SHANGHAI COMMERCIAL BANK



2012
ANNUAL REPORT

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CORPORATE PROFILE

Established in November 1950, Shanghai Commercial Bank is one of the renowned local Chinese banks in Hong Kong and has a niche market position in the corporate and trade finance sectors.

The Bank has always been pursuing the motto of its founder, Mr. Kwang-pu Chen, to 'Serve the Community'. The Bank's slogan of 'For Personalized Service' and 'All in a Family' denotes the Bank's devotion to providing personalized services to its clients and promoting a harmonious relationship among its staff members.

The Bank offers a comprehensive range of retail and corporate banking services and products including deposits, securities trading, credit cards, wealth management services and corporate and personal loans.

In addition to 44 branches in Hong Kong, the Bank has a global network of overseas branches in San Francisco, Los Angeles, New York and London. In Mainland China, the Bank has established a branch presence in Shenzhen and Shanghai.

FIVE-YEAR FINANCIAL SUMMARY

	2012	2011	2010	2009	2008
FOR THE YEAR (IN HK$ MILLION)					
Net interest income	1,925	1,982	1,893	1,735	1,966
Other operating income	1,061	1,057	1,251	1,159	958
Operating expenses	992	884	1,040	1,264	1,004
Operating profit	2,034	2,174	2,020	1,572	1,547
Profit before other comprehensive income attributable to equity holders	1,648	1,798	1,701	1,336	1,185
Dividend	820	860	860	800	800
AT YEAR END (IN HK$ MILLION)					
Shareholders' funds	19,251	18,022	17,114	16,034	14,833
Total assets	137,187	126,978	118,642	112,910	109,749
Total deposits	110,682	103,097	95,463	91,489	89,532
Total loans and advances	53,977	55,480	51,028	44,340	50,168
FINANCIAL RATIOS					
Capital adequacy ratio	18%	18%	19%	19%	19%
Liquidity ratio	61%	47%	51%	55%	47%
Loan to deposit ratio*	48.77%	53.81%	57.11%	52.03%	58.06%
Dividend to profit before other comprehensive income payout ratio	49.75%	47.82%	50.57%	59.88%	67.49%
Return on average assets	1.25%	1.46%	1.47%	1.20%	1.09%

* Loan to deposit ratios for Year 2011 to Year 2012 are stated based on total loans and advances including trade financing loans to total deposits. (Year 2008 to Year 2010 were stated based on total loans and advances, trade bills and holdings of debt securities issued by corporations to total deposits.)

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the Sixty-second Annual General Meeting of the Members of the Bank will be held at its Shanghai Branch, Room 913, China Merchants Tower, 161 Lu Jia Zui Road (E), Pu Dong, Shanghai, China on Thursday, 25th April 2013 at 10:00 a.m. to transact the following business:

(1) To receive and consider the audited financial statements and the Reports of the Directors and of the Auditor for the year ended 31st December 2012;
(2) To declare Dividend in respect of the year 2012;
(3) To elect Directors;
(4) To approve the payment of Directors' fees for the year ended 31st December 2012;
(5) To re-appoint Auditor and to authorise the Directors to fix their remuneration.

A Member entitled to attend and vote at the Meeting is entitled to appoint a proxy to attend and vote instead of him. A proxy need not also be a Member.

The Register of Members of the Bank will be closed from Thursday, 18th April 2013 to Thursday, 25th April 2013, both days inclusive.

By Order of the Board
May Yuen-ling Kwok
Corporate Secretary

Hong Kong, 30th January 2013

BOARD OF DIRECTORS



Front row from left to right

Mr. Richard Jason Lloyd Yorke, Mr. David Allen Hoyt, Mr. Lincoln Chu Kuen Yung, Mr. Hung-ching Yung, Mr. Stephen Ching Yen Lee, Madam Ning Li Ming.

Back row from left to right

Mr. Edward Kawah Chu, Dr. Richard Lee, Mr. David Sek-chi Kwok, Mr. Johnson Mou Daid Cha, Mr. Chen Yih Pin, Mr. Gordon Che Keung Kwong.



Mr. Fan Yifei

# Lincoln Chu Kuen Yung, JP Chairman & Non-executive Director	
^ David Sek-chi Kwok Chief Executive & Managing Director	
# Hung-ching Yung, JP	
# Shen Ruolei	(resigned on 25th May 2012)
(Ye Jun, Alternate)	(resigned on 25th May 2012)
*** Dr. Richard Lee**	
*** Johnson Mou Daid Cha** (Dr. Lam Chat Yu, Alternate)	
# Stephen Ching Yen Lee	
^ Edward Kawah Chu	
# David Allen Hoyt	
(Ignatius Wooi-kean Choong, Alternate)	(resigned on 20th April 2012)
(John Van Antwerp Rindlaub, Alternate)	(appointed on 20th April 2012)
# Chen Yih Pin (Yi-Jen Chiou, Alternate)	
*** Gordon Che Keung Kwong**	
# Ning Li Ming	
(Li Jian Guo, Alternate)	(resigned on 25th May 2012)
(Ye Jun, Alternate)	(appointed on 25th May 2012)
# Richard Jason Lloyd Yorke	
(Clifford Sterling Lawrence, Alternate)	(resigned on 20th April 2012)
(Ignatius Wooi-kean Choong, Alternate)	(appointed on 20th April 2012)
# Fan Yifei	(appointed on 25th May 2012)
(Li Jian Guo, Alternate)	(appointed on 25th May 2012)

^ Executive Directors

* Independent Non-executive Directors

Non-executive Directors

MANAGEMENT

EXECUTIVES

Chief Executive & Managing Director	David Sek-chi Kwok	
Alternate Chief Executives	Edward Kawah Chu Paul Kun-kow Wong	
Assistant General Managers	Hon-ming Mak Burton Chi-shan Cheng Daniel Kwok-hung Chan Stephen Siu-fung Lee Frank Shui-sang Jin Danny Kong-keung Tsang	
Senior Managers	Pui-man Yeung Zachary Wing-kwong Kwan	Francis Yue-cheong Wong Wendy Li-chien Weng
Managers	Vincent Chi-wing Man Thomas Chee-kin Lo Stephen Wing-hing Lai Eric Kai-chiu Fok	Annie Wai-yu Cheung Michael Yiu-wing Fung Jenny Chui-yeung Chau Tim Yuen

OVERSEAS BRANCHES

Los Angeles Branch
Executive Vice President & Manager — Ching-hsing Kao

New York Branch
Senior Vice President & Manager — Timothy Kam-tim Chan

San Francisco Branch
Senior Vice President & Manager — Philip She-hoi Lee

London Branch
Manager — Frederick Yan Chu

MAINLAND BRANCHES

Shenzhen Branch
Manager — Vincent Chi-wing Man

Shanghai Branch
Manager — Lydia Li-ying Chen

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

DIRECTORS

MR. LINCOLN CHU KUEN YUNG, JP

Aged 67. Chairman and Non-executive Director. Mr. Yung was appointed a Director of the Bank since September 1998 and was elected Chairman in December 2007. He has been a Director of The Shanghai Commercial & Savings Bank, Ltd. since March 1991, where he served as Managing Director from 1994 to 2004. He is currently the Chairman of Paofoong Insurance Company (Hong Kong) Limited, the Deputy Managing Director of Nanyang Holdings Limited and is also an Independent Non-executive Director of Tai Ping Carpets International Limited. Mr. Yung has extensive experience in the textile industry, banking and investment. He was a member of the Basic Law Consultative Committee (from 1985 to 1990) and has been involved in various government committees.

MR. DAVID SEK-CHI KWOK

Aged 59. Chief Executive and Managing Director of the Bank. Joined the Bank in October 1971. Appointed a Director in October 2001. General Manager since July 2004, and Chief Executive and Managing Director since October 2007.

MR. HUNG-CHING YUNG, JP

Aged 90. Appointed a Director of the Bank in March 1973. Managing Director of Nanyang Holdings Limited. Chairman of The Shanghai Commercial & Savings Bank, Ltd. A Director of Paofoong Insurance Company (Hong Kong) Limited and The Wing On Enterprises, Limited.

DR. RICHARD LEE

Aged 75. Appointed a Director of the Bank in April 2001. Honorary Chairman of TAL Apparel Limited and a Director of Jardine Matheson Holdings Limited, Hongkong Land Holdings Limited and Mandarin Oriental International Limited.

MR. JOHNSON MOU DAID CHA

Aged 61. Appointed a Director of the Bank in September 2001. Director of Mingly Corporation, HKR International Limited, Hanison Construction Holdings Limited and China International Capital Corporation Limited. Member of the Council, Finance Committee and Investment Sub-committee of The Chinese University of Hong Kong.

MR. STEPHEN CHING YEN LEE

Aged 66. Appointed a Director of the Bank in June 2004. Managing Director of The Shanghai Commercial & Savings Bank, Ltd., Great Malaysia Textile Investments Private Limited, Director of COFCO Corporation and Chairman of Singapore Airlines Limited.

MR. EDWARD KAWAH CHU

Aged 57. Assistant General Manager of the Bank. Joined the Bank in December 1979. Appointed a Director in February 2005. Alternate Chief Executive since October 2007.

MR. DAVID ALLEN HOYT

Aged 57. Appointed a Director of the Bank in April 2006. Senior Executive Vice President, Wholesale Banking, Wells Fargo & Company.

MR. CHEN YIH PIN

Aged 73. Appointed a Director of the Bank in April 2006 and had served as an Alternate Director of the Bank from June 2004 to April 2006. Resident Managing Director of The Shanghai Commercial & Savings Bank, Ltd.

MR. GORDON CHE KEUNG KWONG

Aged 63. Appointed a Director of the Bank in August 2008. Chairman of the Audit Committee of the Bank since January 2009. A fellow member of the Institute of Chartered Accountants in England and Wales, and the Hong Kong Institute of Certified Public Accountants. An Independent Non-executive Director of a number of locally listed companies, including Chow Tai Fook Jewellery Group Limited, NWS Holdings Limited, Henderson Land Development Company Limited, and China COSCO Holdings Company Limited.

MADAM NING LI MING

Aged 63. Appointed a Director of the Bank in July 2009. Director of Shanghai United International Investment Limited and Shenergy Company Limited. Chairman of United MetLife Insurance Company Limited.

MR. RICHARD JASON LLOYD YORKE

Aged 45. Appointed a Director of the Bank in June 2011. Executive Vice President & Group Head International, Wells Fargo Bank, N.A. A Director of Wells Fargo International Banking Corporation and Wells Fargo Bank International, Ireland.

MR. FAN YIFEI

Aged 48. Appointed a Director of the Bank in May 2012. Chairman of Bank of Shanghai. Director of Shanghai United International Investment Limited, and Executive Vice President of China Investment Corporation.

MR. IGNATIUS WOOI-KEAN CHOONG

Aged 51. Served as an Alternate Director of the Bank since January 1997. Appointed an Alternate Director to Mr. Richard Jason Lloyd Yorke in April 2012. Director, Wells Fargo Bank, N.A.

DR. LAM CHAT YU

Aged 61. Appointed an Alternate Director to Mr. Johnson Mou Daid Cha in May 2002. He has more than 30 years of experience in asset management and technology investment in Silicon Valley, California and Asia. He is a Director of Mingly Corporation.

MR. YI-JEN CHIOU

Aged 55. Appointed an Alternate Director to Mr. Chen Yih Pin in February 2007. Director and President of The Shanghai Commercial & Savings Bank, Ltd.

MR. YE JUN

Aged 40. Served as an Alternate Director of the Bank since July 2009. Appointed an Alternate Director to Madam Ning Li Ming in May 2012. Director of Bank of Shanghai, Shanghai United International Investment Limited and United MetLife Insurance Company Limited.

MR. LI JIAN GUO

Aged 49. Served as an Alternate Director of the Bank since August 2009. Appointed an Alternate Director to Mr. Fan Yifei in May 2012. Vice President of Bank of Shanghai. Director of Shanghai United International Investment Limited.

MR. JOHN VAN ANTWERP RINDLAUB

Aged 68. Appointed an Alternate Director to Mr. David Allen Hoyt in April 2012. Executive Vice President and Asia Regional President, Wells Fargo Bank, N.A. Director of Wells Fargo International Banking Corporation.

SENIOR MANAGEMENT

MR. DAVID SEK-CHI KWOK

(Biographical details are set out on page 8)

MR. EDWARD KAWAH CHU

(Biographical details are set out on page 9)

MR. PAUL KUN-KOW WONG

Aged 61. Assistant General Manager & Chief of Treasury of the Bank. Joined the Bank in February 1974. Alternate Chief Executive since August 2012.

MR. HON-MING MAK

Aged 61. Assistant General Manager & Chief of Corporate Banking of the Bank. Joined the Bank in March 1971.

MR. BURTON CHI-SHAN CHENG

Aged 51. Assistant General Manager & Chief of Information Technology & Operations of the Bank. Rejoined the Bank in August 1996.

MR. DANIEL KWOK-HUNG CHAN

Aged 51. Assistant General Manager & Chief of Organization and Methods of the Bank. Rejoined the Bank in March 2008.

MR. STEPHEN SIU-FUNG LEE

Aged 46. Assistant General Manager & Chief of Retail Banking of the Bank. Joined the Bank in March 2010.

MR. FRANK SHUI-SANG JIN

Aged 55. Assistant General Manager & Chief of General Administration of the Bank. Joined the Bank in May 2010.

MR. DANNY KONG-KEUNG TSANG

Aged 54. Assistant General Manager & Chief of Legal, Compliance & Risk Management of the Bank. Joined the Bank in May 2008.

MS. WENDY LI-CHIEN WENG

Aged 43. Chief Financial Controller of the Bank. Joined the Bank in May 2012.

MR. PUI-MAN YEUNG

Aged 60. Chief Auditor of the Bank. Rejoined the Bank in May 1982.

2012 AT A GLANCE

Shanghai Branch
上海分行

Our Shanghai Branch commenced business in January 2013. A soft opening ceremony was held to commemorate this milestone.

本銀行上海分行於二零一三年一月開業。分行已舉行簡單而隆重的開幕典禮，以標誌此里程碑。










上海商業銀行


2 存款及提款 Deposits & Withd
Deposits & Withdrawals





三地上銀 一心為您

創新驅動 共謀發展 攜手並進

The 13th Tripartite Partnership Conference
第十三屆滬港台“上海銀行”業務研討會

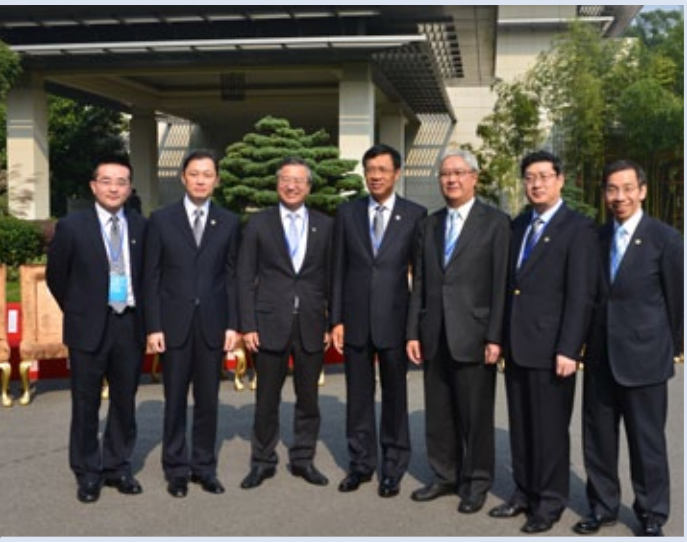
The Bank participated in the 13th Tripartite Partnership Conference held in November 2012 in Shanghai, and will continue to leverage the strategic partnership with Bank of Shanghai in Mainland China and The Shanghai Commercial and Savings Bank in Taiwan to capture every business opportunity across the globe.

本銀行於二零一二年十一月參與在上海舉辦的第十三屆滬港台“上海銀行”業務研討會，並透過與中國內地的上海銀行及台灣的上海商業儲蓄銀行的策略夥伴關係，繼續開拓環球商機。










第十三届沪港台“上海银行”业务研讨会


三地上海 一心為您
順心如意
財源廣進
上海商業銀行
SHANGHAI COMMERCIAL BANK
處處為您著想


连系两岸三地
接通理财之路
就是三地上海银行
上海商業銀行
SHANGHAI COMMERCIAL BANK
客户服务热线：755-8222-8606


$
¥
綠色通道

2012 AT A GLANCE



Awards and Recognition

屢獲殊榮

In recognition of the Bank's Chairman Mr. Lincoln Yung's exemplary accomplishments and commitment to advancing the banking industry in Hong Kong over the years, Mr. Yung was elected Fellow by the Hong Kong Institute of Bankers.

