	429,178	–	429,178
Total assets	34,444,660	4,961,391	39,406,051
Liabilities			
Interest payable	235,247	1,856	237,103
Accounts payable, accrued expenses and other liabilities	5,480,716	–	5,480,716
Derivative financial instruments	308,915	–	308,915
Deferred tax liabilities	21,691	–	21,691
Insurance liabilities	684,212	–	684,212
Debt securities	27,854,985	140,882	27,995,867
Total liabilities	34,585,766	142,738	34,728,504
Net position	(141,106)	4,818,653	4,677,547
Off-balance sheet net notional position #	141,363	(140,882)	481

\# Off-balance sheet net notional position represents the difference between the notional amounts of foreign currency derivative financial instruments, which are principally used to reduce the Group's exposure to currency movements, and their fair values.

The Company	HK$ HK$'000	US$ HK$'000	Total HK$'000
As at 31 December 2005			
Assets			
Cash and short-term funds	1,355,737	1,118,601	2,474,338
Interest and remittance receivables	310,811	38,876	349,687
Prepayments, deposits and other assets	47,410	–	47,410
Tax recoverable	4,994	–	4,994
Derivative financial instruments	85,266	–	85,266
Mortgage portfolio, net	29,417,710	–	29,417,710
Investment securities:			
– available-for-sale	596,461	1,393,512	1,989,973
– held-to-maturity	2,114,492	2,410,402	4,524,894
Investment in a subsidiary	60,960	–	60,960
Fixed assets	22,158	–	22,158
Reinsurance assets	429,178	–	429,178
Total assets	34,445,177	4,961,391	39,406,568
Liabilities			
Interest payable	235,247	1,856	237,103
Accounts payable, accrued expenses and other liabilities	5,480,687	–	5,480,687
Derivative financial instruments	308,915	–	308,915
Deferred tax liabilities	21,824	–	21,824
Insurance liabilities	684,212	–	684,212
Debt securities	27,854,985	140,882	27,995,867
Total liabilities	34,585,870	142,738	34,728,608
Net position	(140,693)	4,818,653	4,677,960
Off-balance sheet net notional position #	141,363	(140,882)	481

Off-balance sheet net notional position represents the difference between the notional amounts of foreign currency derivative financial instruments, which are principally used to reduce the Group's exposure to currency movements, and their fair values.

The Group	HK$ HK$'000	US$ HK$'000	Total HK$'000
As at 31 December 2004			
Assets			
Cash and short-term funds	363,353	4,974,664	5,338,017
Interest and remittance receivables	299,288	32,488	331,776
Prepayments, deposits and other assets	192,644	–	192,644
Deferred expense, net	8,951	–	8,951
Mortgage portfolio, net	34,938,580	–	34,938,580
Investment securities (held-to-maturity)	1,269,825	2,823,428	4,093,253
Fixed assets	23,452	–	23,452
Reinsurance assets	331,179	–	331,179
Deferred tax assets	8,629	–	8,629
Total assets	37,435,901	7,830,580	45,266,481
Liabilities			
Interest payable	228,534	–	228,534
Accounts payable, accrued expenses and other liabilities	4,825,066	–	4,825,066
Tax payable	47,229	–	47,229
Insurance liabilities	508,981	–	508,981
Debt securities	35,494,740	–	35,494,740
Total liabilities	41,104,550	–	41,104,550
Net position	(3,668,649)	7,830,580	4,161,931

The Company	HK$ HK$'000	US$ HK$'000	Total HK$'000
As at 31 December 2004			
Assets			
Cash and short-term funds	363,343	4,974,664	5,338,007
Interest and remittance receivables	299,121	32,488	331,609
Prepayments, deposits and other assets	192,644	–	192,644
Deferred expense, net	8,951	–	8,951
Mortgage portfolio, net	34,829,101	–	34,829,101
Investment securities (held-to-maturity)	1,269,825	2,823,428	4,093,253
Investment in a subsidiary	109,447	–	109,447
Fixed assets	23,452	–	23,452
Reinsurance assets	331,179	–	331,179
Deferred tax assets	8,609	–	8,609
Total assets	37,435,672	7,830,580	45,266,252
Liabilities			
Interest payable	228,534	–	228,534
Accounts payable, accrued expenses and other liabilities	4,825,045	–	4,825,045
Tax payable	47,167	–	47,167
Insurance liabilities	508,981	–	508,981
Debt securities	35,494,740	–	35,494,740
Total liabilities	41,104,467	–	41,104,467
Net position	(3,668,795)	7,830,580	4,161,785

3.4. Cash flow and fair value interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The ALCO sets limits on the level of interest rate mismatch that may be undertaken, which is monitored regularly.

The Group makes prudent use of a range of financial instruments such as interest rate swaps, basis swaps, forward rate agreements and the issuance of MBS to manage the interest rate mismatch risk. The proceeds of the fixed-rate debt securities are generally swapped into HIBOR-based funds via interest rate swaps. Through the use of such swaps, interest expenses will be changed from a fixed-rate basis to a floating-rate basis in order to better match the floating-rate income from the mortgage assets.

The tables below summarise the Group's exposure to interest rate risks. Included in the tables are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The carrying amounts of derivative financial instruments, which are principally used to reduce the Group's exposure to interest rate movements, are included under the heading "Non-interest bearing".

Expected repricing and maturity dates do not differ significantly from the contract dates.

The Group	Up to 1 month HK$'000	Over 1 month to 3 months HK$'000	Over 3 months to 1 year HK$'000	Over 1 year to 5 years HK$'000	Over 5 years HK$'000	Non-interest bearing HK$'000	Total HK$'000
As at 31 December 2005							
Assets							
Cash and short-term funds	2,446,499	6,800	–	–	–	23,233	2,476,532
Interest and remittance receivables	–	–	–	–	–	349,922	349,922
Prepayments, deposits and other assets	–	–	–	–	–	47,410	47,410
Tax recoverable						5,056	5,056
Derivative financial instruments	–	–	–	–	–	85,266	85,266
Mortgage portfolio, net	29,105,379	217,046	81,284	71,953	–	–	29,475,662
Investment securities:							
– available-for-sale	851,092	728,377	–	–	–	410,504	1,989,973
– held-to-maturity	–	675,273	506,000	2,182,126	1,161,495	–	4,524,894
Fixed assets	–	–	–	–	–	22,158	22,158
Reinsurance assets	–	–	–	–	–	429,178	429,178
Total assets	32,402,970	1,627,496	587,284	2,254,079	1,161,495	1,372,727	39,406,051
Liabilities							
Interest payable	–	–	–	–	–	237,103	237,103
Accounts payable, accrued expenses and other liabilities	5,254,078	–	–	–	–	226,638	5,480,716
Derivative financial instruments	–	–	–	–	–	308,915	308,915
Tax payable	–	–	–	–	–	–	–
Deferred tax liabilities	–	–	–	–	–	21,691	21,691
Insurance liabilities	–	–	–	–	–	684,212	684,212
Debt securities	2,779,677	3,806,397	9,297,010	7,752,058	4,360,725	–	27,995,867
Total liabilities	8,033,755	3,806,397	9,297,010	7,752,058	4,360,725	1,478,559	34,728,504
Total interest sensitivity gap*	24,369,215	(2,178,901)	(8,709,726)	(5,497,979)	(3,199,230)		

* before the repricing effect of derivative financial instruments on the debt securities.