為表揚本銀行董事長榮智權先生多年來對香港銀行界的卓越貢獻及成就，香港銀行學會向榮先生頒授資深會士榮銜。





With its strong commitment to offering diverse solutions to SMEs, the Bank received the Best SME's Partner Award, Cross-strait Banking Services Award and the Outstanding Corporate Image Award in 2012.

本銀行致力為中小企業客戶提供多元化方案，並於二零一二年榮獲「中小企業最佳拍檔獎」、「兩岸三地銀行服務大獎」及「傑出企業形象大獎」。

Staff members of the Bank successfully completed the training modules and professional examinations organized by the Hong Kong Institute of Bankers, and attained the "Certified Financial Management Planner" qualification.

本銀行員工於二零一二年成功完成由香港銀行學會舉辦的培訓課程及專業試，並獲頒發「專業財富管理師」資格。



Promotion Campaigns
推廣活動

To capture every business opportunity, the Bank rolled out various marketing programmes, and introduced new design concept into its promotion materials to reinforce its brand image.

本銀行把握多個商機推出多項推廣活動，並把新設計概念套用於宣傳物品，以加強品牌形象。

In Support of Youth Sports
支持青少年體育活動

The Bank spares no effort in supporting ChelseaFC Soccer School (HK) to nurture local youth football talents and support the community.

本銀行積極支持車路士足球學校（香港）培育本地青少年足球精英及舉辦有關社區活動。





MESSAGE TO SHAREHOLDERS

In 2012, Shanghai Commercial Bank (the 'Bank') reported a consolidated net profit after tax of HK$1,651.5 million, representing a decrease of HK$150.7 million or 8.36% as compared with the previous year, and if excluding the Lehman Brothers related recoveries in 2011, the reduction in current year's net profit would have been 3.8%. Total comprehensive income at HK$2,092.8 million, which included the unrealized gains of the debt instruments and equity investment holdings, was 18.2% or HK$322.6 million more than 2011. Total deposits increased by 7.4% whereas total loans and advances declined by 2.7%. Net interest income decreased by 2.9% and net interest margin averaged at 1.55% while net fee and commission income fell by 5.4%. The Bank, however, continued to maintain a strong capital adequacy ratio at 18%, a comfortable liquidity ratio at 61%, and the loan-to-deposit ratio was at 49% as at the end of 2012. The return on average total assets and average equity were 1.25% and 8.84% respectively, and the cost-to-income ratio was 33.2%, as compared to 29.1% in 2011.

The Bank continued to expand its branch network with the opening of the Mody Road Branch at Tsimshatsui in July 2012 to serve our local and overseas VIP and Green Channel customers. We are also pleased to report that our Shanghai Representative Office attained branch status in December 2012. This signifies a major step towards deepening our presence in China and opens the door for a closer collaboration with our alliance, Bank of Shanghai and our parent, The Shanghai Commercial & Savings Bank in Taiwan.

During the year, we introduced new banking services to our corporate clients and expanded our product range for the high net worth customers. We also enhanced our mobile banking capabilities to enable customers to conduct securities trading and bank transactions at anytime and wherever they are.

The newly implemented Basel III capital standard and risk-weighting floor on mortgage business is not expected to have a negative impact on the Bank. Having the benefit of a strong capital base, we will endeavour to continue cautiously looking for new business opportunities. The construction of the new Head Office building in Central is progressing on schedule. All our colleagues are looking forward to witnessing this state-of-the-art architectural landmark with eco-friendly features in 2016.

On behalf of the Board of Directors, we welcome Mr. Fan Yifei, Chairman of Bank of Shanghai and Executive Vice President of China Investment Corporation, who joined our Board in 2012. We wish to extend our deep appreciation to the retired Mr. Shen Ruolei, of Shanghai United International Investment Ltd. for his valuable contribution during his 13-year tenure as Director, from 1999 to 2012. Also, we welcome Mr. John Van Antwerp Rindlaub, Executive Vice President & Asia Regional President of Wells Fargo Bank, who joined our Board as an Alternate to Mr. David Allen Hoyt.

We want to express our heartfelt appreciation to our Board of Directors for their guidance and strong leadership, to our customers for their loyalty and continuous support, to our colleagues for their commitment and dedicated hard work. 2013 maybe challenging but we look forward to it with enthusiasm.

Lincoln Chu Kuen Yung
Chairman

David Sek-Chi Kwok
Chief Executive & Managing Director

Hong Kong, 12th March 2013

The Directors have pleasure in submitting their report together with the audited consolidated financial statements for the year ended 31st December 2012 .

Principal activities

Shanghai Commercial Bank Limited (the 'Bank') and its subsidiary companies (together, the 'Group') are engaged in the provision of banking and related financial services.

Profit and appropriations

The Group's profit for the year after taxation and other comprehensive income less non-controlling interests is set out in the consolidated statement of changes in equity on page 30.

The Directors recommend the payment of a final dividend of HK$41 per ordinary share totalling HK$820,000,000.

Other reserves

Movements in the other reserves of the Group and the Bank during the year are set out in Note 33 to the consolidated financial statements.

Donations

During the year donations made by the Bank and its subsidiary companies for charitable and other purposes amounted to HK$3,082,000.

Properties and equipment

Details of the movements in properties and equipment of the Group and the Bank are shown in Note 25 to the consolidated financial statements.

Directors

The Directors of the Bank during the year and up to the date of this report are:

Hung-ching Yung	
Lincoln Chu Kuen Yung	
Shen Ruolei	(resigned on 25th May 2012)
(Ye Jun, Alternate)	(resigned on 25th May 2012)
Dr. Richard Lee	
Johnson Mou Daid Cha	
(Dr. Lam Chat Yu, Alternate)	
David Sek-chi Kwok	
Stephen Ching Yen Lee	
Edward Kawah Chu	
David Allen Hoyt	
(Ignatius Wooi-kean Choong, Alternate)	(resigned on 20th April 2012)
(John Van Antwerp Rindlaub, Alternate)	(appointed on 20th April 2012)
Chen Yih Pin	
(Yi-Jen Chiou, Alternate)	
Gordon Che Keung Kwong	
Ning Li Ming	
(Li Jian Guo, Alternate)	(resigned on 25th May 2012)
(Ye Jun, Alternate)	(appointed on 25th May 2012)
Richard Jason Lloyd Yorke	
(Clifford Sterling Lawrence, Alternate)	(resigned on 20th April 2012)
(Ignatius Wooi-kean Choong, Alternate)	(appointed on 20th April 2012)
Fan Yifei	(appointed on 25th May 2012)
(Li Jian Guo, Alternate)	(appointed on 25th May 2012)

In accordance with Article 104(A) of the Bank's Articles of Association, Mr. Hung-ching Yung, Mr. Lincoln Chu Kuen Yung, Mr. Johnson Mou Daid Cha and Madam Ning Li Ming shall retire by rotation at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

In accordance with Article 95 of the Bank's Articles of Association, Mr. Fan Yifei shall retire at the forthcoming Annual General Meeting and, being eligible, offer himself for re-election.

Directors' interests

No contracts of significance in relation to the Group's business to which the Bank, its subsidiary companies, its fellow subsidiaries or its holding companies was a party and in which a Director of the Bank had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

At no time during the year was the Bank, its subsidiaries, its fellow subsidiaries or its parent company a party to any arrangement to enable the Directors and Chief Executive of the Bank (including their spouse and children under 18 years of age) to hold any interests or short positions in the shares or underlying shares in, or debentures of, the Bank or its associated corporation.

Management contracts

No substantial contracts concerning the management and administration of the whole or any substantial part of the business of the Bank were entered into or existed during the year.

Financial disclosures

The Bank has followed the disclosure requirements set out in the 'Banking (Disclosure) Rules' and the 'Guideline on the Application of the Banking (Disclosure) Rules' under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority ('HKMA'). The Bank has complied with the capital requirements related to capital base and capital adequacy ratio stipulated by the HKMA.

Compliance with the Corporate Governance Code and Corporate Governance Report

The Directors of the Bank acknowledge their responsibility for preparing the consolidated financial statements that give a true and fair view of the state of affairs of the Bank and the Group in accordance with the statutory requirements and applicable accounting standards. According to Article 123 of the Bank's Articles of Association, the Bank adopts the guidelines set out in the Code of Best Practice contained in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ('Code of Best Practice'). The Code of Best Practice has eventually developed into the present form known as The Corporate Governance Code and Corporate Governance Report which became effective commencing from 1st April 2012. After taking into consideration the individual circumstances of the Bank, which is a private company, the Board of Directors of the Bank has adopted those provisions in the Code on Corporate Governance Practices that are relevant to the Bank, and the following code provisions are considered not applicable for the time being but the matters would be evaluated whenever necessary: A.6.4, A.6.5, A.6.6, B.1.5, C.2.1, D.3.1, D.3.2, E.1.4, and paragraphs G to P relating to the preparation of a Corporate Governance Report.

Auditor

The consolidated financial statements have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board
Lincoln Chu Kuen Yung
Chairman

Hong Kong, 12th March 2013

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF SHANGHAI COMMERCIAL BANK LIMITED

(Incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of Shanghai Commercial Bank Limited (the 'Bank') and its subsidiaries (together, the 'Group') set out on pages 24 to 124, which comprise the consolidated and company statements of financial position as at 31st December 2012, and the consolidated and company income statements, the consolidated and company statements of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Consolidated Financial Statements

The directors of the Bank are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the Group as at 31st December 2012, and of the Bank's and the Group's profits and cash flows of the Group for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 12th March 2013

CONSOLIDATED INCOME STATEMENT

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31st December 2012	2011
Interest income	6	2,980,614	2,702,557
Interest expense	6	(1,055,811)	(720,598)
Net interest income		1,924,803	1,981,959
Fee and commission income	7	655,385	692,770
Fee and commission expense	7	(35,986)	(38,150)
Net fee and commission income		619,399	654,620
Dividend income	8	29,986	28,599
Net trading income	9	143,867	112,247
Net losses from disposal of equipment		(296)	(843)
Net gains from disposal of available-for-sale investments		177,488	155,824
Other operating income	10(a)	66,596	84,763
Net earned insurance premium	10(b)	38,784	30,820
Net insurance claims incurred and movement in policyholders' liabilities		(14,499)	(9,374)
Operating expenses	11	(991,518)	(884,057)
Impairment losses on available-for-sale investments		(6,187)	–
Reversal of impairment losses on loans and advances to customers	13	45,436	19,905
Operating profit		2,033,859	2,174,463
Share of net profits of jointly controlled entities		38,498	16,488
Profit before income tax		2,072,357	2,190,951
Income tax expense	14	(420,895)	(388,837)
Profit for the year		1,651,462	1,802,114
Attributable to:			
Equity holders of the Bank		1,648,303	1,798,417
Non-controlling interests		3,159	3,697
		1,651,462	1,802,114
Dividend			
Final dividend proposed after the end of the reporting period	16	820,000	860,000

The notes on pages 34 to 124 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31st December 2012	2011
Profit for the year		**1,651,462**	1,802,114
Exchange differences on translation of foreign operations		**3,278**	24,393
Net gains/ (losses) on available-for-sale investments			
Fair value changes on available-for-sale investments taken to equity		**698,674**	88,898
Exchange differences on translation of available-for-sale investments		**(3,185)**	(302)
Fair value changes transferred to income statement on disposal of available-for-sale investments		**(177,488)**	(155,824)
Impairment losses transferred from investment revaluation reserve to income statement	33	**6,187**	–
Deferred income tax	31	**(86,540)**	10,992
Share of investment revaluation reserve of jointly controlled entities	33	**419**	(103)
Total comprehensive income for the year		**2,092,807**	1,770,168
Attributable to:			
Equity holders of the Bank		**2,088,769**	1,768,479
Non-controlling interests		**4,038**	1,689
		2,092,807	1,770,168

The notes on pages 34 to 124 are an integral part of these consolidated financial statements.

INCOME STATEMENT

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31st December 2012	2011
Interest income	6	2,947,235	2,656,480
Interest expense	6	(1,056,653)	(720,701)
Net interest income		1,890,582	1,935,779
Fee and commission income	7	644,266	671,157
Fee and commission expense	7	(30,452)	(31,678)
Net fee and commission income		613,814	639,479
Dividend income	8	70,681	75,577
Net trading income	9	143,881	112,087
Net losses from disposal of equipment		(292)	(840)
Net gains from disposal of available-for-sale investments		178,248	155,824
Other operating income	10	74,185	99,330
Operating expenses	11	(976,951)	(874,007)
Impairment losses on available-for-sale investments		(6,187)	–
Reversal of impairment losses on loans and advances to customers	13	45,436	19,905
Profit before income tax		2,033,397	2,163,134
Income tax expense	14	(419,253)	(386,685)
Profit for the year		1,614,144	1,776,449
Dividend			
Final dividend proposed after the end of the reporting period	16	820,000	860,000

The notes on pages 34 to 124 are an integral part of these consolidated financial statements.

STATEMENT OF COMPREHENSIVE INCOME

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31st December 2012	2011
Profit for the year		**1,614,144**	1,776,449
Exchange differences on translation of foreign operations		**3,509**	24,388
Net gains/ (losses) on available-for-sale investments			
Fair value changes on available-for-sale investments taken to equity		**697,100**	95,515
Exchange differences on translation of available-for-sale investments		**(3,185)**	(302)
Fair value changes transferred to income statement on disposal of available-for-sale investments		**(178,248)**	(155,824)
Impairment losses transferred from investment revaluation reserve to income statement	33	**6,187**	–
Deferred income tax	31	**(86,106)**	10,001
Total comprehensive income for the year		**2,053,401**	1,750,227

The notes on pages 34 to 124 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(All amounts in HK dollar thousands unless otherwise stated)

	Note	As at 31st December 2012	2011
ASSETS			
Cash and balances with banks	17	**29,889,669**	27,739,092
Placements with and loans and advances to banks	18	**19,627,668**	14,865,476
Loans and advances to customers	19(a)	**53,715,110**	55,195,656
Financial assets held for trading	20	**349,763**	444,237
Derivative financial instruments	21	**51,446**	70,294
Investment securities:			
– Available-for-sale	22	**26,958,980**	22,008,660
– Held-to-maturity	23	**2,496,830**	2,764,783
Investments in jointly controlled entities	24(a)	**219,865**	189,308
Properties and equipment	25	**2,339,324**	2,040,164
Investment properties	26	**137,145**	9,193
Deferred income tax assets	31	**45,487**	44,755
Other assets	27	**1,355,881**	1,606,222
TOTAL ASSETS		**137,187,168**	126,977,840
LIABILITIES			
Deposits and balances from banks		**5,545,795**	4,331,800
Deposits from customers	28	**110,681,915**	103,097,196
Derivative financial instruments	21	**39,891**	45,409
Other liabilities	29	**1,257,107**	1,208,269
Provisions	30	**87,309**	94,691
Current income tax liabilities		**56,762**	14,872
Deferred income tax liabilities	31	**205,410**	104,551
TOTAL LIABILITIES		**117,874,189**	108,896,788
EQUITY			
CAPITAL AND RESERVES ATTRIBUTABLE TO THE EQUITY HOLDERS			
Share capital	32	**2,000,000**	2,000,000
Retained earnings			
– Proposed final dividend		**820,000**	860,000
– Others		**7,465,990**	6,669,090
Other reserves	33	**8,965,268**	8,493,399
		19,251,258	18,022,489
Non-controlling interests in equity		**61,721**	58,563
TOTAL EQUITY		**19,312,979**	18,081,052
TOTAL EQUITY AND LIABILITIES		**137,187,168**	126,977,840

Approved and authorised for issue by the Board of Directors on 12th March 2013.

Lincoln Chu Kuen Yung
Chairman

Hung-ching Yung
Director

Gordon Che Keung Kwong
Director

David Sek-chi Kwok
Managing Director & Chief Executive

The notes on pages 34 to 124 are an integral part of these consolidated financial statements.