The Company	Up to 1 month HK$'000	Over 1 month to 3 months HK$'000	Over 3 months to 1 year HK$'000	Over 1 year to 5 years HK$'000	Over 5 years HK$'000	Non-interest bearing HK$'000	Total HK$'000
As at 31 December 2005							
Assets							
Cash and short-term funds	2,445,917	6,800	–	–	–	21,621	2,474,338
Interest and remittance receivables	–	–	–	–	–	349,687	349,687
Prepayments, deposits and other assets	–	–	–	–	–	47,410	47,410
Tax recoverable						4,994	4,994
Derivative financial instruments	–	–	–	–	–	85,266	85,266
Mortgage portfolio, net	29,079,967	210,902	54,888	71,953	–	–	29,417,710
Investment securities:							
– available-for-sale	851,092	728,377	–	–	–	410,504	1,989,973
– held-to-maturity	–	675,273	506,000	2,182,126	1,161,495	–	4,524,894
Investment in a subsidiary	26,292	6,357	27,311	–	–	1,000	60,960
Fixed assets	–	–	–	–	–	22,158	22,158
Reinsurance assets	–	–	–	–	–	429,178	429,178
Total assets	32,403,268	1,627,709	588,199	2,254,079	1,161,495	1,371,818	39,406,568
Liabilities							
Interest payable	–	–	–	–	–	237,103	237,103
Accounts payable, accrued expenses and other liabilities	5,254,078	–	–	–	–	226,609	5,480,687
Derivative financial instruments	–	–	–	–	–	308,915	308,915
Tax payable	–	–	–	–	–	–	–
Deferred tax liabilities	–	–	–	–	–	21,824	21,824
Insurance liabilities	–	–	–	–	–	684,212	684,212
Debt securities	2,779,677	3,806,397	9,297,010	7,752,058	4,360,725	–	27,995,867
Total liabilities	8,033,755	3,806,397	9,297,010	7,752,058	4,360,725	1,478,663	34,728,608
Total interest sensitivity gap*	24,369,513	(2,178,688)	(8,708,811)	(5,497,979)	(3,199,230)		

* before the repricing effect of derivative financial instruments on the debt securities.

The Group	Up to 1 month HK$'000	Over 1 month to 3 months HK$'000	Over 3 months to 1 year HK$'000	Over 1 year to 5 years HK$'000	Over 5 years HK$'000	Non-interest bearing HK$'000	Total HK$'000
As at 31 December 2004							
Assets							
Cash and short-term funds	2,597,299	2,714,272	–	–	–	26,446	5,338,017
Interest and remittance receivables	–	–	–	–	–	331,776	331,776
Prepayments, deposits and other assets	–	–	–	–	–	192,644	192,644
Deferred expense, net	–	–	–	–	–	8,951	8,951
Mortgage portfolio, net	33,828,508	727,245	357,907	24,920	–	–	34,938,580
Investment securities – held-to-maturity	966,358	473,362	710,679	1,050,401	892,453	–	4,093,253
Fixed assets	–	–	–	–	–	23,452	23,452
Reinsurance assets	–	–	–	–	–	331,179	331,179
Deferred tax assets	–	–	–	–	–	8,629	8,629
Total assets	37,392,165	3,914,879	1,068,586	1,075,321	892,453	923,077	45,266,481
Liabilities							
Interest payable	–	–	–	–	–	228,534	228,534
Accounts payable, accrued expenses and other liabilities	4,533,637	–	–	–	–	291,429	4,825,066
Tax payable	–	–	–	–	–	47,229	47,229
Insurance liabilities	–	–	–	–	–	508,981	508,981
Debt securities	5,570,000	6,956,600	4,614,250	14,260,940	4,092,950	–	35,494,740
Total liabilities	10,103,637	6,956,600	4,614,250	14,260,940	4,092,950	1,076,173	41,104,550
Total interest sensitivity gap*	27,288,528	(3,041,721)	(3,545,664)	(13,185,619)	(3,200,497)		

* before the repricing effect of derivative financial instruments on the debt securities.

The Company	Up to 1 month HK$'000	Over 1 month to 3 months HK$'000	Over 3 months to 1 year HK$'000	Over 1 year to 5 years HK$'000	Over 5 years HK$'000	Non-interest bearing HK$'000	Total HK$'000
As at 31 December 2004							
Assets							
Cash and short-term funds	2,597,294	2,714,272	–	–	–	26,441	5,338,007
Interest and remittance receivables	–	–	–	–	–	331,609	331,609
Prepayments, deposits and other assets	–	–	–	–	–	192,644	192,644
Deferred expense, net	–	–	–	–	–	8,951	8,951
Mortgage portfolio, net	33,828,508	712,545	284,434	3,614	–	–	34,829,101
Investment securities – held-to-maturity	966,358	473,362	710,679	1,050,401	892,453	–	4,093,253
Investment in a subsidiary	–	14,562	72,780	21,105	–	1,000	109,447
Fixed assets	–	–	–	–	–	23,452	23,452
Reinsurance assets	–	–	–	–	–	331,179	331,179
Deferred tax assets	–	–	–	–	–	8,609	8,609
Total assets	37,392,160	3,914,741	1,067,893	1,075,120	892,453	923,885	45,266,252
Liabilities							
Interest payable	–	–	–	–	–	228,534	228,534
Accounts payable, accrued expenses and other liabilities	4,533,637	–	–	–	–	291,408	4,825,045
Tax payable	–	–	–	–	–	47,167	47,167
Insurance liabilities	–	–	–	–	–	508,981	508,981
Debt securities	5,570,000	6,956,600	4,614,250	14,260,940	4,092,950	–	35,494,740
Total liabilities	10,103,637	6,956,600	4,614,250	14,260,940	4,092,950	1,076,090	41,104,467
Total interest sensitivity gap*	27,288,523	(3,041,859)	(3,546,357)	(13,185,820)	(3,200,497)		

* before the repricing effect of derivative financial instruments on the debt securities.