STATEMENT OF FINANCIAL POSITION

(All amounts in HK dollar thousands unless otherwise stated)

	Note	As at 31st December 2012	2011
ASSETS			
Cash and balances with banks	17	**29,889,662**	27,739,080
Placements with and loans and advances to banks	18	**19,627,668**	14,865,476
Loans and advances to customers	19(a)	**53,715,110**	55,195,656
Financial assets held for trading	20	**348,189**	444,237
Derivative financial instruments	21	**51,446**	70,294
Investment securities:			
– Available-for-sale	22	**26,912,083**	21,888,699
– Held-to-maturity	23	**403,620**	662,366
Investments in jointly controlled entities	24(a)	**116,000**	116,000
Investments in and loans to subsidiaries	24(b)	**2,408,166**	2,086,442
Properties and equipment	25	**2,009,388**	1,985,901
Investment properties	26	**32,999**	42,620
Deferred income tax assets	31	**45,487**	44,323
Other assets	27	**932,634**	1,420,350
TOTAL ASSETS		**136,492,452**	126,561,444
LIABILITIES			
Deposits and balances from banks		**5,545,795**	4,331,800
Deposits from customers	28	**110,681,915**	103,097,196
Derivative financial instruments	21	**39,891**	45,409
Other liabilities	29	**799,614**	990,358
Provisions	30	**86,833**	94,320
Current income tax liabilities		**56,381**	14,599
Deferred income tax liabilities	31	**205,375**	104,516
TOTAL LIABILITIES		**117,415,804**	108,678,198
EQUITY			
CAPITAL AND RESERVES ATTRIBUTABLE TO THE EQUITY HOLDERS			
Share capital	32	**2,000,000**	2,000,000
Retained earnings			
– Proposed final dividend		**820,000**	860,000
– Others		**7,289,812**	6,526,826
Other reserves	33	**8,966,836**	8,496,420
		19,076,648	17,883,246
TOTAL EQUITY AND LIABILITIES		**136,492,452**	126,561,444

Approved and authorised for issue by the Board of Directors on 12th March 2013.

Lincoln Chu Kuen Yung
Chairman

Hung-ching Yung
Director

Gordon Che Keung Kwong
Director

David Sek-chi Kwok
Managing Director & Chief Executive

The notes on pages 34 to 124 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Attributable to the equity holders			Non-controlling interests	Total equity
		Share capital	Other reserves	Retained earnings		
Balance at 1st January 2011		2,000,000	8,423,589	6,690,421	57,754	17,171,764
Profit for the year		–	–	1,798,417	3,697	1,802,114
Other comprehensive income						
Fair value gains, net of tax:						
– available-for-sale investments	33	–	101,898	–	(2,008)	99,890
Currency translation differences	33	–	23,839	252	–	24,091
Share of investment revaluation reserve of jointly controlled entities	33	–	(103)	–	–	(103)
Realised on disposal of available-for-sale investments	33	–	(155,824)	–	–	(155,824)
Total other comprehensive income		–	(30,190)	252	(2,008)	(31,946)
Transfer from retained earnings	33	–	100,000	(100,000)	–	–
Dividend relating to 2010		–	–	(860,000)	(880)	(860,880)
Balance at 31st December 2011		2,000,000	8,493,399	7,529,090	58,563	18,081,052

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (CONTINUED)

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Attributable to the equity holders			Non-controlling interests	Total equity
		Share capital	Other reserves	Retained earnings		
Balance at 1st January 2012		2,000,000	8,493,399	7,529,090	58,563	18,081,052
Profit for the year		–	–	1,648,303	3,159	1,651,462
Other comprehensive income						
Fair value gains, net of tax: – available-for-sale investments	33	–	611,559	–	575	612,134
Currency translation differences	33	–	3,125	(3,032)	–	93
Share of investment revaluation reserve of jointly controlled entities	33	–	419	–	–	419
Realised on disposal of available-for-sale investments	33	–	(177,792)	–	304	(177,488)
Impairment losses on available-for-sale investments	33	–	6,187	–	–	6,187
Total other comprehensive income		–	443,498	(3,032)	879	441,345
Transfer from retained earnings	33	–	28,371	(28,371)	–	–
Dividend relating to 2011		–	–	(860,000)	(880)	(860,880)
Balance at 31st December 2012		2,000,000	8,965,268	8,285,990	61,721	19,312,979

	Year ended 31st December	
	2012	2011
Proposed dividend in retained earnings	820,000	860,000

The notes on pages 34 to 124 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

(All amounts in HK dollar thousands unless otherwise stated)

	Year ended 31st December	
	2012	2011
Cash flows from operating activities		
Profit before income tax	**2,072,357**	2,190,951
Share of net profits of jointly controlled entities	**(38,498)**	(16,488)
Reversal of impairment losses on loans and advances to customers	**(45,436)**	(19,905)
Impairment losses on available-for-sale investments	**6,187**	–
Depreciation expenses	**52,385**	59,210
Net losses from disposal of equipment	**296**	843
Net gains from disposal of available-for-sale investments	**(177,488)**	(155,824)
Amortisation of held-to-maturity and available-for-sale investments	**43,360**	55,572
Interest income on held-to-maturity and available-for-sale investments	**(768,914)**	(689,946)
Dividend income	**(29,986)**	(28,599)
Hong Kong profits tax paid	**(223,524)**	(106,866)
Overseas tax paid	**(127,317)**	(91,092)
Cash flows from operating activities before changes in operating assets and liabilities	**763,422**	1,197,856
Changes in operating assets and liabilities:		
– Net decrease/ (increase) in cash and balances with banks with original maturity beyond three months	**1,718,037**	(1,497,797)
– Net increase in placements with and loans and advances to banks with original maturity beyond three months	**(5,333,562)**	(294,153)
– Net decrease in financial assets held for trading	**94,474**	285,955
– Net decrease/ (increase) in derivative financial instruments	**13,330**	(16,909)
– Net decrease/ (increase) in loans and advances to customers	**1,525,934**	(4,470,606)
– Net decrease/ (increase) in other assets	**235,642**	(281,814)
– Net increase in deposits and balances from banks	**1,213,995**	193,655
– Net increase in deposits from customers	**7,584,719**	7,634,005
– Net increase/ (decrease) in other liabilities and provisions	**41,456**	(268,076)
Net cash flows from operating activities	**7,857,447**	2,482,116

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31st December 2012	2011
Cash flows from investing activities			
Interest received on held-to-maturity and available-for-sale investments		741,773	688,420
Dividends received on available-for-sale investments		28,524	27,888
Dividends received from jointly controlled entities		8,360	1,550
Purchases of properties and equipment		(259,191)	(108,867)
Purchases of investment properties		(219,658)	(9,315)
Proceeds from sale of equipment		291	206
Purchases of available-for-sale investments		(15,473,240)	(9,997,142)
Purchases of held-to-maturity investments		(241,367)	(972,194)
Proceeds from sale and redemption of available-for-sale investments		11,300,362	9,368,636
Proceeds from redemption of held-to-maturity investments		487,367	947,044
Net cash flows from investing activities		(3,626,779)	(53,774)
Cash flows from financing activities			
Dividend paid to the equity holders		(860,000)	(860,000)
Dividend paid to non-controlling interests		(880)	(880)
Net cash flows from financing activities		(860,880)	(860,880)
Net increase in cash and cash equivalents		3,369,788	1,567,462
Cash and cash equivalents at beginning of the year		26,648,821	25,026,574
Effect of exchange rate changes on cash and cash equivalents		(72,544)	54,785
Cash and cash equivalents at end of the year	34	29,946,065	26,648,821
Cash flows from operating activities and investing activities included:			
Interest received		2,974,774	2,618,205
Interest paid		(998,216)	(639,417)

The notes on pages 34 to 124 are an integral part of these consolidated financial statements.

1 GENERAL INFORMATION

Shanghai Commercial Bank Limited (the 'Bank') and its subsidiary companies (together, the 'Group') are engaged in the provision of banking and related financial services in Hong Kong, United States, United Kingdom and the People's Republic of China.

The Bank is a financial institution incorporated in Hong Kong. The address of its registered office is 35/F., Gloucester Tower, The Landmark, 15 Queen's Road Central, Hong Kong.

These consolidated financial statements are presented in thousands of units of Hong Kong Dollars (HK$'000), unless otherwise stated. These consolidated financial statements were approved for issue by the Board of Directors on 12th March 2013.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group and the financial statements of the Bank have been prepared in accordance with Hong Kong Financial Reporting Standards ('HKFRSs') issued by the Hong Kong Institute of Certified Public Accountants ('HKICPA'). The consolidated financial statements of the Group and the financial statements of the Bank have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale investments, financial assets designated at fair value, financial assets held for trading and derivative financial instruments at fair value.

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

(a) Standards, amendments and interpretations effective beginning 1st January 2012

(i) There were no standards, amendments and interpretations, which became effective in 2012, relevant to the Group.

(ii) The following standards, amendments and interpretations, which became effective in 2012 are not currently relevant to the Group (although they may affect the accounting for future transactions and events):

HKAS 12 (Amendment) 'Deferred tax: Recovery of underlying assets' introduces an exception to the principle for the measurement of deferred tax assets or liabilities arising on an investment property measured at fair value. HKAS 12 requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. The amendment introduces a rebuttable presumption that an investment property measured at fair value is recovered entirely by sale. The amendment is applicable retrospectively to annual periods beginning on or after 1st January 2012 with early adoption permitted. As the Group adopts cost model for the investment properties, the amendments have no impact to the Group's consolidated financial statements.

HKFRS 1 (Revised) 'First-time adoption of Hong Kong Financial Reporting Standards' was issued in December 2010. The amendments consist of two narrow amendments to HKFRS 1. The first amendment allows an entity that has been subject to severe hyperinflation to measure assets and liabilities at fair value and to use that fair value as the deemed cost of those assets and liabilities in its opening HKFRS statement of financial position.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1 Basis of preparation (Continued)

(a) Standards, amendments and interpretations effective beginning 1st January 2012 (Continued)

(ii) The following standards, amendments and interpretations, which became effective in 2012 are not currently relevant to the Group (although they may affect the accounting for future transactions and events): (Continued)

The second amendment removes the fixed transition dates in HKFRS 1 requirements regarding the exception to retrospective application for derecognition of financial instruments and the exemption from the initial fair value measurement of financial instruments. The fixed transition dates are replaced by 'the date of transition to HKFRSs'. As a result, a first-time HKFRS adopter is not required to restate derecognition transactions and/or initial fair value measurements that occurred before its date of transition to HKFRSs. HKFRS 1 (Revised) is effective for annual periods beginning on or after 1st July 2011. Since these amendments are not relevant to existing adopters of HKFRS, the amendment has no impact to the Group's consolidated financial statements.

HKFRS 7 (Amendment) 'Disclosures-Transfers of financial assets' introduces new disclosure requirement on transfers of financial assets. Disclosure is required by class of asset of the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party yet remain on the entity's statement of financial position. The gain or loss on the transferred asset and any retained interest in those assets must be given. In addition, other disclosures must enable users to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. The disclosures must be presented by type of ongoing involvement. For example, the retained exposure could be presented by type of financial instrument (such as guarantees, call or put options), or by type of transfer (such as factoring of receivables, securitisations or securities lending). The amendment is applicable to annual periods beginning on or after 1st July 2011 with early adoption permitted. The amendment has no impact to the Group's consolidated financial statements.

(b) The following new standards, new interpretations and amendments to standards and interpretations have been issued but are not effective for the financial year beginning 1st January 2012 and have not been early adopted

The Group's and the Bank's assessment of the impact of these new standards and interpretations is set out below.

HKFRS 7 (Amendment) 'Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities' requires an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with HKAS 32 Financial Instruments: Presentation. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with HKAS 32. These amendments will not impact the Bank's financial position or performance and will become effective for annual periods beginning on or after 1st January 2013.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1 Basis of preparation (Continued)

(b) The following new standards, new interpretations and amendments to standards and interpretations have been issued but are not effective for the financial year beginning 1st January 2012 and have not been early adopted (Continued)

HKFRS 7 (Amendment) 'Financial Instruments: Disclosures - Transition to HKFRS 9' is effective for annual periods beginning on or after 1st January 2015. The amendment provides relief from the requirement to restate comparative financial statements which was originally available only to entities that chose to apply HKFRS 9 prior to 2012. Instead, additional transition disclosures will be required to help investors to better understand the effect of initial application of the standard. The Group is considering the financial impact of the amendment and the timing of its application.

HKFRS 9 'Financial instruments' reflects the first phase of the project to reduce the complexity of the current requirements and on the replacement of HKAS 39 and applies to classification and measurement of financial assets and liabilities as defined in HKAS 39. The standard was initially effective for annual periods beginning on or after 1st January 2013, but Amendments to HKFRS 9 Mandatory Effective Date of HKFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to 1st January 2015. In subsequent phases, the IASB will address impairment and hedge accounting. The Group will quantify the effect of the adoption of the first phase of HKFRS 9 in conjunction with the other phases, when issued, to present a comprehensive picture.

HKFRS 10 'Consolidated financial statements' builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. The standard does not have impact on the Group's financial statements.

HKFRS 11 'Joint Arrangements' classifies joint arrangements as either joint operations (combining the existing concepts of jointly controlled assets and jointly controlled operations) or joint ventures (equivalent to the existing concept of a jointly controlled entity). Joint operation is a joint arrangement whereby the parties that have joint control have rights to the assets and obligations for the liabilities. Joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. HKFRS 11 requires the use of equity method of accounting for interests in joint ventures thereby eliminating the proportionate consolidation method. The determination of as to whether a joint arrangement is a joint operation or a joint venture is based on the parties' rights and obligations under the arrangement, with the existence of a separate legal vehicle no longer being the key factor. Transitional provisions vary depending on how an interest is classified under HKAS 31. The effective date of HKFRS 11 is 1st January 2013, with early application permitted in certain circumstances.

As the Group accounted for its investment in jointly controlled entities using the equity method, the new standard does not have impact to the Group's financial statements.

HKFRS 12 'Disclosures of interests in other entities' includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The standard does not have impact to the Group's financial statements.

HKFRS 13 'Fair value measurement' aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across HKFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within HKFRSs. Adoption of the standard is not expected to have a material impact to the Group's financial statements.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1 Basis of preparation (Continued)

(b) The following new standards, new interpretations and amendments to standards and interpretations have been issued but are not effective for the financial year beginning 1st January 2012 and have not been early adopted (Continued)

HKAS 1 (Revised) 'Presentation of Items of Other Comprehensive Income' is effective for annual periods beginning on or after 1st July 2012, with full retrospective application. Earlier application permitted. The amendments retain the option to present profit or loss and other comprehensive income in a single continuous statement or in two separate but consecutive statements. Items of other comprehensive income are required to be grouped into those that will and will not subsequently be reclassified into profit or loss. Tax on items of other comprehensive income is required to be allocated on the same basis. The measurement and recognition of items of profit or loss and other comprehensive income are not affected by the amendments.

HKAS 19 'Employee benefits' is effective for annual periods beginning on or after 1st January 2013, with earlier application permitted. Retrospective application is required with certain exceptions. The amendments require the recognition of changes in the defined benefit obligation and in plan assets when those changes occur, eliminating the corridor approach and accelerating the recognition of past service costs. Changes in the defined benefit obligation and in plan assets are disaggregated into three components: service costs, net interest on the net defined benefit liabilities (assets) and remeasurements of the net defined benefit liabilities (assets). Net interest is calculated using a high quality corporate bond yield. This may be lower than the rate currently used to calculate the expected return on plan assets, resulting in a decrease in net income. The amendments will not have significant impact on the Group's consolidated financial statements.

HKAS 27 (Revised 2011) 'Separate financial statements' has been amended for the issuance of HKFRS 10 but retains the current guidance for separate financial statements. HKAS 27 (Revised 2011) is effective for annual periods beginning on or after 1st January 2013, early adoption is permitted. The revised standard will not have significant impact to the Group's financial statements.

HKAS 28 (Revised 2011) 'Investments in associates and joint ventures' has been amended for conforming changes based on the issuance of HKFRS 10 and HKFRS 11. HKAS 28 (Revised 2011) is effective for annual periods beginning on or after 1st January 2013, early adoption is permitted. The revised standard will not have significant impact to the Group's financial statements.

HKAS 32 (Amendment) 'Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities' is effective for annual periods beginning on or after 1st January 2014. The amendment addresses inconsistencies in current practice when applying the offsetting criteria and clarifies the meaning of 'currently has a legally enforceable right of set-off'; and the application of offsetting criteria to some gross settlement systems (such as central clearing house systems) that may be considered equivalent to net settlement. The Group is considering the financial impact of the amendment.

(c) Early adoption of standards

The Group did not early-adopt new or amended standards in 2012.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.2 Consolidation

The consolidated financial statements include the financial statements of the Bank and all its subsidiaries made up to 31st December 2012.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Investments in subsidiaries are accounted for at cost less impairment. Cost is adjusted to reflect changes in consideration arising from contingent consideration amendments. Cost also includes direct attributable costs of investment.

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 subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

When the Group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

(c) Jointly controlled entities

A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity. A jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an investment.

The consolidated income statement included the Group's share of the results of jointly controlled entities, and the consolidated statement of financial position included the Group's share of the net assets of the jointly controlled entities.

In the Bank's statement of financial position, the investments in jointly controlled entities are stated at cost less provision, if necessary, for impairment losses. The results of jointly controlled entities are accounted for by the Bank on the basis of dividends received or receivable.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 thousands of units of Hong Kong Dollars (HK$'000), which is the Bank's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions that are transactions denominated, or that require settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions.