The table below summarises the effective interest rate* by major currencies for major monetary financial instruments not carried at fair value through profit or loss:

	2005		2004	
	HK$	US$	HK$	US$
	%	%	%	%
Assets				
Cash and short-term funds	4.05%	4.38%	0.31%	2.38%
Mortgage portfolio	5.48%	–	1.87%	–
Investment securities	4.20%	4.61%	3.43%	3.88%
Liabilities				
Other liabilities	4.23%	–	0.35%	–
Debt securities	4.23%	3.10%	3.22%	–

* before the repricing effect of derivative financial instruments on the debt securities.

3.5. Liquidity risk

Liquidity risk represents the risk of the Group not being able to repay its obligations or to fund committed purchases of mortgage loans. Liquidity risk is managed by monitoring the actual inflow and outflow of funds on a daily basis and projecting longer-term inflows and outflows of funds across a full maturity spectrum. The Group has established diversified funding sources to support the growth of its business and the maintenance of a balanced portfolio of liabilities. The table below analyses the Group's major assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

The Group	Repayable on demand HK$'000	Up to 1 month HK$'000	Over 1 month to 3 months HK$'000	Over 3 months to 1 year HK$'000	Over 1 year to 5 years HK$'000	Over 5 years HK$'000	Undated HK$'000	Total HK$'000
As at 31 December 2005								
Assets								
Cash and short-term funds	44,170	2,425,562	6,800	–	–	–	–	2,476,532
Mortgage portfolio	16,491	340,864	337,233	2,498,400	12,227,645	14,023,454	84,349	29,528,436
Investment securities								
– available-for-sale	–	851,092	308,962	–	419,415	–	410,504	1,989,973
– held-to-maturity	–	–	659,497	506,000	2,182,125	1,177,272	–	4,524,894
	60,661	3,617,518	1,312,492	3,004,400	14,829,185	15,200,726	494,853	38,519,835
Liabilities								
Debt securities	–	1,279,677	1,906,461	8,928,218	11,520,785	4,360,726	–	27,995,867

The Company	Repayable on demand HK$'000	Up to 1 month HK$'000	Over 1 month to 3 months HK$'000	Over 3 months to 1 year HK$'000	Over 1 year to 5 years HK$'000	Over 5 years HK$'000	Undated HK$'000	Total HK$'000
As at 31 December 2005								
Assets								
Cash and short-term funds	41,976	2,425,562	6,800	–	–	–	–	2,474,338
Mortgage portfolio	16,491	340,425	336,810	2,496,468	12,216,479	13,979,402	84,349	29,470,424
Investment securities								
– available-for-sale	–	851,092	308,962	–	419,415	–	410,504	1,989,973
– held-to-maturity	–	–	659,497	506,000	2,182,125	1,177,272	–	4,524,894
	58,467	3,617,079	1,312,069	3,002,468	14,818,019	15,156,674	494,853	38,459,629
Liabilities								
Debt securities	–	1,279,677	1,906,461	8,928,218	11,520,785	4,360,726	–	27,995,867

The Group	Repayable on demand HK$'000	Up to 1 month HK$'000	Over 1 month to 3 months HK$'000	Over 3 months to 1 year HK$'000	Over 1 year to 5 years HK$'000	Over 5 years HK$'000	Undated HK$'000	Total HK$'000
As at 31 December 2004								
Assets								
Cash and short-term funds	11,600	2,612,144	2,714,273	–	–	–	–	5,338,017
Mortgage portfolio	19,423	337,169	502,130	2,601,582	12,419,692	19,168,338	4,354	35,052,688
Investment securities								
– held-to-maturity	–	962,654	454,055	710,679	1,054,105	911,760	–	4,093,253
	31,023	3,911,967	3,670,458	3,312,261	13,473,797	20,080,098	4,354	44,483,958
Liabilities								
Debt securities	–	270,000	4,756,600	5,041,200	21,333,990	4,092,950	–	35,494,740

The Company	Repayable on demand HK$'000	Up to 1 month HK$'000	Over 1 month to 3 months HK$'000	Over 3 months to 1 year HK$'000	Over 1 year to 5 years HK$'000	Over 5 years HK$'000	Undated HK$'000	Total HK$'000
As at 31 December 2004								
Assets								
Cash and short-term funds	11,590	2,612,144	2,714,273	–	–	–	–	5,338,007
Mortgage portfolio	19,409	336,345	501,304	2,597,835	12,398,892	19,084,954	4,354	34,943,093
Investment securities								
– held-to-maturity	–	962,654	454,055	710,679	1,054,105	911,760	–	4,093,253
	30,999	3,911,143	3,669,632	3,308,514	13,452,997	19,996,714	4,354	44,374,353
Liabilities								
Debt securities	–	270,000	4,756,600	5,041,200	21,333,990	4,092,950	–	35,494,740

3.6. Mortgage insurance risk

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Group faces under its insurance contracts is that the actual claims exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims are greater than estimated. Insurance events are random and the actual number and amount of claims and benefits will vary from year to year from the estimate established using statistical techniques.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected across the board by a change in any subset of the portfolio. The Group has developed a business strategy to diversify the type of mortgage insurance risks accepted and within each of the key categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

The frequency and severity of claims can be affected by several factors. The most significant are a downturn of the economy and a slump in the local property market. Economic downturn, which may cause a rise in defaulted payment, affects the frequency of claims. A drop in property prices, where the collateral value falls below the outstanding balance of the mortgage loan, will increase the severity of claims.

The Group manages these risks by adopting a set of prudent insurance eligibility criteria. To ensure sufficient provision is set aside for meeting future claim payments, the Group calculates technical reserves on prudent liability valuation assumptions and the method prescribed in the regulatory guidelines. The Group also takes out quota-share reinsurance from its approved mortgage reinsurers in an effort to limit its risk exposure. The Group conducts comprehensive assessment including the financial strength and credit ratings of the mortgage reinsurers in accordance with the approved selection framework set by the Credit Committee. The approved mortgage reinsurers are subject to periodic reviews.

3.7. Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not wholly presented on the Group's balance sheet at their fair value. Bid prices are used to estimate fair values of assets, whereas offer prices are applied for liabilities.

	Carrying value		Fair value	
	2005	2004	2005	2004
	HK$'000	HK$'000	HK$'000	HK$'000
Financial assets				
Cash and short-term funds	**2,476,532**	5,338,017	**2,476,532**	5,338,017
Mortgage portfolio, net	**29,475,662**	34,938,580	**29,475,662**	34,938,580
Investment securities				
– held-to-maturity	**4,524,894**	4,093,253	**4,473,414**	4,155,162
Financial liabilities				
Debt securities	**27,995,867**	35,494,740	**28,002,890**	36,226,409
Other liabilities	**4,278,202**	4,553,637	**4,278,202**	4,553,637

(a) Cash and short-term funds

Cash and short-term funds include bank deposits. The fair value of floating-rate deposits is the carrying amount. The estimated fair value of fixed-rate deposits, which are normally less than 3 months, is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity. Therefore, the fair value of the deposits is approximately equal to its carrying value.

(b) Mortgage portfolio, net

Mortgage portfolio is stated net of impairment allowance. A very insignificant portion of mortgage portfolio bear interest at fixed rate. Therefore, the carrying value of mortgage portfolio is a reasonable estimate of fair value.

(c) Investment securities

Investment securities include only interest-bearing assets held to maturity, as assets available-for-sale are measured at fair value. Fair values for held-to-maturity assets are based on market prices or broker/dealer price quotations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

(d) Debt securities

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

(e) **Other liabilities**

Other liabilities represent the deferred consideration used for credit enhancement on the mortgage loans purchased from the Government of the Hong Kong Special Administrative Region ("HKSAR") in December 2003 and January 2004. The fair value of other liabilities is their carrying amount.

(f) **Financial instruments measured at fair value in the financial statements**

The total amount of the change in fair value estimated using a valuation technique that was recognised in profit or loss during the year is HK$14,687,000 (2004: nil). There are no (2004: nil) financial instruments measured at fair value using a valuation technique that is not supported by observable market data.

4. Critical accounting estimates and assumptions

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4.1. Impairment allowances on mortgage portfolio

The Group reviews its mortgage portfolio to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group or economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

4.2. Fair value of derivatives

The fair values of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are validated before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk, volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

4.3. Impairment of available-for-sale investments

The Group determines that available-for-sale investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates, among other factors, the normal volatility in listed price. In addition, impairment may be appropriate when there is evidence of a deterioration in the financial health of the investment, industry and sector performance, changes in technology, and operational and financing cash flows.

4.4. Held-to-maturity investments

The Group follows the guidance of HKAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to keep these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value, not amortised cost.

4.5. Profits taxes

The Group is subject to profits taxes in Hong Kong. Significant estimates are required in determining the provision for profits taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the year in which such determination is made.

5. Interest income

	The Group	
	2005	2004
	HK$'000	HK$'000
Mortgage portfolio	**1,283,327**	802,250
Cash and short-term funds	**95,784**	66,034
Investment securities – listed	**73,610**	66,250
Investment securities – unlisted	**131,810**	87,340
	1,584,531	1,021,874

Included within interest income is HK$834,000 for the year with respect to interest income accrued on impaired mortgage portfolio.

6. Interest expense

	The Group	
	2005	2004
	HK$'000	HK$'000
Bank loans and debt securities wholly repayable within 5 years	**858,905**	188,626
Debt securities not wholly repayable within 5 years	**104,993**	21,539
	963,898	210,165

7. Other income, net

	The Group 2005 HK$'000	2004 HK$'000
Early prepayment fees and late charges	27,185	21,434
Net insurance premiums earned (Note 11)	101,181	52,580
Guarantee fees income on MBS	20,529	23,005
Excess servicing receipts on MBS	18,893	62,698
Exchange difference	5,217	(3,931)
Change in fair value of derivatives and debt securities	(2,112)	–
Issuance costs of debt securities and MBS	(3,840)	(4,706)
Net loss on disposal of available-for-sale securities	(6,989)	–
Others	5,197	8,721
	165,261	159,801

Change in fair value of derivatives and debt securities represents the aggregate of (i) HK$12,575,000 realised fair value gain on financial instruments designated as at fair value through profit or loss and (ii) HK$14,687,000 of mark-to-market losses for derivatives and debt securities under fair value hedges and those designated as at fair value through profit or loss.

8. Operating expenses

	The Group 2005 HK$'000	2004 HK$'000
Staff costs		
Salaries and benefits	71,511	68,042
Pension costs – defined contribution plans	4,239	3,753
Premises		
Rental	6,368	8,250
Others	4,259	3,986
Directors' emoluments	–	–
Depreciation	10,952	16,224
Consultancy fees	2,170	2,918
Auditors' remuneration		
Audit service	325	270
Others	219	604
Other operating expenses	14,589	14,614
	114,632	118,661

9. Write-back of impairment losses on loans/provisions for bad and doubtful loans

	The Group 2005 HK$'000	The Group 2004 HK$'000
Write-back of impairment losses on loans – collective assessment	(18,639)	–
Provisions/(write-back) for bad and doubtful loans		
– Specific	–	94,868
– General	–	(5,431)
	(18,639)	89,437

10. Taxation

(a) Taxation charge in the consolidated income statement represents:

	The Group 2005 HK$'000	The Group 2004 HK$'000
Hong Kong profits tax		
– Provision for current year	87,763	97,796
– Underprovision in prior years	431	930
	88,194	98,726
Deferred taxation	1,076	671
	89,270	99,397

Hong Kong profits tax has been provided at the rate of 17.5% (2004: 17.5%) on the estimated assessable profit for the year. Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 17.5% (2004: 17.5%).

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 2005 HK$'000	The Group 2004 HK$'000
Profit before taxation	689,901	763,412
Calculated at a taxation rate of 17.5%	120,733	133,597
Income not subject to taxation	(52,608)	(38,434)
Expenses not deductible for taxation purposes	20,714	3,304
Underprovision in prior years	431	930
Taxation charge	89,270	99,397

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

	The Group	
	2005	2004
	HK$'000	HK$'000
Tax recoverable for Hong Kong profits tax	(5,056)	–
Provision for Hong Kong profits tax	–	47,229
Deferred tax liabilities/(assets)	21,691	(8,629)
	16,635	38,600

	The Company	
	2005	2004
	HK$'000	HK$'000
Tax recoverable for Hong Kong profits tax	(4,994)	–
Provision for Hong Kong profits tax	–	47,167
Deferred tax liabilities/(assets)	21,824	(8,609)
	16,830	38,558

There is no significant unprovided deferred taxation as at and for the year ended 31 December 2005.