Monetary items denominated in foreign currency are translated with the closing rate as at the reporting date. If several exchange rates are available, the forward rate is used at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred. Non-monetary items measured at historical cost denominated in a foreign currency are translated with the exchange rate as at the date of initial recognition; non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rates at the date when the fair value was determined.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at exchange rates at statement of financial position dates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

All foreign exchange gains and losses recognised in the income statement are presented net in the income statement within the corresponding item. Foreign exchange gains and losses on other comprehensive income items are presented in other comprehensive income within the corresponding item.

In the case of changes in the fair value of monetary assets denominated in foreign currency classified as available-for-sale, a distinction is made between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security.

Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount, except impairment, are recognised in other comprehensive income.

Translation differences on non-monetary financial instruments, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary financial instruments, such as equities classified as available-for-sale investments, are included in other comprehensive income.

(c) Group companies and overseas branches

The results and financial position of all the Group's entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- Income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- All resulting exchange differences are recognised in other comprehensive income.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.3 Foreign currency translation (Continued)

(c) Group companies and overseas branches (Continued)

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to other comprehensive income. When a foreign operation is disposed of, or partially disposed of, such exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.4 Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified as held for trading or designated at fair value through profit or loss, are recognised within 'interest income' and 'interest expense' in the income statement 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, where 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.

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.

2.5 Fee and commission income and expense

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group retained no part of the loan package for itself or retained a part at the same effective interest rate as the other participants. Commissions and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party - such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses - are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionate basis. Asset management fees related to investment funds are recognised rateably over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

2.6 Dividend income

Dividends are recognised in the income statement when the entity's right to receive payment is established.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.7 Leases

(a) Operating lease

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 lease (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

(b) Finance lease

Leasehold land classified as finance lease commences amortisation from the time when the land interest becomes available for its intended use. Amortisation on leasehold land classified as finance lease and depreciation on those assets is calculated using the straight-line method to allocate their cost over their estimated useful lives.

Interest in leasehold land is amortised on a straight-line basis over the unexpired period of the lease term.

2.8 Properties and equipment

(a) Land and bank premises

Land and buildings comprise mainly branches and offices. Leasehold land classified as finance lease and buildings are stated at historical cost, which includes expenditure that is directly attributable to the acquisition of the items, less accumulated depreciation and impairment losses. Depreciation of land and buildings is provided annually by charging a sum sufficient to write down the cost of the land and buildings systematically, based on management's appraisal of the conditions of the land and buildings, which includes estimations of the remaining useful lives of the buildings, which are not expected to exceed 40 years.

Interest in freehold land is stated at cost and included as properties and equipment on the statement of financial position.

(b) Furniture, fittings and equipment

Furniture, fittings and equipment are stated at historical cost less accumulated depreciation and impairment losses. Depreciation of furniture, fittings and equipment other than computer equipment is calculated to write off the cost of the assets over their estimated useful lives on a reducing balance basis at a rate of 25% in the year of addition and at 20% per annum thereafter. Computer equipment is depreciated on a straight line basis over four years.

Subsequent costs are included in the asset's carrying amount or 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 expensed in the income statement during the financial period in which they are incurred.

(c) Property under development

Leasehold land for properties under development is stated at historical cost, less accumulated depreciation and impairment losses, and development expenditure is stated at the aggregate amount of costs incurred up to the date of completion. For depreciation of leasehold land for properties under development, please refer to Note 2.8(a) above.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. 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 (Note 2.21). The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains or losses on disposals are determined by comparing proceeds and the carrying amount of the relevant assets and are recognised in the income statement.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.9 Financial assets

2.9.1 Classification

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 investments. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

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

This category has two sub-categories: financial assets held for trading, and financial assets designated at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of recent actual pattern of short-term profit-making. Derivatives are also categorised as held for trading unless they are designated as hedging instruments. Financial assets held for trading consist of debt instruments, including money-market paper, traded corporate and bank loans, and equity instruments, as well as financial assets with embedded derivatives. They are recognised in the consolidated statement of financial position as 'Financial assets held for trading'.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to the consolidated income statement. Gains and losses arising from changes in fair value are included directly in the consolidated income statement and are reported as 'Net trading income'. Interest income and expense and dividend income on financial assets held for trading are included in 'Net trading income' or 'Dividend income', respectively. The instruments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership and the transfer qualifies for derecognition.

The Group designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed. According to HKAS 39, the fair value option is only applied when the following conditions are met:

(i) the application on the fair value option reduces or eliminates an accounting mismatch that would otherwise arise; or

(ii) the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis; or

(iii) the financial assets consists of debt host and an embedded derivatives that must be separated.

Financial assets for which the fair value option is applied are recognised in the consolidated statement of financial position as 'Financial assets designated at fair value'. Fair value changes relating to financial assets designated at fair value through profit or loss are recognised in 'Net income from financial instruments designated at fair value through profit or loss'.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.9 Financial assets (Continued)

2.9.1 Classification (Continued)

(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, other than: (i) those that the entity intends to sell immediately or in the short term, which are classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss; (ii) those that the entity upon initial recognition designates as available-for-sale; or (iii) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

Loans and receivables are initially recognised at fair value which is the cash given originally to purchase the loan including any transaction costs and measured subsequently at amortised cost using the effective interest rate method. Loans and receivables are reported in the statement of financial position as placements with and loans and advances to banks or customers. Interest on loans is included in the income statement and is reported as interest income. In the case of an impairment, it is reported as a deduction from the carrying value of the loans and advances to banks and customers and recognised in the income statement as impairment losses on loans and advances to banks and customers, as appropriate.

(c) Held-to-maturity investments

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, other than:

(i) those that the Group upon initial recognition designates as at fair value through profit or loss;

(ii) those that the Group designates as available-for-sale investments; and

(iii) those that meet the definition of loans and receivables.

They are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method. They are derecognised when the rights to receive cash flows have expired.

Interest on held-to-maturity investments are included in the income statement and are reported as interest income. In the case of an impairment, it has been reported as a deduction from the carrying value of the investment and recognised in the income statement as impairment charges on held-to-maturity investments.

(d) Available-for-sale investments

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. Available-for-sale investments consist mainly of debt and equity investments.

Available-for-sale investments are initially recognised at fair value which is the cash given including any transaction costs and measured subsequently at fair value with gains and losses been recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses, until the financial assets are derecognised. If an available-for-sale investment is determined to be impaired the cumulative gain or loss previously recognised in the statement of comprehensive income is recognised in the income statement. However, interest is calculated using the effective interest method and foreign currency gains and losses on monetary assets classified as available-for-sale investments are recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement as 'Dividend income' when the Group's right to receive payment is established.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.9 Financial assets (Continued)

2.9.2 Reclassification of financial assets

The Group may choose to reclassify a non-derivative trading financial asset out of the held for trading category if the financial asset is no longer held for the purpose of selling it in the near term. Financial assets are permitted to be reclassified out of the held for trading category only in rare circumstances arising from a single event that is unusual and highly unlikely to recur in the near term. In addition, the Group may choose to reclassify financial assets that would meet the definition of loans and receivables out of the held for trading or available-for-sale investments categories if the Group has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable, and no reversals of fair value gains or losses recorded before reclassification date are subsequently made. Effective interest rates for financial assets reclassified to loans and receivables and held-to-maturity investments categories are determined at the reclassification date. Further increases in estimates of cash flows adjust effective interest rates prospectively.

On reclassification of a financial asset out of the 'at fair value through profit or loss' category all embedded derivatives are re-assessed and, if necessary, separately accounted for.

2.9.3 Recognition and measurement

Regular-way purchases and sales of financial assets at fair value through profit or loss, held-to-maturity investments and available-for-sale investments are recognised on trade-date - the date on which the Group commits to purchase or sell the asset.

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 carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the income statement. 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. Financial liabilities are derecognised when they are extinguished – that is, when the obligation is discharged, cancelled or expires.

Available-for-sale investments 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 period in which they arise. They are presented within 'net trading income' (for financial assets that are held for trading), and within 'net income from financial instruments designated at fair value through profit or loss' (for financial assets that are designated at fair value through profit or loss). Gains and losses arising from changes in the fair value of available-for-sale investments are recognised directly in other comprehensive income, until the financial asset is derecognised or impaired. At this time the cumulative gain or loss previously recognised in the equity is recognised in the income statement. However, interest calculated using the effective interest method and foreign currency gains and losses on monetary assets classified as available-for-sale investments are recognised in the income statement.

2.10 Impairment of financial assets

(a) Assets carried at amortised cost

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred 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 the group of financial assets that can be reliably estimated.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.10 Impairment of financial assets (Continued)

(a) Assets carried at amortised cost (Continued)

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral; and
- Downgrading below investment grade level.

The estimated period between a loss occurring and its identification is determined by local management for each identified portfolio. In general, the periods used vary between 3 months and 12 months; in exceptional cases, longer periods are warranted.

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.

For loans and receivables category, 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 instruments 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 (i.e. on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past due status and other relevant factors). Those characteristics 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 currently exist.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.10 Impairment of financial assets (Continued)

(a) Assets carried at amortised cost (Continued)

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 (for example, changes in unemployment rates, property prices, payment status, or other factors 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 loan is uncollectible, it is written off against the related allowances for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

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 (such as an improvement in the debtor's credit rating), 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 classified as available-for-sale investments

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt securities, the group uses the criteria set out in (a) above. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale investments, the cumulative loss - measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that investment previously recognised in income statement - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale investments increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in income statement, the impairment loss is reversed through the income statement.

2.11 Financial liabilities

Financial liabilities are classified into two categories: financial liabilities at fair value through profit or loss and other financial liabilities. All financial liabilities are classified at inception and recognised initially at fair value.

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

This category has two sub-categories: financial liabilities held for trading, and those designated at fair value through profit or loss at inception.

A financial liability is classified as held for trading if it is incurred principally for the purpose of repurchasing in the short term. It is carried at fair value and any gains and losses from changes in fair value are recognised in the income statement.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.11 Financial liabilities (Continued)

(a) Financial liabilities at fair value through profit or loss (Continued)

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

(i) The designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring the financial liabilities or recognising the gains and losses on them on different bases; or

(ii) Part of a group of financial liabilities that are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis are designated at fair value through profit or loss; and

(iii) Financial instruments, such as debt securities issued, containing one or more embedded derivatives significantly modify the cash flows, are designated at fair value through profit or loss.

Financial liabilities designated as at fair value through profit or loss are designated as such at inception. Financial liabilities designated at fair value through profit or loss are carried at fair value and any gains and losses from changes in fair value are recognised in the income statement.

(b) Other financial liabilities

Other financial liabilities are recognised initially at fair value net of transaction costs incurred. Other financial liabilities are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the other financial liabilities using the effective interest method.

2.12 Determination of fair value

For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg and Reuters.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs (for example, LIBOR yield curve, FX rates, volatilities and counterparty spreads) existing at the dates of the statement of financial position.

The Group uses widely recognised valuation models for determining fair values of non-standardised financial instruments of lower complexity, such as options or interest rate and currency swaps. For these financial instruments, inputs into models are generally market-observable.

For more complex instruments, the Group uses developed models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Valuation models are used primarily to value derivatives transacted in the over-the-counter market, unlisted debt securities (including those with embedded derivatives) and other debt instruments for which markets were or have become illiquid. Some of the inputs to these models may not be market observable and are therefore estimated based on assumptions.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.12 Determination of fair value (Continued)

The output of a model is always an estimate or approximation of a value that cannot be determined with certainty, and valuation techniques employed may not fully reflect all factors relevant to the positions the Group holds. Valuations are therefore adjusted, where appropriate, to allow for additional factors including model risks, liquidity risk and counterparty risk. Based on the established fair value model governance policies, and related controls and procedures applied, management believes that these valuation techniques are necessary and appropriate to fairly state the values of financial instruments carried at fair value in the statement of financial position. Price data and parameters used in the measurement procedures applied are generally reviewed carefully and adjusted, if necessary- particularly in view of the current market developments.

In cases when the fair value of unlisted equity instruments cannot be determined reliably, the instruments are carried at cost less impairment. The fair value for loans and receivables as well as liabilities to banks and customers are determined using a present value model on the basis of contractually agreed cash flows, taking into account credit quality, liquidity and costs.

The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

2.13 Derivative financial instruments

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.

2.14 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Group's entities operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from depreciation of properties and equipment, revaluation of certain financial assets and liabilities including derivative contracts, provisions for pensions and other post-retirement benefits and tax losses carried forward; and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.14 Current and deferred income tax (Continued)

Deferred income tax assets are recognised only to the extent that 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 on investments in subsidiaries and jointly controlled entities, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not be reversed in the foreseeable future.

Deferred tax related to fair value re-measurement of available-for-sale investments, which are charged or credited to other comprehensive income, is also credited or charged to other comprehensive income and is subsequently recognised in the income statement together with the deferred gain or loss upon disposal.

2.15 Employee benefits

(a) Retirement benefit costs

The Group operates three retirement benefit schemes comprising of a defined contribution scheme, a Mandatory Provident Fund Scheme and a defined benefit scheme that are available to the Group's employees. However, the principal schemes that the Group contributes to are the defined contribution scheme and the Mandatory Provident Fund Scheme. The assets of the Group's Mandatory Provident Fund Scheme, the defined contribution scheme and the defined benefit scheme are held separately from those of the Group in independently administered funds.

The Group's contributions to the defined contribution scheme and the Mandatory Provident Fund Scheme are charged to the income statement.

The defined benefit scheme is funded by payments from the Group by taking recommendations of independent qualified actuaries. The defined benefit costs are assessed using the Attained Age Method and the cost of providing the benefit is charged to the income statement so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries, who value the scheme once every three years.

(b) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. Employee entitlements to sick leave and maternity leave are recognised when the absences occur.

(c) Termination benefits

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed: a termination when the entity has a detailed formal plan to terminate the employment of current employees without possibility of withdrawal. In the case of an offer made to encourage voluntary redundancy the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to present value.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.16 Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if that party controls, jointly controls or has significant influence over the Group; is a member of the same financial reporting group, such as parents, subsidiaries and fellow subsidiaries; is an associate or a joint venture of the Group or parent reporting group; is a key management personnel of the Group or parents, or where the Group and the party are subject to common control. Related parties may be individuals or entities.

2.17 Investment properties

Property that is held for long-term rental yields or for capital appreciation or both is classified as investment property. Investment properties are land and office buildings. Investment properties are measured at cost less subsequent accumulated depreciation and any accumulated impairment losses. Depreciation is charged so as to write off the cost of investment properties using the straight-line method over the unexpired period of the lease term for land and the shorter of the leases or 40 years for buildings.

2.18 Repossessed assets

Repossessed collateral assets are recorded as 'Repossessed assets' and reported in 'Other assets' and the relevant loans are derecognised. The repossessed collateral assets are measured at the lower of carrying amount and fair value less cost to sell.

2.19 Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including cash, balances with banks, placements with and loans and advances to banks, treasury bills and certificates of deposit that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

2.20 Fiduciary activities

The Group commonly acts as trustees and in other fiduciary capacities, for a fee and commission income, that result in the holding or placing of assets on behalf of individuals, trusts and other institutions. These assets and income arising thereon are excluded from these financial statements, as they are not assets of the Group.

2.21 Impairment of investment in subsidiaries, jointly controlled entities and non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.22 Provisions

Provisions for restructuring costs and legal claims are recognised when: the Group has a present legal or constructive obligation as a result of past events; 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.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as interest expense.

2.23 Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. The fair value of a financial guarantee at the time of signature is zero because all guarantees are agreed on arm's length terms and the value of the premium agreed corresponds to the value of the guarantee obligation. No receivable for the future premiums is recognised. Subsequent to initial recognition, the Group's liabilities under such guarantees are measured at the higher of the initial amount, less amortisation of fees recognised in accordance with HKAS 18, and the best estimate of the amount required to settle the guarantee. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgment of management. The fee income earned is recognised on a straight-line basis over the life of the guarantee.

Any increase in the liability relating to guarantees is reported in the income statement within other operating expenses.

3 FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Group's financial performance.

The Group's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Group regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

The Group has in place policies and procedures for the identification, measurement, control and monitoring of credit, liquidity, market, interest rate, foreign exchange and operational risks. Market risk includes currency risk, interest rate and other price risk. One of the major functions of the Board of Directors is to ensure that the Group establishes policies, procedures and controls to manage the various types of risk it faces. The Board of Directors has delegated its powers to the Executive Committee, the Asset and Liability Committee, the Credit Committee and the Operational Risk Management Committee for the supervision of major functional areas, and in particular, the Executive Committee has been delegated with the authority to oversee and guide the management of different risks. Senior management is always watchful for changes in economic, political and market conditions in which the Group operates and the inherent risks the Group faces.