The major components of deferred tax (assets)/liabilities and the movements during the year are as follows:

	The Group				
	Accelerated tax depreciation HK$'000	General provision/ Impairment allowances HK$'000	Tax losses HK$'000	Fair value gains HK$'000	Total HK$'000
As at 1 January 2004	3,687	(12,987)	–	–	(9,300)
Recognised in the income statement	(280)	951	–	–	671
As at 31 December 2004	3,407	(12,036)	–	–	(8,629)
Effect of adopting HKAS 39	–	9,317	–	–	9,317
As at 1 January 2005	3,407	(2,719)	–	–	688
Recognised in the income statement	5	1,194	(123)	–	1,076
Charged to equity	–	–	–	19,927	19,927
As at 31 December 2005	**3,412**	**(1,525)**	**(123)**	**19,927**	**21,691**

	The Company			
	Accelerated tax depreciation HK$'000	General provision/ Impairment allowances HK$'000	Fair value gains HK$'000	Total HK$'000
As at 1 January 2004	3,687	(12,987)	–	(9,300)
Recognised in the income statement	(280)	971	–	691
As at 31 December 2004	3,407	(12,016)	–	(8,609)
Effect of adopting HKAS 39	–	9,317	–	9,317
As at 1 January 2005	3,407	(2,699)	–	708
Recognised in the income statement	5	1,184	–	1,189
Charged to equity	–	–	19,927	19,927
As at 31 December 2005	**3,412**	**(1,515)**	**19,927**	**21,824**

The amounts shown in the consolidated balance sheet and Company's balance sheet include deferred tax assets of HK$1,525,000 (2004: HK$12,036,000) and HK$1,515,000 (2004: HK$12,016,000) respectively to be recovered after more than twelve months.

11. Revenue account for mortgage insurance business

	The Group	
	2005 HK$'000	2004 HK$'000
Gross premiums written	**459,465**	341,796
Reinsurance premiums	**(281,277)**	(217,081)
Net premiums written	**178,188**	124,715
Increase in unearned premiums, net	**(77,519)**	(70,904)
Net premiums earned before provisions	**100,669**	53,811
Write-back/(provisions) for outstanding claims and claims incurred but not reported (Note 26)	**512**	(1,231)
Net premiums earned (Note 7)	**101,181**	52,580
Management expenses	**(9,226)**	(5,249)
Underwriting gains	**91,955**	47,331

The management expenses formed part of the operating expenses in Note 8.

12. Net profit for the year

The net profit for the year is dealt with in the financial statements of the Company to the extent of HK$601,223,000 (2004: HK$663,818,000).

13. Dividend

	The Company	
	2005 HK$'000	2004 HK$'000
Proposed dividend of HK$0.125 (2004: HK$0.125) per ordinary share	250,000	250,000

The dividend paid during the year ended 2005 was HK$250 million. The directors proposed a final dividend in respect of 2005 of HK$0.125 per ordinary share on 28 April 2006. The proposed dividend is not reflected as a dividend payable as at 31 December 2005.

14. Cash and short-term funds

	The Group	
	2005 HK$'000	2004 HK$'000
Cash at banks	44,170	11,600
Time deposits with banks	2,432,362	5,326,417
	2,476,532	5,338,017

	The Company	
	2005 HK$'000	2004 HK$'000
Cash at banks	41,976	11,590
Time deposits with banks	2,432,362	5,326,417
	2,474,338	5,338,007

15. Interest and remittance receivable

	The Group	
	2005	2004
	HK$'000	HK$'000
Interest receivable from mortgage portfolio	**124,801**	49,675
Interest receivable from interest rate swap contracts	**111,870**	216,424
Interest receivable from investment securities	**79,138**	43,886
Interest receivable from time deposits with banks	**1,318**	6,173
Loan instalments, in transit	**32,795**	15,618
	349,922	331,776

	The Company	
	2005	2004
	HK$'000	HK$'000
Interest receivable from mortgage portfolio	**124,566**	49,508
Interest receivable from interest rate swap contracts	**111,870**	216,424
Interest receivable from investment securities	**79,138**	43,886
Interest receivable from time deposits with banks	**1,318**	6,173
Loan instalments, in transit	**32,795**	15,618
	349,687	331,609

16. Prepayments, deposits and other assets

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Corporate club debentures	**750**	670
Other receivables, net	**–**	155,294
Others	**46,660**	36,680
	47,410	192,644

In 2004, the Group classified the mortgage loans as “Other receivables, net” where the mortgage loans were overdue for 180 days or more, the collateral properties were repossessed, or the mortgagors became bankrupt at the forced sale value of the collateral properties after setting off provisions of HK$59,530,000 against the outstanding principal balance of the mortgage loans of HK$214,824,000. In 2005, these balances are reclassified to “Mortgage portfolio, net” (Note 19).

17. Deferred expense, net

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Deferred expenses arising on issuance of debt securities	–	8,951

In 2004, net discount on the debt securities issued was recorded as deferred expense. In 2005, such premium/discount was reclassified to form part of the carrying value of "Debt securities" (Note 25).

18. Derivative financial instruments

The Group uses the following derivative instruments for both hedging and non-hedging purposes:

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates or a combination of all these. No exchange of principal takes place except for certain currency swaps. The Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligation. This risk is monitored on an ongoing basis with reference to the current fair value, a proportion of the notional amount of the contracts and the liquidity of the market.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time. The fair values of derivative instruments held are set out below.

	Contract/ notional amount HK$'000	The Group and the Company Fair values as at 31 December 2005 Assets HK$'000	Liabilities HK$'000
(a) Derivatives designated as at fair value through profit or loss			
Interest rate swaps	40,007,850	33,371	(78,122)
Currency swaps	58,467	–	(1,306)
		33,371	(79,428)
(b) Derivatives designated as fair value hedge			
Interest rate swaps	21,601,280	51,895	(229,156)
Currency swaps	82,896	–	(331)
		51,895	(229,487)
Total recognised derivative assets /(liabilities)		85,266	(308,915)

The notional principal amounts of outstanding derivative contracts as at 31 December 2004 were as follows:

Interest rate swaps	HK$73,869,330,000
Currency swaps	HK$ nil

The replacement costs and potential future credit exposure amounts of the derivative 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			
	2005		2004	
	Replacement cost HK$'000	Potential future credit exposure HK$'000	Replacement cost HK$'000	Potential future credit exposure HK$'000
Interest rate contracts	174,053	119,892	1,114,718	147,007
Exchange rate contracts	293	3,752	–	–
	174,346	123,644	1,114,718	147,007

The replacement costs represent the cost of replacing all derivative 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 34). The Group has not experienced any non-performance by its counterparties.

Management has established limits on the above exposures that are monitored regularly by the Credit Committee.

19. Mortgage portfolio, net

(a) Mortgage portfolio less allowance/provisions

	The Group	
	2005	2004
	HK$'000	HK$'000
Outstanding principal balance of mortgage portfolio	**29,528,436**	35,052,688
Allowance for loan impairment/provisions for bad and doubtful loans	**(52,774)**	(114,108)
	29,475,662	34,938,580

	The Company	
	2005	2004
	HK$'000	HK$'000
Outstanding principal balance of mortgage portfolio	**29,470,424**	34,943,093
Allowance for loan impairment/provisions for bad and doubtful loans	**(52,714)**	(113,992)
	29,417,710	34,829,101

As at 31 December 2005, the mortgage portfolio had a weighted average remaining term of 10 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 2045.