The Risk Management Department is responsible for monitoring the overall risk management of the Group's operations, except for credit risk, which is managed by the Credit Committee. Reconciliation procedures are also in place to ensure that the systems capture all necessary data. Prior to implementation of any new product or service, various analyses, testing, development and planning will be performed and its proposal will be endorsed by the Product Development Supervisory Committee before submission to the management for approval. All of the above arrangements ensure that the risk management processes are operating effectively.

Delegated by the Board of Directors, the Audit Committee has an oversight role over the above management functions as a whole. Supporting the Audit Committee, the Audit Department performs regular audits to ensure compliance with the policies and procedures.

3.1 Credit risk

The Group takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Group by failing to discharge an obligation. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Group's portfolio, could result in losses that are different from those provided for at the end of the reporting period.

The Group has in place effective credit review, monitoring and control systems including an effective loan classification system that identify, monitor, and determine loan loss provisions in a timely manner. Management therefore carefully manages the exposure to credit risk.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, industry sector and by country are approved annually by the Board of Directors.

The exposure to any one counterparty including banks and brokers is further restricted by sub-limits covering on- and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing these lending limits where appropriate. The Group has in place effective monitoring and control systems to identify, monitor and address problem credits in an accurate and timely manner. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees. The Group further mitigates credit risk by entering into netting arrangements with counterparties such as banks with which it undertakes credit activities.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Risk limit control and mitigation policies

(a) Collateral

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these methods is the taking of security for funds advanced, which is a common practice. The Group implements guidelines on the acceptability of specific classes of collateral for credit risk mitigation. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, inventory and accounts receivable; and
- Charges over bank deposits and financial instruments such as debt securities and equities.

In addition to the above, the Group will also seek for guarantee where appropriate. To minimise credit loss, the Group will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances which are partially secured or unsecured.

(b) Derivatives

The Group maintains strict control limits on net open derivatives positions (i.e. the difference between purchase and sale contracts), by both amount and term. 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 values are 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 lending limits with customers, together with potential exposures from market movements. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the Group requires margin deposits from counterparties.

(c) Credit-related commitments

The Group has issued credit related commitments including guarantees and letters of credit. These instruments carry similar credit risk as loans. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit - which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties - carry the same credit risk as loans. Documentary and commercial letters of credit - which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions - are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.2 Impairment and provisioning policies

The Group has established effective control systems that enable the Group to identify, monitor, and determine loan loss provisions in a timely manner. Policies and procedures are in place to ensure the aggregate amount of individually and collectively assessed loan loss provisions are adequate to absorb estimated credit losses in the loan portfolio. The table below shows the percentage of the Group's on-balance sheet items relating to loans and advances and the associated impairment allowances for each of the Group's internal loan classification categories:

The Group and the Bank

	2012		2011	
	Loans and advances (%)	Impairment allowances (%)	Loans and advances (%)	Impairment allowances (%)
1 – pass	96.82	0.40	96.65	0.39
2 – special mention	2.34	0.53	1.69	0.47
3 – sub-standard	0.74	7.30	1.59	6.20
4 – doubtful	0.06	23.92	0.03	16.20
5 – loss	0.04	58.24	0.04	51.63
	100.00		100.00	

Grade 1 'Pass' represents loans for which borrowers are current in meeting commitments and full repayment of interest and principal is not in doubt.

Grade 2 'Special mention' represents loans with significant deficiencies and potential weakness such that if adverse conditions persist, ultimate loss for the Bank may occur.

Grade 3 'Sub-standard' represents loans in which borrowers are displaying a definable weakness that is likely to jeopardise repayment. These loans include rescheduled loans and loans where some loss of principal or interest is possible after taking into account the net realisable value of security.

Grade 4 'Doubtful' represents loans which collection in full is improbable and the Group expects to sustain a loss of interest and/or principal after taking into account the net realisable value of security.

Grade 5 'Loss' represents loans which considered as uncollectible after exhausting all collection efforts such as realisation of collateral, initiation of legal proceedings and need to be fully or partially written off.

The credit review, monitoring and control systems assist management to determine whether objective evidence of impairment exists under HKAS 39, based on the following criteria set out by the Group:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position; and
- Deterioration in the value of collateral.

The Group's policy requires the review of individual financial assets that are above materiality thresholds at least annually or more regularly when individual circumstances require. Impairment allowances on individually assessed accounts are determined by an evaluation of the loss incurred at the end of the reporting period on a case-by-case basis. The assessment normally encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account.

Collectively assessed impairment allowances are provided for: (i) portfolios of homogenous assets that are individually below materiality thresholds; and (ii) losses that have been incurred but have not yet been identified, by using the available historical experience and management judgment.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.3 Maximum exposure to credit risk before collateral held or other credit enhancements

The Group

	Maximum exposure	
	2012	2011
Credit risk exposures relating to on-balance sheet assets are as follows:		
Balances with banks	13,064,838	16,944,163
Placements with and loans and advances to banks	19,627,668	14,865,476
Loans and advances to customers:		
Loans to individuals:		
– Overdrafts	561,215	533,500
– Credit cards	315,880	338,764
– Term loans and others	4,978,534	5,573,480
– Mortgages	6,934,623	6,912,793
Loans to corporate entities:		
– Large corporate customers and others	34,356,686	35,397,648
– Small and medium size enterprises (SME)	6,568,172	6,439,471
Financial assets held for trading:		
– Debt securities	206,967	321,358
Derivative financial instruments	51,446	70,294
Investment securities:		
– available-for-sale debt securities	25,370,282	20,447,675
– held-to-maturity debt securities	2,496,830	2,764,783
Other assets	1,355,881	1,606,222
Credit risk exposures relating to off-balance sheet items are as follows:		
– Financial guarantees	2,207,870	2,340,000
– Loan commitments and other credit related contingent liabilities	41,448,553	39,058,307
At 31st December	159,545,445	153,613,934

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.3 Maximum exposure to credit risk before collateral held or other credit enhancements (Continued)

The Bank

	Maximum exposure	
	2012	2011
Credit risk exposures relating to on-balance sheet assets are as follows:		
Balances with banks	13,064,838	16,944,163
Placements with and loans and advances to banks	19,627,668	14,865,476
Loans and advances to customers:		
Loans to individuals:		
– Overdrafts	561,215	533,500
– Credit cards	315,880	338,764
– Term loans and others	4,978,534	5,573,480
– Mortgages	6,934,623	6,912,793
Loans to corporate entities:		
– Large corporate customers and others	34,356,686	35,397,648
– Small and medium size enterprises (SME)	6,568,172	6,439,471
Financial assets held for trading:		
– Debt securities	206,967	321,358
Derivative financial instruments	51,446	70,294
Investment securities:		
– available-for-sale debt securities	25,329,782	20,347,481
– held-to-maturity debt securities	403,620	662,366
Other assets	932,634	1,420,350
Credit risk exposures relating to off-balance sheet items are as follows:		
– Financial guarantees	2,207,870	2,340,000
– Loan commitments and other credit related contingent liabilities	41,459,033	39,058,307
At 31st December	156,998,968	151,225,451

The above tables represent a worst case scenario of credit risk exposures to the Group and the Bank at 31st December 2012 and 2011, without taking account of any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out above are based on net carrying amounts. For letters of guarantee issued, the maximum exposure to credit risk is the maximum amount that the bank could be required to pay if the guarantees are called upon. For loan commitments and other credit related contingent liabilities that are irrevocable over the life of the respective facilities or revocable in the event of a significant adverse change, the maximum exposure to credit risk is disclosed as the full amount of the committed facilities.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.3 Maximum exposure to credit risk before collateral held or other credit enhancements (Continued)

Credit risk mitigation, collateral and other credit enhancements

The Group uses a variety of techniques to reduce the credit risk arising from its lending activities. Enforceable legal documentation establishes the Group's direct, irrevocable and unconditional recourse to any collateral, security or other credit enhancements provided.

The table below describes the nature of collateral held and their financial effect by class of financial asset:

Balances and placements with and loans and advances to banks	These exposures are generally considered to be low risk due to the nature of the counterparties. Collateral is generally not sought on these balances.
Securities lending	The Group has in place general guidelines on maximum loan to value ratio under securities lending. The loans and advances under securities lending are fully secured by the securities pledged.
Loans and advances	These exposures are secured, partially secured or unsecured depending on the type of collateral and type of facilities offered to customers. The major types of collateral taken include residential properties, other properties, bank deposits, stocks and shares and wealth management products. Recognised guarantees are also employed by the Group for credit enhancement. As at 31st December 2012, the collateral coverage of advances to customers is 85% (2011: 86%). As at 31st December 2012, 89% (2011: 89%) of the trade bills are bankers' acceptance under letters of credit.
Trading debt securities	These exposures are carried at fair value which reflects the credit risk. No collateral is sought directly from the issuer or the counterparty; however this may be implicit in the terms of the instrument.
Derivative financial instruments	Master netting agreements are typically used to enable the effects of derivative assets and liabilities with the same counterparty to be offset when measuring these exposures.
Available-for-sale debt securities	The exposures are subject to approved counterparty limit and country limit and under close monitoring in accordance with relevant policies of the Group. Impairment assessment is also conducted periodically.
Held-to-maturity debt securities	The exposures are subject to approved counterparty limit and country limit and under close monitoring in accordance with relevant policies of the Group. Impairment assessment is also conducted periodically.
Contingent liabilities and commitments	The components and nature of contingent liabilities and commitments are disclosed in Note 35. Regarding the commitments that are unconditionally cancellable without prior notice, the Group would withdraw the credit facilities extended to borrowers in case their credit quality deteriorates. Accordingly, these commitments do not expose the Group to significant credit risk.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.4 Loans and advances

Loans and advances are summarised as follows:

The Group and the Bank

	2012	2011
Neither past due nor impaired	52,197,723	53,493,718
Past due but not impaired	1,325,586	1,065,672
Impaired	453,767	920,195
Gross	53,977,076	55,479,585
Less: impairment allowances	(261,966)	(283,929)
Net	53,715,110	55,195,656

The total impairment allowances for loans and advances is HK$261,966,000 (2011: HK$283,929,000) of which HK$48,484,000 (2011: HK$69,069,000) represents the individual impairment allowances and the remaining amount of HK$213,482,000 (2011:HK$214,860,000) represents the collective impairment allowances. Further information of the impairment allowances for loans and advances to customers is provided in Note 19.

(a) Loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the policies and procedures adopted by the Group.

The Group and the Bank As at 31st December 2012

	Individuals				Corporate entities		
	Overdrafts	Credit cards	Term loans and others	Mortgages	Large corporate customers and others	SME	Total loans and advances to customers
Grades:							
1 – pass	537,040	311,445	4,835,311	6,604,963	32,605,522	6,191,015	51,085,296
2 – special mention	18,544	7,301	81,825	134,244	639,134	231,379	1,112,427
Total	555,584	318,746	4,917,136	6,739,207	33,244,656	6,422,394	52,197,723

The Group and the Bank As at 31st December 2011

	Individuals				Corporate entities		
	Overdrafts	Credit cards	Term loans and others	Mortgages	Large corporate customers and others	SME	Total loans and advances to customers
Grades:							
1 – pass	504,697	336,083	5,381,864	6,646,265	33,732,538	6,088,799	52,690,246
2 – special mention	20,091	5,575	45,862	86,739	419,520	225,685	803,472
Total	524,788	341,658	5,427,726	6,733,004	34,152,058	6,314,484	53,493,718

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.4 Loans and advances (Continued)

(b) Loans and advances past due but not impaired

Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. Gross amount of loans and advances by class to customers that were past due but not impaired were as follows:

The Group and the Bank As at 31st December 2012

	Individuals				
	Overdrafts	Credit cards	Term loans and others	Mortgages	Total
Past due up to 30 days	–	1,549	42,177	133,875	177,601
Past due 30 – 60 days	528	367	882	20,049	21,826
Past due 60 – 90 days	–	151	–	18,706	18,857
Past due over 90 days	–	–	12,278	–	12,278
Total	528	2,067	55,337	172,630	230,562

	Corporate entities		
	Large corporate customers and others	SME	Total
Past due up to 30 days	943,269	117,169	1,060,438
Past due 30 – 60 days	13,702	20,255	33,957
Past due 60 – 90 days	–	629	629
Past due over 90 days	–	–	–
Total	956,971	138,053	1,095,024

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.4 Loans and advances (Continued)

(b) Loans and advances past due but not impaired (Continued)

The Group and the Bank As at 31st December 2011

	Individuals				
	Overdrafts	Credit cards	Term loans and others	Mortgages	Total
Past due up to 30 days	765	1,640	98,918	87,978	189,301
Past due 30 – 60 days	–	500	35,002	23,300	58,802
Past due 60 – 90 days	–	416	1,153	6,042	7,611
Past due over 90 days	307	–	1,880	1,846	4,033
Total	1,072	2,556	136,953	119,166	259,747

	Corporate entities		
	Large corporate customers and others	SME	Total
Past due up to 30 days	701,284	86,016	787,300
Past due 30 – 60 days	7,364	4,592	11,956
Past due 60 – 90 days	4,006	2,663	6,669
Past due over 90 days	–	–	–
Total	712,654	93,271	805,925

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated by reference to market price or indexes of similar assets.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.4 Loans and advances (Continued)

(c) Loans and advances overdue for more than 3 months

(i) Gross amount of overdue loans and advances

The Group and the Bank

	2012		2011	
		% of gross loans and advances to customers		% of gross loans and advances to customers
Gross loans and advances which have been overdue for:				
– six months or less but over three months	57,386	0.11	89,316	0.16
– one year or less but over six months	15,835	0.03	158,417	0.29
– over one year	158,601	0.29	34,442	0.06
	231,822	0.43	282,175	0.51

(ii) Value of collateral held and impairment allowances against overdue loans and advances

The Group and the Bank

	Outstanding amount	Current market value of collateral	Covered portion by collateral	Uncovered portion by collateral	Individually assessed impairment allowances
As at 31st December 2012					
Overdue loans and advances	231,822	363,651	210,010	21,812	29,893
As at 31st December 2011					
Overdue loans and advances	282,175	399,172	200,863	81,312	47,841

Collateral held against such loans and advances mainly include mortgages over properties.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.4 Loans and advances (Continued)

(d) Individually impaired loans and advances

The individually impaired loans and advances to customers before taking into consideration the cash flows from collateral held is HK$453,767,000 (2011: HK$920,195,000).

The breakdown of the gross amount of individually impaired loans and advances by class, along with the fair value of related collateral held by the Group as security, are as follows:

The Group and the Bank

	Individuals				Corporate entities		Total		
	Overdrafts	Credit cards	Term loans and others	Mortgages	Large corporate customers and others	SME		% of total loans and advances to customers	Impairment allowances
As at 31st December 2012									
Individually impaired loans and advances	7,646	4,462	27,927	49,648	325,614	38,470	453,767	0.84	48,484
Fair value of collateral	28,529	–	76,910	144,362	427,673	85,175	762,649		
As at 31st December 2011									
Individually impaired loans and advances	9,671	4,163	34,791	86,846	721,250	63,474	920,195	1.66	69,069
Fair value of collateral	29,484	–	54,553	172,383	842,327	134,985	1,233,732		

(e) Rescheduled loans and advances net of amounts included in loans and advances overdue for more than 3 months

The Group and the Bank

	2012		2011	
		% of gross loans and advances to customers		% of gross loans and advances to customers
Rescheduled loans and advances	205,314	0.38	181,940	0.33

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.5 Debt securities

The table below presents an analysis of debt securities by rating agency designation for the respective issues at 31st December, based on Standard & Poor's ratings or their equivalent. In the absence of issue rating, the debt securities are reported as unrated, though most of the issuers of these debt securities have issuer ratings from the rating agencies.