(b) Allowance for loan impairment/provisions for bad and doubtful loans

	The Group			
	2005	2004		
	Collective assessment HK$'000	Specific provision HK$'000	General provision HK$'000	Total HK$'000
Balance as at 1 January	124,767	15,320	73,973	89,293
Adoption of HKAS 39	(54,289)	–	–	–
Adjusted balance as at 1 January	70,478	15,320	73,973	89,293
Amount written off	(63,609)	(53,767)	(618)	(54,385)
(Released)/charged to income statement	(18,639)	94,868	(5,431)	89,437
Transfer from other receivables (Note 16)	59,530	–	–	–
Amounts recovered	5,014	422	–	422
As at 31 December	52,774	56,843	67,924	124,767

	The Company			
	2005	2004		
	Collective assessment HK$'000	Specific provision HK$'000	General provision HK$'000	Total HK$'000
Balance as at 1 January	124,651	15,320	73,973	89,293
Adoption of HKAS 39	(54,256)	–	–	–
Adjusted balance as at 1 January	70,395	15,320	73,973	89,293
Amount written off	(63,609)	(53,767)	(618)	(54,385)
(Released)/charged to income statement	(18,616)	94,868	(5,547)	89,321
Transfer from other receivables	59,530	–	–	–
Amounts recovered	5,014	422	–	422
As at 31 December	52,714	56,843	67,808	124,651

As regards the allowance for loan impairment on the guaranteed mortgage loans under the two MBS programmes, a sum of HK$306,000 allowance for loan impairment was grouped under "Mortgage portfolio, net" (2004: loan provisioning of HK$10,659,000 grouped under "Other provisions" in Note 23).

(c) The total mortgage loans on which interest was placed in suspense or has ceased to accrue as at 31 December 2004 were as follows:

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Gross mortgage loans	–	56,668
Specific provisions	–	(9,120)
	–	47,548

In 2005, no interest was placed in suspense and interest income on impaired loans will continue to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment losses (Note 5).

Allowance for loan impairment was made after taking into account the current market value of the collateral of the delinquent loans.

20. Investment securities

(a) Available-for-sale securities

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Debt securities at fair value		
Unlisted	1,563,461	–
Listed	16,008	–
Other securities at fair value		
Listed	410,504	–
Total available-for-sale securities	1,989,973	–

Available-for-sale securities are analysed by categories of issuers as follows:

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Banks and other financial institutions	1,176,062	–
Corporate entities	233,458	–
Others	580,453	–
	1,989,973	–

The movement in available-for-sale securities is summarised as follows:

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
As at 1 January	–	–
Additions	4,094,763	–
Disposals (sale and redemption)	(2,224,488)	–
Amortisation	9,245	–
Revaluation surplus transfer to equity (Note 28)	113,866	–
Exchange difference	(3,413)	–
As at 31 December	1,989,973	–

There were no impairment provisions on available-for-sale securities in 2005.

(b) Held-to-maturity securities

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Debt securities at amortised cost		
Listed in Hong Kong	592,656	223,906
Listed outside Hong Kong	998,012	1,423,712
	1,590,668	1,647,618
Unlisted	2,934,226	2,445,635
Total held-to-maturity securities	4,524,894	4,093,253
Market value of listed securities – held-to-maturity	1,580,266	1,672,408

Held-to-maturity securities are analysed by categories of issuers as follows:

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Banks and other financial institutions	2,207,929	1,956,669
Corporate entities	1,094,916	993,878
Public sector entities	877,050	875,770
Central governments	344,999	263,232
Others	–	3,704
	4,524,894	4,093,253

The movement in held-to-maturity securities is summarised as follows:

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
As at 1 January	**4,093,253**	3,535,525
Additions	**6,054,641**	1,741,749
Disposals (sale and redemption)	**(5,617,764)**	(1,178,170)
Amortisation	**841**	(7,617)
Exchange difference	**(6,077)**	1,766
As at 31 December	**4,524,894**	4,093,253

There were no impairment provisions on held-to-maturity securities in 2005.

21. Fixed assets

	The Group and the Company				
	Leasehold improvement HK$'000	Office equipment, furniture and fixtures HK$'000	Computers HK$'000	Motor vehicle HK$'000	Total HK$'000
Cost					
As at 1 January 2005	7,055	6,051	83,845	539	97,490
Additions	121	102	9,435	–	9,658
Disposal/write-offs	–	(265)	–	–	(265)
As at 31 December 2005	**7,176**	**5,888**	**93,280**	**539**	**106,883**
Accumulated depreciation					
As at 1 January 2005	565	2,495	70,439	539	74,038
Charge for the year (Note 8)	1,086	1,106	8,760	–	10,952
Disposal/write-offs	–	(265)	–	–	(265)
As at 31 December 2005	**1,651**	**3,336**	**79,199**	**539**	**84,725**
Net book value					
As at 31 December 2005	**5,525**	**2,552**	**14,081**	**–**	**22,158**
As at 31 December 2004	6,490	3,556	13,406	–	23,452

22. Investment in a subsidiary

	The Company 2005 HK$'000	The Company 2004 HK$'000
Unlisted shares, at cost	1,000	1,000
Due from a subsidiary	59,960	108,447
	60,960	109,447

The amount due from a subsidiary is unsecured, interest-bearing and has no fixed term of repayment.

The details of the subsidiary at 31 December 2005 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 and servicing	HK$1,000,000 of HK$1 each	Ordinary	100%

23. Accounts payable, accrued expenses and other liabilities

	The Group 2005 HK$'000	The Group 2004 HK$'000
Accounts payable and accrued expenses	219,413	270,696
Other payable (Note 30)	975,876	–
Other liabilities	4,278,202	4,533,637
Other provisions	7,225	20,733
	5,480,716	4,825,066

	The Company 2005 HK$'000	The Company 2004 HK$'000
Accounts payable and accrued expenses	219,413	270,696
Other payable (Note 30)	975,876	–
Other liabilities	4,278,202	4,533,637
Other provisions	7,196	20,712
	5,480,687	4,825,045