The Group As at 31st December 2012

	Financial assets held for trading	Available-for-sale investments	Held-to-maturity investments	Total
AAA	–	371,160	2,292,164	2,663,324
AA- to AA+	189,381	4,658,052	–	4,847,433
A- to A+	17,586	4,309,177	204,666	4,531,429
Lower than A-	–	1,686,312	–	1,686,312
Unrated	–	14,345,581	–	14,345,581
Total	206,967	25,370,282	2,496,830	28,074,079

The Group As at 31st December 2011

	Financial assets held for trading	Available-for-sale investments	Held-to-maturity investments	Total
AAA	–	834,326	2,364,477	3,198,803
AA- to AA+	182,183	6,372,790	–	6,554,973
A- to A+	17,560	5,954,440	400,306	6,372,306
Lower than A-	–	330,556	–	330,556
Unrated	121,615	6,955,563	–	7,077,178
Total	321,358	20,447,675	2,764,783	23,533,816

The Bank As at 31st December 2012

	Financial assets held for trading	Available-for-sale investments	Held-to-maturity investments	Total
AAA	–	371,160	202,951	574,111
AA- to AA+	189,381	4,647,528	–	4,836,909
A- to A+	17,586	4,309,177	200,669	4,527,432
Lower than A-	–	1,686,312	–	1,686,312
Unrated	–	14,315,605	–	14,315,605
Total	206,967	25,329,782	403,620	25,940,369

The Bank As at 31st December 2011

	Financial assets held for trading	Available-for-sale investments	Held-to-maturity investments	Total
AAA	–	823,874	266,080	1,089,954
AA- to AA+	182,183	6,338,868	–	6,521,051
A- to A+	17,560	5,954,440	396,286	6,368,286
Lower than A-	–	330,556	–	330,556
Unrated	121,615	6,899,743	–	7,021,358
Total	321,358	20,347,481	662,366	21,331,205

There were no overdue debt securities in the year of 2012 (2011: Nil).

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.6 Repossessed asset

During the year, the Group and the Bank obtained a residential property of carrying amount of HK$5,742,000 (2011: Nil) by taking possession of collateral held as security.

At 31st December 2012, the fair value of the repossessed asset of the Group and the Bank amounted to HK$6,380,000 (2011: HK$22,993,000).

Repossessed asset is sold as soon as practicable with the proceeds used to reduce the outstanding indebtedness. Repossessed asset is classified in the statement of financial position within 'Other assets'.

3.1.7 Concentration of risks of financial assets with credit risk exposure

(a) Geographical sectors

The following table breaks down the Group's main credit exposures at their carrying amounts, as categorised by geographical region as of 31st December 2012 and 2011. For this table, the Group has allocated exposures to regions based on the country of domicile of its counterparties.

The Group As at 31st December 2012

	Hong Kong	Asia Pacific excluding Hong Kong	North and South America	Europe	Middle East and Africa	Total
Balances with banks	20,637,323	5,871,232	158,480	2,866,666	25	29,533,726
Placements with and loans and advances to banks	7,586,081	10,159,937	–	1,881,650	–	19,627,668
Loans and advances to customers:						
Loans to individuals:						
– Overdrafts	549,544	10,607	594	470	–	561,215
– Credit cards	312,171	3,709	–	–	–	315,880
– Term loans and others	4,018,576	189,709	763,578	6,671	–	4,978,534
– Mortgages	5,559,953	149,983	441,113	783,085	489	6,934,623
Loans to corporate entities:						
– Large corporate customers and others	23,666,429	1,516,598	8,863,608	310,051	–	34,356,686
– SME	5,581,745	719,896	266,531	–	–	6,568,172
Financial assets held for trading – debt securities	–	17,711	189,256	–	–	206,967
Derivative financial instruments	29,110	349	835	21,152	–	51,446
Investment securities – debt securities	10,276,757	11,553,433	5,522,265	514,657	–	27,867,112
Other assets	1,333,512	1,464	19,878	1,027	–	1,355,881
	79,551,201	30,194,628	16,226,138	6,385,429	514	132,357,910

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.7 Concentration of risks of financial assets with credit risk exposure (Continued)

(a) Geographical sectors (Continued)

The Group As at 31st December 2011

	Hong Kong	Asia Pacific excluding Hong Kong	North and South America	Europe	Middle East and Africa	Total
Balances with banks	15,122,789	9,195,848	254,101	2,749,960	128	27,322,826
Placements with and loans and advances to banks	7,638,967	6,781,700	–	444,809	–	14,865,476
Loans and advances to customers:						
Loans to individuals:						
– Overdrafts	525,339	7,469	219	473	–	533,500
– Credit cards	336,033	2,731	–	–	–	338,764
– Term loans and others	4,400,408	291,941	875,259	5,872	–	5,573,480
– Mortgages	5,885,131	119,803	344,439	562,713	707	6,912,793
Loans to corporate entities:						
– Large corporate customers and others	25,407,439	1,286,019	8,313,002	391,188	–	35,397,648
– SME	5,868,011	365,380	206,080	–	–	6,439,471
Financial assets held for trading – debt securities	86,862	53,305	181,191	–	–	321,358
Derivative financial instruments	37,628	581	2,742	29,343	–	70,294
Investment securities – debt securities	7,556,279	8,036,682	4,521,518	3,097,979	–	23,212,458
Other assets	1,571,917	1,395	32,050	860	–	1,606,222
	74,436,803	26,142,854	14,730,601	7,283,197	835	122,594,290

The Bank As at 31st December 2012

	Hong Kong	Asia Pacific excluding Hong Kong	North and South America	Europe	Middle East and Africa	Total
Balances with banks	20,637,323	5,871,232	158,480	2,866,666	25	29,533,726
Placements with and loans and advances to banks	7,586,081	10,159,937	–	1,881,650	–	19,627,668
Loans and advances to customers:						
Loans to individuals:						
– Overdrafts	549,544	10,607	594	470	–	561,215
– Credit cards	312,171	3,709	–	–	–	315,880
– Term loans and others	4,018,576	189,709	763,578	6,671	–	4,978,534
– Mortgages	5,559,953	149,983	441,113	783,085	489	6,934,623
Loans to corporate entities:						
– Large corporate customers and others	23,666,429	1,516,598	8,863,608	310,051	–	34,356,686
– SME	5,581,745	719,896	266,531	–	–	6,568,172
Financial assets held for trading – debt securities	–	17,711	189,256	–	–	206,967
Derivative financial instruments	29,110	349	835	21,152	–	51,446
Investment securities – debt securities	8,195,735	11,522,331	5,504,810	510,526	–	25,733,402
Other assets	910,265	1,464	19,878	1,027	–	932,634
	77,046,932	30,163,526	16,208,683	6,381,298	514	129,800,953

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.7 Concentration of risks of financial assets with credit risk exposure (Continued)

(a) Geographical sectors (Continued)

The Bank As at 31st December 2011

	Hong Kong	Asia Pacific excluding Hong Kong	North and South America	Europe	Middle East and Africa	Total
Balances with banks	15,122,789	9,195,848	254,101	2,749,960	128	27,322,826
Placements with and loans and advances to banks	7,638,967	6,781,700	–	444,809	–	14,865,476
Loans and advances to customers:						
Loans to individuals:						
– Overdrafts	525,339	7,469	219	473	–	533,500
– Credit cards	336,033	2,731	–	–	–	338,764
– Term loans and others	4,400,408	291,941	875,259	5,872	–	5,573,480
– Mortgages	5,885,131	119,803	344,439	562,713	707	6,912,793
Loans to corporate entities:						
– Large corporate customers and others	25,407,439	1,286,019	8,313,002	391,188	–	35,397,648
– SME	5,868,011	365,380	206,080	–	–	6,439,471
Financial assets held for trading – debt securities	86,862	53,305	181,191	–	–	321,358
Derivative financial instruments	37,628	581	2,742	29,343	–	70,294
Investment securities – debt securities	5,456,338	7,985,653	4,500,507	3,067,349	–	21,009,847
Other assets	1,386,045	1,395	32,050	860	–	1,420,350
	72,150,990	26,091,825	14,709,590	7,252,567	835	120,205,807

(b) Industry sectors

The following table breaks down the Group's main credit exposures at their carrying amounts, as categorised by the industry sectors of its counterparties.

For the analysis of investment securities - debt securities by issuers, refer to Notes 22 and 23.

The Group and the Bank As at 31st December 2012

	Financial institutions	Manufacturing	Real estate	Wholesale and retail trade	Import and export trade	Other industries	Individuals	Total
Balances with banks	29,533,726	–	–	–	–	–	–	29,533,726
Placements with and loans and advances to banks	19,627,668	–	–	–	–	–	–	19,627,668
Loans and advances to customers:								
Loans to individuals:								
– Overdrafts	–	–	–	–	–	–	561,215	561,215
– Credit cards	–	–	–	–	–	–	315,880	315,880
– Term loans and others	–	–	–	–	–	–	4,978,534	4,978,534
– Mortgages	–	–	–	–	–	–	6,934,623	6,934,623
Loans to corporate entities:								
– Large corporate customers and others	–	2,207,441	12,545,673	1,238,010	7,334,349	11,031,213	–	34,356,686
– SME	–	724,570	2,577,210	304,568	795,093	2,166,731	–	6,568,172
	49,161,394	2,932,011	15,122,883	1,542,578	8,129,442	13,197,944	12,790,252	102,876,504

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.7 Concentration of risks of financial assets with credit risk exposure (Continued)

(b) Industry sectors (Continued)

The Group and the Bank As at 31st December 2011

	Financial institutions	Manufacturing	Real estate	Wholesale and retail trade	Import and export trade	Other industries	Individuals	Total
Balances with banks	27,322,826	–	–	–	–	–	–	27,322,826
Placements with and loans and advances to banks	14,865,476	–	–	–	–	–	–	14,865,476
Loans and advances to customers:								
Loans to individuals:								
– Overdrafts	–	–	–	–	–	–	533,500	533,500
– Credit cards	–	–	–	–	–	–	338,764	338,764
– Term loans and others	–	–	–	–	–	–	5,573,480	5,573,480
– Mortgages	–	–	–	–	–	–	6,912,793	6,912,793
Loans to corporate entities:								
– Large corporate customers and others	–	2,363,312	11,806,141	959,413	7,280,163	12,988,619	–	35,397,648
– SME	–	656,384	2,158,512	334,134	746,860	2,543,581	–	6,439,471
	42,188,302	3,019,696	13,964,653	1,293,547	8,027,023	15,532,200	13,358,537	97,383,958

3.2 Market risk

Market risk is the risk that interest rates, foreign exchange rates, equity or commodity prices will move relative to positions taken, resulting in profits or losses. In the ordinary course of business, the Group enters into various types of financial instruments, mainly forward exchange contracts, that are mainly customer-driven and are entered into on behalf of customers. The Group's market risk is managed by the Treasury Department and monitored by management under the limits and guidelines laid down in the foreign exchange risk management policy and policy on allocating transactions of financial instruments to the trading, non-trading or investment book approved by the Executive Committee.

3.2.1 Market risk measurement techniques

The measuring procedures and limit system used for market risk management have been approved by the Executive Committee. Limits on notional, stop loss and sensitivity are set for trading positions which are marked-to-market daily. The transactions included in the trading book as at 31st December 2012 and 2011 for the Group and the Bank are not significant.

Stress tests provide an indication of the potential size of losses that could arise in extreme conditions. The stress testing is tailored to the business and typically uses scenario analysis. The results of the stress tests are reviewed by management and the Board of Directors.

3.2.2 Market risk sensitivity summary for 2012 and 2011

The Group uses different types of derivatives to manage foreign exchange and interest rate sensitivity primarily by hedging its underlying positions. The types of derivatives used by the Group include forward exchange rate and interest rate contracts which are typically made over-the-counter and are managed within limits approved by the Executive Committee. The policy on the use of derivatives is reviewed by the Executive Committee and recommended changes and amendments are submitted to the Board for consideration.

Interest rate risk

At 31st December 2012, if market interest rates had been 100 basis points higher (2011: 100 basis points higher) with other variables held constant, profit before tax for the year would have been HK$59,314,000 lower (2011: HK$31,216,000 lower). Available-for-sale investment revaluation shown as other comprehensive income would have been reduced by HK$79,944,000 (2011: reduced by HK$440,020,000).

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.2 Market risk sensitivity summary for 2012 and 2011 (Continued)

Foreign exchange risk

At 31st December 2012, over 90% (2011: over 90%) of the net on-balance sheet position of the Group were denominated in HKD and USD, and these two currencies were closely pegged, there is immaterial foreign exchange risk arising from the translation of foreign-currency denominated financial assets and financial liabilities into HKD.

3.2.3 Foreign exchange risk

Foreign exchange risk is the risk that the holding of foreign currencies will affect the Group's position as a result of a change in foreign currency exchange rates. The Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Group's foreign exchange risk arises primarily from currency exposures originated by the Group's commercial banking businesses. The foreign exchange risk is managed by the Treasury Department and monitored by management and the Asset and Liability Committee within position limits set in the foreign exchange risk management policy approved by the Executive Committee. The Board sets limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions, which are monitored daily. The table below summarises the Group's exposure to foreign currency exchange rate risk at 31st December. Included in the table are the Group's financial instruments at carrying amounts, categorised by currency.

Concentrations of currency risk: on- and off-balance sheet financial instruments

The Group As at 31st December 2012	HK$	US$	RMB	Other	Total
Assets					
Cash and balances with banks	18,466,485	4,766,911	2,193,185	4,463,088	29,889,669
Placements with and loans and advances to banks	1,020,690	10,014,359	8,074,566	518,053	19,627,668
Loans and advances to customers	32,805,997	17,336,954	1,998,464	1,573,695	53,715,110
Financial assets held for trading	11,101	320,951	17,711	–	349,763
Derivative financial instruments	–	2,346	30,208	18,892	51,446
Investment securities:					
– Available-for-sale	11,442,249	10,299,495	861,756	4,355,480	26,958,980
– Held-to-maturity	2,089,318	407,512	–	–	2,496,830
Total	65,835,840	43,148,528	13,175,890	10,929,208	133,089,466
Liabilities					
Deposits and balances from banks	2,633,847	2,339,146	211,915	360,887	5,545,795
Deposits from customers	53,079,149	34,751,288	12,326,921	10,524,557	110,681,915
Derivative financial instruments	–	2,096	27,805	9,990	39,891
Other liabilities	872,582	273,192	35,272	76,061	1,257,107
Total	56,585,578	37,365,722	12,601,913	10,971,495	117,524,708
Net on-balance sheet position	9,250,262	5,782,806	573,977	(42,287)	15,564,758
Credit commitments	27,672,745	14,265,762	619,457	670,908	43,228,872

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.3 Foreign exchange risk (Continued)

Concentrations of currency risk: on- and off-balance sheet financial instruments

The Group As at 31st December 2011

	HK$	US$	RMB	Other	Total
Assets					
Cash and balances with banks	13,424,551	4,448,597	3,724,976	6,140,968	27,739,092
Placements with and loans and advances to banks	5,206,965	4,813,643	4,260,343	584,525	14,865,476
Loans and advances to customers	35,029,283	17,260,451	1,406,103	1,499,819	55,195,656
Financial assets held for trading	9,108	294,962	140,167	–	444,237
Derivative financial instruments	–	10,084	24,543	35,667	70,294
Investment securities:					
– Available-for-sale	8,059,562	9,882,967	462,101	3,604,030	22,008,660
– Held-to-maturity	2,098,502	666,281	–	–	2,764,783
Total	63,827,971	37,376,985	10,018,233	11,865,009	123,088,198
Liabilities					
Deposits and balances from banks	1,804,531	1,951,544	184,653	391,072	4,331,800
Deposits from customers	50,955,747	31,674,252	8,967,105	11,500,092	103,097,196
Derivative financial instruments	–	8,327	19,245	17,837	45,409
Other liabilities	729,000	341,788	47,176	54,664	1,172,628
Total	53,489,278	33,975,911	9,218,179	11,963,665	108,647,033
Net on-balance sheet position	10,338,693	3,401,074	800,054	(98,656)	14,441,165
Credit commitments	25,791,725	14,062,491	591,505	952,586	41,398,307

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.3 Foreign exchange risk (Continued)

Concentrations of currency risk: on- and off-balance sheet financial instruments

The Bank As at 31st December 2012

	HK$	US$	RMB	Other	Total
Assets					
Cash and balances with banks	18,466,478	4,766,911	2,193,185	4,463,088	29,889,662
Placements with and loans and advances to banks	1,020,690	10,014,359	8,074,566	518,053	19,627,668
Loans and advances to customers	32,805,997	17,336,954	1,998,464	1,573,695	53,715,110
Financial assets held for trading	9,527	320,951	17,711	–	348,189
Derivative financial instruments	–	2,346	30,208	18,892	51,446
Investment securities:					
– Available-for-sale	11,395,352	10,299,495	861,756	4,355,480	26,912,083
– Held-to-maturity	–	403,620	–	–	403,620
Total	63,698,044	43,144,636	13,175,890	10,929,208	130,947,778
Liabilities					
Deposits and balances from banks	2,633,847	2,339,146	211,915	360,887	5,545,795
Deposits from customers	53,079,149	34,751,288	12,326,921	10,524,557	110,681,915
Derivative financial instruments	–	2,096	27,805	9,990	39,891
Other liabilities	414,946	273,169	35,229	76,270	799,614
Total	56,127,942	37,365,699	12,601,870	10,971,704	117,067,215
Net on-balance sheet position	7,570,102	5,778,937	574,020	(42,496)	13,880,563
Credit commitments	27,672,745	14,265,762	619,457	670,908	43,228,872

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.3 Foreign exchange risk (Continued)

Concentrations of currency risk: on- and off-balance sheet financial instruments

The Bank As at 31st December 2011

	HK$	US$	RMB	Other	Total
Assets					
Cash and balances with banks	13,424,539	4,448,597	3,724,976	6,140,968	27,739,080
Placements with and loans and advances to banks	5,206,965	4,813,643	4,260,343	584,525	14,865,476
Loans and advances to customers	35,029,283	17,260,451	1,406,103	1,499,819	55,195,656
Financial assets held for trading	9,108	294,962	140,167	–	444,237
Derivative financial instruments	–	10,084	24,543	35,667	70,294
Investment securities:					
– Available-for-sale	7,942,757	9,879,811	462,101	3,604,030	21,888,699
– Held-to-maturity	–	662,366	–	–	662,366
Total	61,612,652	37,369,914	10,018,233	11,865,009	120,865,808
Liabilities					
Deposits and balances from banks	1,804,531	1,951,544	184,653	391,072	4,331,800
Deposits from customers	50,955,747	31,674,252	8,967,105	11,500,092	103,097,196
Derivative financial instruments	–	8,327	19,245	17,837	45,409
Other liabilities	546,754	341,765	47,176	54,663	990,358
Total	53,307,032	33,975,888	9,218,179	11,963,664	108,464,763
Net on-balance sheet position	8,305,620	3,394,026	800,054	(98,655)	12,401,045
Credit commitments	25,791,725	14,062,491	591,505	952,586	41,398,307

3.2.4 Interest rate risk

Interest rate risk is the risk that the Group's position may be adversely affected by a change of market interest rates. The Group's interest rate risk arises primarily from the timing differences in the repricing of interest bearing assets, liabilities and commitments (repricing risk) as well as change of market rates or pricing indices at different time or by different amounts for different financial instruments (basis risk). The primary objective of interest rate risk management is to limit the potential adverse effects of interest rate movement on net interest income by closely monitoring the net repricing gap of the Group's assets and liabilities. The interest rate risk is managed by the Treasury Department and monitored by management and the Asset and Liability Committee under the limits and guidelines laid down in the interest rate risk management policy approved by the Executive Committee.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk (Continued)

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 in the event that unexpected movements arise. The Board sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily by management.

The table below summarises the Group's exposure to interest rate risks. It includes the Group's financial instruments at carrying amounts (non-derivatives), categorised by the earlier of contractual re-pricing (for example floating rate notes) or maturity dates.

The Group As at 31st December 2012

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Assets							
Cash and balances with banks	12,730,646	–	–	–	–	17,159,023	29,889,669
Placements with and loans and advances to banks	–	9,342,615	10,210,669	–	–	74,384	19,627,668
Loans and advances to customers	44,950,061	5,064,469	3,462,434	79,187	–	158,959	53,715,110
Financial assets held for trading	1,574	–	17,578	89,470	98,875	142,266	349,763
Derivative financial instruments	–	–	–	–	–	51,446	51,446
Investment securities:							
– Available-for-sale	3,276,548	9,305,382	883,778	9,249,658	2,165,189	2,078,425	26,958,980
– Held-to-maturity	38,756	297,112	500,041	1,357,796	295,151	7,974	2,496,830
Investments in jointly controlled entities	–	–	–	–	–	219,865	219,865
Properties and equipment	–	–	–	–	–	2,339,324	2,339,324
Investment properties	–	–	–	–	–	137,145	137,145
Deferred income tax assets	–	–	–	–	–	45,487	45,487
Other assets	255,727	–	496,687	–	–	603,467	1,355,881
Total assets	61,253,312	24,009,578	15,571,187	10,776,111	2,559,215	23,017,765	137,187,168
Liabilities							
Deposits and balances from banks	4,804,921	710,056	–	–	–	30,818	5,545,795
Deposits from customers	62,785,331	21,715,835	16,484,775	301,891	–	9,394,083	110,681,915
Derivative financial instruments	–	–	–	–	–	39,891	39,891
Other liabilities	285,082	–	–	–	–	972,025	1,257,107
Provisions	–	–	–	–	–	87,309	87,309
Current income tax liabilities	–	–	–	–	–	56,762	56,762
Deferred income tax liabilities	–	–	–	–	–	205,410	205,410
Total liabilities	67,875,334	22,425,891	16,484,775	301,891	–	10,786,298	117,874,189
Total interest repricing gap	(6,622,022)	1,583,687	(913,588)	10,474,220	2,559,215	12,231,467	19,312,979

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk (Continued)

The Group As at 31st December 2011

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Assets							
Cash and balances with banks	16,627,682	–	–	–	–	11,111,410	27,739,092
Placements with and loans and advances to banks	–	8,116,584	6,670,186	–	–	78,706	14,865,476
Loans and advances to customers	44,428,506	5,982,771	4,334,011	327,543	–	122,825	55,195,656
Financial assets held for trading	–	–	121,852	108,351	89,234	124,800	444,237
Derivative financial instruments	–	–	–	–	–	70,294	70,294
Investment securities:							
– Available-for-sale	2,123,088	4,358,408	2,557,096	9,197,140	2,198,831	1,574,097	22,008,660
– Held-to-maturity	116,535	283,236	166,587	1,848,725	339,512	10,188	2,764,783
Investments in jointly controlled entities	–	–	–	–	–	189,308	189,308
Properties and equipment	–	–	–	–	–	2,040,164	2,040,164
Investment properties	–	–	–	–	–	9,193	9,193
Deferred income tax assets	–	–	–	–	–	44,755	44,755
Other assets	223,160	–	751,382	–	–	631,680	1,606,222
Total assets	63,518,971	18,740,999	14,601,114	11,481,759	2,627,577	16,007,420	126,977,840
Liabilities							
Deposits and balances from banks	3,590,239	710,768	–	–	–	30,793	4,331,800
Deposits from customers	58,478,407	22,446,171	13,117,730	262,164	–	8,792,724	103,097,196
Derivative financial instruments	–	–	–	–	–	45,409	45,409
Other liabilities	330,060	–	–	–	–	878,209	1,208,269
Provisions	–	–	–	–	–	94,691	94,691
Current income tax liabilities	–	–	–	–	–	14,872	14,872
Deferred income tax liabilities	–	–	–	–	–	104,551	104,551
Total liabilities	62,398,706	23,156,939	13,117,730	262,164	–	9,961,249	108,896,788
Total interest repricing gap	1,120,265	(4,415,940)	1,483,384	11,219,595	2,627,577	6,046,171	18,081,052

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk (Continued)

The Bank As at 31st December 2012

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Assets							
Cash and balances with banks	12,730,646	–	–	–	–	17,159,016	29,889,662
Placements with and loans and advances to banks	–	9,342,615	10,210,669	–	–	74,384	19,627,668
Loans and advances to customers	44,950,061	5,064,469	3,462,434	79,187	–	158,959	53,715,110
Financial assets held for trading	–	–	17,578	89,470	98,875	142,266	348,189
Derivative financial instruments	–	–	–	–	–	51,446	51,446
Investment securities:							
– Available-for-sale	3,276,548	9,295,373	879,792	9,224,447	2,165,189	2,070,734	26,912,083
– Held-to-maturity	38,756	77,514	46,709	238,518	–	2,123	403,620
Investments in jointly controlled entities	–	–	–	–	–	116,000	116,000
Investments in and loans to subsidiaries	–	–	–	–	–	2,408,166	2,408,166
Properties and equipment	–	–	–	–	–	2,009,388	2,009,388
Investment properties	–	–	–	–	–	32,999	32,999
Deferred income tax assets	–	–	–	–	–	45,487	45,487
Other assets	255,727	–	496,687	–	–	180,220	932,634
Total assets	61,251,738	23,779,971	15,113,869	9,631,622	2,264,064	24,451,188	136,492,452
Liabilities							
Deposits and balances from banks	4,804,921	710,056	–	–	–	30,818	5,545,795
Deposits from customers	62,785,331	21,715,835	16,484,775	301,891	–	9,394,083	110,681,915
Derivative financial instruments	–	–	–	–	–	39,891	39,891
Other liabilities	285,082	–	–	–	–	514,532	799,614
Provisions	–	–	–	–	–	86,833	86,833
Current income tax liabilities	–	–	–	–	–	56,381	56,381
Deferred income tax liabilities	–	–	–	–	–	205,375	205,375
Total liabilities	67,875,334	22,425,891	16,484,775	301,891	–	10,327,913	117,415,804
Total interest repricing gap	(6,623,596)	1,354,080	(1,370,906)	9,329,731	2,264,064	14,123,275	19,076,648

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk (Continued)

The Bank As at 31st December 2011

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Assets							
Cash and balances with banks	16,627,682	–	–	–	–	11,111,398	27,739,080
Placements with and loans and advances to banks	–	8,116,584	6,670,186	–	–	78,706	14,865,476
Loans and advances to customers	44,428,506	5,982,771	4,334,011	327,543	–	122,825	55,195,656
Financial assets held for trading	–	–	121,852	108,351	89,234	124,800	444,237
Derivative financial instruments	–	–	–	–	–	70,294	70,294
Investment securities:							
– Available-for-sale	2,123,088	4,352,408	2,503,844	9,162,844	2,193,831	1,552,684	21,888,699
– Held-to-maturity	116,535	232,972	101,374	207,617	–	3,868	662,366
Investments in jointly controlled entities	–	–	–	–	–	116,000	116,000
Investments in and loans to subsidiaries	–	–	–	–	–	2,086,442	2,086,442
Properties and equipment	–	–	–	–	–	1,985,901	1,985,901
Investment properties	–	–	–	–	–	42,620	42,620
Deferred income tax assets	–	–	–	–	–	44,323	44,323
Other assets	223,160	–	751,382	–	–	445,808	1,420,350
Total assets	63,518,971	18,684,735	14,482,649	9,806,355	2,283,065	17,785,669	126,561,444
Liabilities							
Deposits and balances from banks	3,590,239	710,768	–	–	–	30,793	4,331,800
Deposits from customers	58,478,407	22,446,171	13,117,730	262,164	–	8,792,724	103,097,196
Derivative financial instruments	–	–	–	–	–	45,409	45,409
Other liabilities	330,060	–	–	–	–	660,298	990,358
Provisions	–	–	–	–	–	94,320	94,320
Current income tax liabilities	–	–	–	–	–	14,599	14,599
Deferred income tax liabilities	–	–	–	–	–	104,516	104,516
Total liabilities	62,398,706	23,156,939	13,117,730	262,164	–	9,742,659	108,678,198
Total interest repricing gap	1,120,265	(4,472,204)	1,364,919	9,544,191	2,283,065	8,043,010	17,883,246

3.3 Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfill commitments to lend. The Group's liquidity risk is managed by the Treasury Department and monitored by management and the Asset and Liability Committee in accordance with the guidelines and procedures laid down in the liquidity management policy approved by the Board of Directors, which has regard to a variety of factors, including liquidity ratio, loan to deposit ratio, liquidity cushion, maturity mismatch profile, diversity and stability of the deposit base and ability to borrow in the interbank market. An adequate stock of high quality liquid assets is being maintained at all times, in order to enable the Group to meet deposit withdrawals, to repay interbank borrowings, and to make new loans and investments as and when required in a timely and cost effective manner.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.1 Liquidity risk management process

The Group's liquidity management process, as carried out within the Group and monitored by management, includes:

- Day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are borrowed by customers. The Group maintains an active presence in global money markets to enable this to happen;
- Maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- Monitoring statement of financial position liquidity ratios against internal and regulatory requirements; and
- Managing the concentration and profile of debt maturities.

Monitoring and reporting take the form of cash flow measurement and projections for the next day, week and month respectively, as these are key periods for liquidity management. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets (Notes 3.3.4).

Management also monitors unmatched medium-term assets, the level and type of undrawn lending commitments, the usage of overdraft facilities and the impact of contingent liabilities such as standby letters of credit and guarantees.

3.3.2 Maturity analysis

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date.

The Group As at 31st December 2012

	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	18,849,630	11,040,039	–	–	–	–	–	29,889,669
Placements with and loans and advances to banks	–	–	9,377,750	10,249,918	–	–	–	19,627,668
Loans and advances to customers	4,787,957	3,905,186	4,565,616	8,901,648	16,734,488	14,820,215	–	53,715,110
Financial assets held for trading	–	228	359	18,034	89,471	98,875	142,796	349,763
Derivative financial instruments	–	12,611	15,635	22,852	348	–	–	51,446
Investment securities:								
– Available-for-sale	–	833,447	1,452,423	2,680,537	17,691,760	2,709,361	1,591,452	26,958,980
– Held-to-maturity	–	38,757	223,133	504,861	1,435,010	295,069	–	2,496,830
Investments in jointly controlled entities	–	–	–	–	–	–	219,865	219,865
Properties and equipment	–	–	–	–	109,483	2,194,372	35,469	2,339,324
Investment properties	–	–	–	–	–	137,145	–	137,145
Deferred income tax assets	–	–	–	–	45,487	–	–	45,487
Other assets	50,620	728,063	10,221	38,698	524,160	2,619	1,500	1,355,881
Total assets	23,688,207	16,558,331	15,645,137	22,416,548	36,630,207	20,257,656	1,991,082	137,187,168
Liabilities								
Deposits and balances from banks	460,364	4,258,603	–	–	826,828	–	–	5,545,795
Deposits from customers	41,812,290	30,185,812	21,775,249	16,605,543	303,021	–	–	110,681,915
Derivative financial instruments	–	9,748	11,873	18,192	78	–	–	39,891
Other liabilities	68,949	835,894	65,064	287,200	–	–	–	1,257,107
Provisions	–	87,215	–	–	–	94	–	87,309
Current income tax liabilities	–	–	–	56,762	–	–	–	56,762
Deferred income tax liabilities	–	–	–	–	205,410	–	–	205,410
Total liabilities	42,341,603	35,377,272	21,852,186	16,967,697	1,335,337	94	–	117,874,189
Net liquidity gap	(18,653,396)	(18,818,941)	(6,207,049)	5,448,851	35,294,870	20,257,562	1,991,082	19,312,979

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.2 Maturity analysis (Continued)

The Group As at 31st December 2011

	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	13,864,948	13,874,144	–	–	–	–	–	27,739,092
Placements with and loans and advances to banks	–	–	8,152,449	6,713,027	–	–	–	14,865,476
Loans and advances to customers	4,636,291	3,499,484	6,128,219	10,881,141	17,044,174	13,006,347	–	55,195,656
Financial assets held for trading	–	647	1,257	121,869	108,351	89,234	122,879	444,237
Derivative financial instruments	–	11,223	24,532	34,193	346	–	–	70,294
Investment securities:								
– Available-for-sale	–	632,445	401,219	3,144,792	13,578,383	2,688,082	1,563,739	22,008,660
– Held-to-maturity	–	117,614	209,434	249,474	1,848,857	339,404	–	2,764,783
Investments in jointly controlled entities	–	–	–	–	–	–	189,308	189,308
Properties and equipment	–	–	–	–	105,888	1,898,763	35,513	2,040,164
Investment properties	–	–	–	–	–	9,193	–	9,193
Deferred income tax assets	–	–	–	–	44,755	–	–	44,755
Other assets	267,617	488,462	6,833	41,354	797,837	2,619	1,500	1,606,222
Total assets	18,768,856	18,624,019	14,923,943	21,185,850	33,528,591	18,033,642	1,912,939	126,977,840
Liabilities								
Deposits and balances from banks	303,516	3,200,635	–	–	827,649	–	–	4,331,800
Deposits from customers	37,413,803	29,723,886	22,510,821	13,185,299	263,387	–	–	103,097,196
Derivative financial instruments	–	6,591	14,998	23,767	53	–	–	45,409
Other liabilities	43,888	720,880	78,570	358,035	6,896	–	–	1,208,269
Provisions	–	94,599	–	–	–	92	–	94,691
Current income tax liabilities	–	–	–	14,872	–	–	–	14,872
Deferred income tax liabilities	–	–	–	–	104,551	–	–	104,551
Total liabilities	37,761,207	33,746,591	22,604,389	13,581,973	1,202,536	92	–	108,896,788
Net liquidity gap	(18,992,351)	(15,122,572)	(7,680,446)	7,603,877	32,326,055	18,033,550	1,912,939	18,081,052

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.2 Maturity analysis (Continued)