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

24. Insurance liabilities and reinsurance assets

	The Group and the Company 2005 HK$'000	The Group and the Company 2004 HK$'000
Gross		
Unearned premiums	681,469	502,746
Claims reported and outstanding	1,930	–
Claims incurred but not reported	813	6,235
Total insurance liabilities, gross	684,212	508,981
Reinsurance		
Unearned premiums	427,003	325,799
Claims reported and outstanding	1,478	392
Claims incurred but not reported	697	4,988
Total reinsurers' share of insurance liabilities	429,178	331,179
Net		
Unearned premiums	254,466	176,947
Claims reported and outstanding	452	(392)
Claims incurred but not reported	116	1,247
Total insurance liabilities, net	255,034	177,802

25. Debt securities

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Debt securities carried at amortised cost		
NIP notes	–	1,000,000
DIP		
(i) notes	3,900,000	24,301,000
(ii) TLC	–	3,000,000
RBIP and other notes	–	7,193,740
Total debt securities carried at amortised cost	3,900,000	35,494,740
Debt securities designated as fair value hedge		
NIP notes	1,005,619	–
DIP notes	15,996,080	–
RBIP and other notes	4,494,241	–
Total debt securities designated as fair value hedge	21,495,940	–
Debt securities designated as at fair value through profit or loss upon initial recognition		
DIP notes	1,934,939	–
RBIP and other notes	664,988	–
Total debt securities designated as at fair value through profit or loss upon initial recognition	2,599,927	–
Total debt securities	27,995,867	35,494,740

As at 1 January 2005, the Group designated on initial recognition HK$2,995,033,000 of financial liabilities as at fair value through profit or loss upon the adoption of HKAS 39. During the year, the Group further designated on initial recognition HK$1,108,467,000 of such financial liabilities as at fair value through profit or loss. The fair value changes are attributable to changes in benchmark interest rates for the debt securities designated as at fair value through profit or loss. The carrying amount of the financial liabilities designated as at fair value through profit or loss upon initial recognition is HK$63,900,000 lower than the amount that the Group would be contractually required to pay at maturity to the note holders.

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
As at 1 January	35,494,740	36,630,290
Issuance for the year	5,101,063	11,398,500
Less: Redemption for the year	(12,347,800)	(12,534,050)
Total nominal value	28,248,003	35,494,740
Unamortised portion of premium/discount (Note 17)	(11,342)	–
Fair value adjustment	(240,794)	–
As at 31 December	27,995,867	35,494,740

Notes issued during the year comprise:

	The Group and the Company	
	DIP	RBIP
	HK$'000	HK$'000
Amount issued at nominal value	4,476,000	625,063
Consideration received	4,475,995	619,969

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

26. Provisions for mortgage insurance business

Provisions for outstanding claims under the mortgage insurance business are recorded net of recoveries from the approved reinsurers. For the year ended 31 December 2005, provision for claims of HK$698,000 (2004: HK$44,000) for risk-sharing business was written back in the income statement of the Group. The gross claim (net of recovery from Authorized Institutions) was HK$944,000 (2004: HK$6,034,000), of which HK$758,000 (2004: HK$4,759,000) was recovered from the approved reinsurers.

27. Share Capital

	2005 and 2004
	HK$'000
Authorized	
3 billion ordinary shares of HK$1 each	3,000,000
Issued and fully paid	
2 billion ordinary shares of HK$1 each	2,000,000

28. Other reserve

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Available-for-sale securities		
As at 1 January	–	–
Revaluation – gross	113,866	–
Revaluation – tax	(19,927)	–
As at 31 December	93,939	–

29. Material related party transactions

Related parties are those parties which have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or other entities.

During the year, the Company entered into various transactions with related parties on an arm's length and commercial basis. The nature of the relationship is set out in the following table:

Name	Interests	Nature of related transaction – see the notes below
The Honourable Henry TANG Ying Yen, GBS, JP	Financial Secretary Controller of the Exchange Fund	(1) (3) (8)
Joseph YAM Chi Kwong, GBS, JP	Chief Executive of the Hong Kong Monetary Authority	(2) (3) (8)
Norman CHAN Tak Lam, SBS, JP (resigned on 27 May 2005)	Deputy Chief Executive of the Hong Kong Monetary Authority	(2) (3) (8)
Peter PANG Sing Tong, JP	Deputy Chief Executive of the Hong Kong Monetary Authority	(2) (3) (8)
CHOI Yiu Kwan, JP (appointed on 1 June 2005)	Deputy Chief Executive of the Hong Kong Monetary Authority	(2) (3) (8)
Anita FUNG Yuen Mei (retired on 12 April 2005)	Treasurer, Head of Global Markets, Asia-Pacific of The Hongkong and Shanghai Banking Corporation Limited	(4) (5) (6) (7)

Name	Interests	Nature of related transaction – see the notes below
Andy HON Hak Keung (retired on 12 April 2005)	General Manager, Mortgages and Auto, Consumer Banking of Standard Chartered Bank (Hong Kong) Limited	(4) (6)
Kenny LAM Kin Sun (appointed on 12 April 2005)	Senior Vice President Global Financial Markets DBS Bank Limited Hong Kong Branch	(10)
David LAM Yim Nam (appointed on 12 April 2005)	Deputy Chief Executive Bank of China (Hong Kong) Limited	(4) (5) (6) (7)
Dr. the Honourable David LI Kwok Po, GBS, LLD (Cantab), JP	Chairman and Chief Executive of The Bank of East Asia, Limited	(4) (5) (6)
The Honourable Frederick MA Si Hang, JP	Secretary for Financial Services and the Treasury	(1)
The Honourable Michael SUEN Ming Yeung, GBS, JP	Secretary for Housing, Planning and Lands	(1)
David SUN Tak Kei	Chairman and Country Managing Partner Ernst & Young	(9)

(1) In 2005, the HKMC purchased about HK$174 million of mortgage loans from the Government of HKSAR (2004: HK$10 billion).

(2) The HKMC is a member of the Central Moneymarkets Unit Service operated by the Hong Kong Monetary Authority ("HKMA") which provides custodian and clearing agent services for the debt securities issued by the HKMC. In 2005, the HKMC paid HK$0.4 million (2004: HK$1.2 million) by way of fees to the HKMA for such services.

(3) The Exchange Fund through HKMA has provided the HKMC with a HK$10 billion revolving credit facility. As at 31 December 2005, there was no outstanding balance (2004: nil).

(4) Being an executive director or senior officer of a financial institution or organisation as specified under the column headed "Interests" in the above table which has entered into an agreement with the HKMC in respect of the purchase of mortgage loans by the HKMC from time to time under the Mortgage Purchase Programme.

(5) Being an executive director or senior officer of a financial institution or organisation as specified under the column headed "Interests" in the above table which has entered into an agreement with the HKMC in respect of the application for mortgage insurance cover from time to time under the Mortgage Insurance Programme.

(6) Being an executive director or senior officer of a financial institution as specified under the column headed "Interests" in the above table which has entered into an agreement with the HKMC, as primary dealer or selling group member in the HK$40 Billion Debt Issuance Programme and the HK$20 Billion Retail Bond Issuance Programme.

(7) Being an executive director or senior officer of a financial institution as specified under the column headed "Interests" in the above table which has entered into an agreement with the HKMC, as arranger or lead manager/co-lead manager in one or more of the HKMC's MBS issues, including the US$3,000,000,000 Bauhinia Mortgage-Backed Securitisation Programme.

(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 ("FSI") by which the FSI 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 FSI, the HKMC pays the rental to the HKMA. In 2005, the HKMC paid HK$6.4 million (2004: nil) of rental to the HKMA.

(9) Ernst & Young were appointed by the HKMC to conduct a network security analysis on the HKMC's computer systems at a consultancy fee of HK$0.2 million (2004: HK$0.2 million).

(10) DBS Bank Limited is the parent company of DBS Bank (Hong Kong) Limited. DBS Bank (Hong Kong) Limited has entered into agreements with the HKMC in respect of the matters set out in paragraphs (4), (5) and (6) above.

30. Effects on the non-consolidation 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 entity ("SPE") 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 SPE incorporated in the Cayman Islands for the purposes of this programme, will from time to time issue MBS.

The above two SPEs are considered to be bankruptcy remote "orphan" entities. Under Section 2B(3) of the Hong Kong Companies Ordinance, as introduced by the Companies (Amendment) Ordinance 2005, which comes into effect for the period beginning 1 January 2006, the two SPEs would be deemed to be subsidiaries of the Company for the purposes of preparing group accounts. However, in accordance with the provisions of paragraph 21A of HKAS 27 "Consolidated and separate financial statements", the financial statements of these two SPEs have not been consolidated into the Group's financial statements for the year ended 2005.

In prior years, all the mortgage loans sold to the SPEs were no longer be recognised as an asset in the balance sheet of the Group. Following the adoption of HKAS 39, mortgage loans sold to the SPEs are derecognised only when the rights to receive cash flows from the financial assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. During the year, the Company sold HK$1 billion of mortgage loans to Bauhinia MBS Limited which issued the same amount of MBS guaranteed by the Company under the Bauhinia MBS Programme. The Company continues to recognise the asset to the extent of the guarantee. A liability due to Bauhinia MBS Limited of HK$1 billion has also been recognised. As at 31 December 2005, the amount due to Bauhinia MBS Limited was HK$975,876,000 (Note 23).

Up to 31 December 2005, HKMC Funding Corporation (1) Limited had issued 8 series of MBS totalling HK$2,837 million in respect of which the Company has guaranteed the timely payment of principal and interest of the MBS. As at 31 December 2005, the aggregate security principal balance of MBS guaranteed by the Company under the MBS Pass-Through Programme was HK$410 million. No allowance for loan impairment on the mortgage loans under the MBS Pass-Through Programme was made in 2005. The financial liability arising from the guarantee was accounted for as financial guarantee liability, a sum of HK$2.8 million grouped under "Other liabilities" (Note 23). As regards the Company's loan provisioning on the guaranteed mortgage loans under the MBS Pass-Through Programme, a sum of HK$1,781,000 was grouped under "Other provisions" (Note 23) in 2004.

Up to 31 December 2005, Bauhinia MBS Limited had issued 5 series of MBS totalling HK$8,400 million in respect of which the Company has guaranteed the timely payment of principal and interest of the MBS. At 31 December 2005, the aggregate security principal balance of MBS guaranteed by the Company under the Bauhinia MBS Programme was HK$4,755 million. As regards the Company's allowance for loan impairment on the mortgage loans securitised under the Bauhinia MBS Programme in 2005, a sum of HK$306,000 was grouped under: "Mortgage portfolio, net" (Note 19) (2004: HK$8,878,000 grouped under "Other provisions"

(Note 23)). No allowance for loan impairment on the mortgage loans securitised under the Bauhinia MBS programme prior to 2005. The financial liability arising from the guarantee for such mortgage loans was accounted for as financial guarantee liability, a sum of HK$32.7 million was grouped under "Other liabilities" (Note 23).

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 HK$'000	Bauhinia MBS Limited HK$'000
For the year ended 31 December 2005		
Operating profit after tax	15	20
As at 31 December 2005		
Mortgage portfolio, net	404,689	3,671,580
Total Assets	411,702	4,807,065
Debt securities	409,842	4,754,534
Total Liabilities	411,576	4,806,999
Total Shareholders' Equity	126	66

In accordance with paragraph 42A of HKAS 27, the Group has set out below the significant items of the pro-forma consolidated income statement and balance sheet of the Group, HKMC Funding Corporation (1) Limited and Bauhinia MBS Limited for the following years:

	2005 HK$'000	2004 HK$'000
Net interest income for the year	657,856	900,660
Net profit for the year	600,666	664,050
Mortgage portfolio, net	33,551,931	40,519,435
Total Assets	43,544,828	50,676,880
Debt securities	33,160,243	41,363,888
Total Liabilities	38,867,089	46,514,792
Total Shareholders' Equity	4,677,739	4,162,088
Capital-to-assets ratio	12.0%	8.6%

31. Commitments

(a) Capital

	The Group and the Company	
	2005	2004
Authorized and contracted for	–	–
Authorized but not contracted for	7,756	10,999
	7,756	10,999

(b) Operating leases

The Group leases the office premises under operating leases. The leases of the office premises run for an initial period of six years and include an option to renew at the then current open market rent. Total future minimum lease payments under non-cancellable operating leases at the balance sheet date are analysed as follows:

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Office premises		
not later than one year	6,368	6,368
later than one year and not later than five years	25,471	25,471
later than five years	–	6,368
	31,839	38,207

32. Mortgage insurance business

The Company offers mortgage insurance which provides cover to the Approved Seller/Servicers for credit losses of up to 25% of the property value of a mortgage loan where 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.

As at 31 December 2005, the total risk-in-force was approximately HK$8.05 billion (2004: HK$5.93 billion) of which HK$5.41 billion (2004: HK$4.16 billion) was ceded to the approved reinsurers and the balance of HK$2.64 billion (2004: HK$1.77 billion) was retained by the Company.

33. Contingent liabilities

The contractual amounts of the guarantees provided under the MBS programmes are:

	The Group and the Company	
	2005	2004
	HK$'000	HK$'000
Guarantees	**5,197,567**	5,869,148

34. Capital-to-assets ratio

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

	2005	2004
Capital-to-assets ratio	**12.0%**	9.3%

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

35. Approval of financial statements

The financial statements were approved by the Board of Directors on 28 April 2006.