The Bank As at 31st December 2012

	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	18,849,623	11,040,039	–	–	–	–	–	29,889,662
Placements with and loans and advances to banks	–	–	9,377,750	10,249,918	–	–	–	19,627,668
Loans and advances to customers	4,787,957	3,905,186	4,565,616	8,901,648	16,734,488	14,820,215	–	53,715,110
Financial assets held for trading	–	228	359	18,034	89,471	98,875	141,222	348,189
Derivative financial instruments	–	12,611	15,635	22,852	348	–	–	51,446
Investment securities:								
– Available-for-sale	–	833,377	1,441,791	2,676,477	17,666,022	2,709,361	1,585,055	26,912,083
– Held-to-maturity	–	38,757	1,303	47,528	316,032	–	–	403,620
Investments in jointly controlled entities	–	–	–	–	–	–	116,000	116,000
Investments in and loans to/ (deposits from) subsidiaries (net)	(744,813)	(101,946)	47,049	977,188	1,689,363	348,165	193,160	2,408,166
Properties and equipment	–	–	–	–	115,998	1,874,399	18,991	2,009,388
Investment properties	–	–	–	–	–	32,999	–	32,999
Deferred income tax assets	–	–	–	–	45,487	–	–	45,487
Other assets	50,620	311,910	9,637	35,479	524,988	–	–	932,634
Total assets	22,943,387	16,040,162	15,459,140	22,929,124	37,182,197	19,884,014	2,054,428	136,492,452
Liabilities								
Deposits and balances from banks	460,364	4,258,603	–	–	826,828	–	–	5,545,795
Deposits from customers	41,812,290	30,185,812	21,775,249	16,605,543	303,021	–	–	110,681,915
Derivative financial instruments	–	9,748	11,873	18,192	78	–	–	39,891
Other liabilities	68,949	394,789	62,085	273,791	–	–	–	799,614
Provisions	–	86,833	–	–	–	–	–	86,833
Current income tax liabilities	–	–	–	56,381	–	–	–	56,381
Deferred income tax liabilities	–	–	–	–	205,375	–	–	205,375
Total liabilities	42,341,603	34,935,785	21,849,207	16,953,907	1,335,302	–	–	117,415,804
Net liquidity gap	(19,398,216)	(18,895,623)	(6,390,067)	5,975,217	35,846,895	19,884,014	2,054,428	19,076,648

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.2 Maturity analysis (Continued)

The Bank As at 31st December 2011

	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	13,864,936	13,874,144	–	–	–	–	–	27,739,080
Placements with and loans and advances to banks	–	–	8,152,449	6,713,027	–	–	–	14,865,476
Loans and advances to customers	4,636,291	3,499,484	6,128,219	10,881,141	17,044,174	13,006,347	–	55,195,656
Financial assets held for trading	–	647	1,257	121,869	108,351	89,234	122,879	444,237
Derivative financial instruments	–	11,223	24,532	34,193	346	–	–	70,294
Investment securities:								
– Available-for-sale	–	632,445	394,456	3,090,956	13,543,788	2,683,082	1,543,972	21,888,699
– Held-to-maturity	–	117,614	157,243	179,896	207,613	–	–	662,366
Investments in jointly controlled entities	–	–	–	–	–	–	116,000	116,000
Investments in and loans to/ (deposits from) subsidiaries (net)	(1,101,521)	(48,527)	70,503	965,411	1,664,772	342,616	193,188	2,086,442
Properties and equipment	–	–	–	–	112,386	1,854,480	19,035	1,985,901
Investment properties	–	–	–	–	–	42,620	–	42,620
Deferred income tax assets	–	–	–	–	44,323	–	–	44,323
Other assets	267,617	309,894	6,229	38,372	798,238	–	–	1,420,350
Total assets	17,667,323	18,396,924	14,934,888	22,024,865	33,523,991	18,018,379	1,995,074	126,561,444
Liabilities								
Deposits and balances from banks	303,516	3,200,635	–	–	827,649	–	–	4,331,800
Deposits from customers	37,413,803	29,723,886	22,510,821	13,185,299	263,387	–	–	103,097,196
Derivative financial instruments	–	6,591	14,998	23,767	53	–	–	45,409
Other liabilities	43,888	554,720	75,641	316,109	–	–	–	990,358
Provisions	–	94,320	–	–	–	–	–	94,320
Current income tax liabilities	–	–	–	14,599	–	–	–	14,599
Deferred income tax liabilities	–	–	–	–	104,516	–	–	104,516
Total liabilities	37,761,207	33,580,152	22,601,460	13,539,774	1,195,605	–	–	108,678,198
Net liquidity gap	(20,093,884)	(15,183,228)	(7,666,572)	8,485,091	32,328,386	18,018,379	1,995,074	17,883,246

3.3.3 Funding approach

Sources of liquidity are regularly reviewed by management to maintain a wide diversification by currency, geography, provider, product and term.

3.3.4 Non-derivative financial liabilities and assets held for managing liquidity risk

The table below presents the cash flows payable by the Group under non-derivative financial liabilities and assets held for managing liquidity risk by remaining contractual maturities at the end of the reporting period. The amounts disclosed in the table are the contractual undiscounted cash flow, whereas the Group manages the liquidity risk based on a different basis, but they do not result in a significantly different analysis.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.4 Non-derivative financial liabilities and assets held for managing liquidity risk (Continued)

The Group As at 31st December 2012

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits and balances from banks	4,719,854	2,169	6,560	843,272	–	5,571,855
Deposits from customers	72,023,298	21,829,923	16,751,514	334,203	–	110,938,938
Other liabilities	895,838	47,056	206,162	–	–	1,149,056
Total	77,638,990	21,879,148	16,964,236	1,177,475	–	117,659,849
Assets held for managing liquidity risk	39,521,779	15,848,576	23,623,209	40,361,474	23,056,290	142,411,328

The Group As at 31st December 2011

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits and balances from banks	3,504,704	1,994	21,454	827,306	–	4,355,458
Deposits from customers	67,170,839	22,568,956	13,279,732	287,165	–	103,306,692
Other liabilities	730,840	61,023	279,078	6,896	–	1,077,837
Total	71,406,383	22,631,973	13,580,264	1,121,367	–	108,739,987
Assets held for managing liquidity risk	37,464,399	15,154,848	22,291,250	38,042,702	24,982,040	137,935,239

The Bank As at 31st December 2012

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits and balances from banks	4,719,854	2,169	6,560	843,272	–	5,571,855
Deposits from customers	72,023,298	21,829,923	16,751,514	334,203	–	110,938,938
Other liabilities	456,391	47,056	206,162	–	–	709,609
Total	77,199,543	21,879,148	16,964,236	1,177,475	–	117,220,402
Assets held for managing liquidity risk	39,521,772	15,848,576	23,623,209	40,361,474	23,056,290	142,411,321

The Bank As at 31st December 2011

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits and balances from banks	3,504,704	1,994	21,454	827,306	–	4,355,458
Deposits from customers	67,170,839	22,568,956	13,279,732	287,165	–	103,306,692
Other liabilities	566,146	61,023	250,332	–	–	877,501
Total	71,241,689	22,631,973	13,551,518	1,114,471	–	108,539,651
Assets held for managing liquidity risk	36,135,531	15,161,476	23,090,180	37,939,231	25,038,543	137,364,961

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.4 Non-derivative financial liabilities and assets held for managing liquidity risk (Continued)

Assets available to meet all of the liabilities and to cover outstanding loan commitments include cash and balances with bank, placements with and loans and advances to banks, loans and advances to customers, investment securities and financial assets held for trading. In addition, debt securities can be pledged to secure liabilities, if necessary. The Group would also be able to meet unexpected net cash outflows by selling securities and accessing additional funding sources such as asset-backed markets.

3.3.5 Derivative liabilities

The table below analyses the Group's derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. Contractual maturities are assessed to be essential for an understanding of the timing of the cashflows on all derivatives. Some of the Group's derivatives are subject to collateral requirements. Cash flows for those derivatives could occur earlier than the contractual maturity. The amounts disclosed in the table are the contractual undiscounted cash flows.

The Group and the Bank As at 31st December 2012

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Derivatives held for trading:						
Exchange rate contracts						
– Outflow	5,886,706	2,439,853	3,402,216	27,663	–	11,756,438
– Inflow	5,890,689	2,441,673	3,407,249	27,958	–	11,767,569

The Group and the Bank As at 31st December 2011

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Derivatives held for trading:						
Exchange rate contracts						
– Outflow	2,391,016	2,993,356	8,362,923	35,269	–	13,782,564
– Inflow	2,395,896	3,003,550	8,374,607	35,577	–	13,809,630

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.6 Off-balance sheet items

(a) Loan and other commitments

The dates of the contractual amounts of the Group's off-balance sheet instruments (Note 35(c)) that commit it to extend credit to customers and other facilities, are summarised in the table below.

(b) Acceptances and other financial facilities

Acceptances and other financial facilities, are also included below based on the conditions existing at the reporting date as to what contractual payments are required.

(c) Operating lease commitments

Where a group company is the lessee, the future minimum lease payments under non-cancellable operating leases, as disclosed in Note 35(b), are summarised in the table below.

(d) Capital commitments

Capital commitments for the acquisition of properties and equipment (Note 35(a)) are summarised in the table below.

The Group As at 31st December 2012

	No later than 1 year	1-5 years	Over 5 years	Total
Loan and other commitments	35,106,977	2,482,232	24,043	37,613,252
Guarantees, acceptances and other financial facilities				
– Acceptances	555,513	–	–	555,513
– Guarantees and standby letters of credit	1,974,529	225,871	7,470	2,207,870
– Documentary and commercial letters of credit	2,799,940	52,297	–	2,852,237
Operating lease commitments	97,416	157,896	–	255,312
Capital commitments	91,711	80,528	–	172,239
Total	40,626,086	2,998,824	31,513	43,656,423

The Group As at 31st December 2011

	No later than 1 year	1-5 years	Over 5 years	Total
Loan and other commitments	32,813,516	2,839,836	8,408	35,661,760
Guarantees, acceptances and other financial facilities				
– Acceptances	830,599	–	–	830,599
– Guarantees and standby letters of credit	2,098,367	234,285	7,348	2,340,000
– Documentary and commercial letters of credit	2,565,948	–	–	2,565,948
Operating lease commitments	88,621	190,075	70	278,766
Capital commitments	120,243	–	–	120,243
Total	38,517,294	3,264,196	15,826	41,797,316

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.6 Off-balance sheet items (Continued)

The Bank As at 31st December 2012

	No later than 1 year	1-5 years	Over 5 years	Total
Loan and other commitments	35,106,977	2,482,232	24,043	37,613,252
Guarantees, acceptances and other financial facilities				
– Acceptances	555,513	–	–	555,513
– Guarantees and standby letters of credit	1,974,529	225,871	7,470	2,207,870
– Documentary and commercial letters of credit	2,799,940	52,297	–	2,852,237
Operating lease commitments	99,920	167,913	4,173	272,006
Capital commitments	88,309	77,716	–	166,025
Total	40,625,188	3,006,029	35,686	43,666,903

The Bank As at 31st December 2011

	No later than 1 year	1-5 years	Over 5 years	Total
Loan and other commitments	32,813,516	2,839,836	8,408	35,661,760
Guarantees, acceptances and other financial facilities				
– Acceptances	830,599	–	–	830,599
– Guarantees and standby letters of credit	2,098,367	234,285	7,348	2,340,000
– Documentary and commercial letters of credit	2,565,948	–	–	2,565,948
Operating lease commitments	89,818	190,075	70	279,963
Capital commitments	122,939	–	–	122,939
Total	38,521,187	3,264,196	15,826	41,801,209

3.4 Fair value of financial assets and liabilities

(a) Financial instruments not measured at fair value

Valuation governance

The Group has in place fair valuation policy to ensure adequate governance and control processes for the designation and valuation of financial instruments to be measured at fair value for financial reporting, risk management and regulatory capital purposes. The valuation process is conducted by control units independent of risk taking units.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities (Continued)

(a) Financial instruments not measured at fair value (Continued)

The table below summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group's statement of financial position at their fair value.

The Group

	Carrying value		Fair value	
	2012	2011	2012	2011
Financial assets				
Balances with banks	29,533,726	27,322,826	29,533,726	27,322,826
Placements with and loans and advances to banks	19,627,668	14,865,476	19,627,668	14,865,476
Loans and advances to customers:				
Loans to individuals:				
– Overdrafts	561,215	533,500	561,215	533,500
– Credit cards	315,880	338,764	315,880	338,764
– Term loans and others	4,978,534	5,573,480	4,978,534	5,573,480
– Mortgages	6,934,623	6,912,793	6,934,623	6,912,793
Loans to corporate entities:				
– Large corporate customers and others	34,356,686	35,397,648	34,356,686	35,397,648
– SME	6,568,172	6,439,471	6,568,172	6,439,471
Investment securities – Held-to-maturity	2,496,830	2,764,783	2,557,121	2,800,071
Financial liabilities				
Deposits and balances from banks	5,545,795	4,331,800	5,545,795	4,331,800
Deposits from customers	110,681,915	103,097,196	110,681,915	103,097,196

The Bank

	Carrying value		Fair value	
	2012	2011	2012	2011
Financial assets				
Balances with banks	29,533,726	27,322,826	29,533,726	27,322,826
Placements with and loans and advances to banks	19,627,668	14,865,476	19,627,668	14,865,476
Loans and advances to customers:				
Loans to individuals:				
– Overdrafts	561,215	533,500	561,215	533,500
– Credit cards	315,880	338,764	315,880	338,764
– Term loans and others	4,978,534	5,573,480	4,978,534	5,573,480
– Mortgages	6,934,623	6,912,793	6,934,623	6,912,793
Loans to corporate entities:				
– Large corporate customers and others	34,356,686	35,397,648	34,356,686	35,397,648
– SME	6,568,172	6,439,471	6,568,172	6,439,471
Investment securities – Held-to-maturity	403,620	662,366	404,802	658,316
Financial liabilities				
Deposits and balances from banks	5,545,795	4,331,800	5,545,795	4,331,800
Deposits from customers	110,681,915	103,097,196	110,681,915	103,097,196

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities (Continued)

(a) Financial instruments not measured at fair value (Continued)

(i) Placements with and loans and advances to banks

Placements with and loans and advances to banks include inter-bank placements. The maturities of these financial assets are within one year. The carrying amount at statement of financial position approximates their fair value.

(ii) Loans and advances to customers

Loans and advances are stated net of impairment allowance. An insignificant portion of loans and advances to customers bears interest at fixed rate. The carrying amount at statement of financial position approximates their fair value.

(iii) Investment securities

The fair value for held-to-maturity securities is based on market prices or broker/dealer price quotations. Where this information is not available, fair value is estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

(iv) Deposits and balances from banks and deposits from customers

Substantially all the deposits and balances from banks and deposits from customers mature within one year from the statement of financial position date. Hence, the carrying amount at statement of financial position approximates their fair value.

(b) Fair value hierarchy

HKFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group's market assumptions. These two types of inputs have created the following fair value hierarchy:

– Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt securities on exchanges (for example, The Hong Kong Stock Exchange, The London Stock Exchange, The Frankfurt Stock Exchange and The New York Stock Exchange) and paper gold.

– Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes the OTC derivative contracts and unlisted debt securities. The sources of input parameters such as HIBOR and LIBOR yield curves or counterparty credit risk are obtained from Bloomberg and Reuters.

– Level 3 – Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities (Continued)

(b) Fair value hierarchy (Continued)

Assets and liabilities measured at fair value:

The Group As at 31st December 2012

	Level 1	Level 2	Level 3	Total
Financial assets held for trading				
Debt securities	206,842	125	–	206,967
Equity securities	134,140	–	–	134,140
Others	8,656	–	–	8,656
Derivative financial instruments				
Currency forwards	–	51,446	–	51,446
Available-for-sale investments				
Debt securities	7,669,160	17,698,368	2,754	25,370,282
Equity securities	115,323	–	1,473,375	1,588,698
Total Assets	8,134,121	17,749,939	1,476,129	27,360,189
Derivative financial instruments				
Currency forwards	–	39,891	–	39,891
Total Liabilities	–	39,891	–	39,891

The Group As at 31st December 2011

	Level 1	Level 2	Level 3	Total
Financial assets held for trading				
Debt securities	181,191	140,167	–	321,358
Equity securities	116,452	–	–	116,452
Others	6,427	–	–	6,427
Derivative financial instruments				
Currency forwards	–	70,294	–	70,294
Available-for-sale investments				
Debt securities	8,765,631	11,679,290	2,754	20,447,675
Equity securities	98,259	–	1,462,726	1,560,985
Total Assets	9,167,960	11,889,751	1,465,480	22,523,191
Derivative financial instruments				
Currency forwards	–	45,409	–	45,409
Total Liabilities	–	45,409	–	45,409

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities (Continued)

(b) Fair value hierarchy (Continued)

The Bank As at 31st December 2012

	Level 1	Level 2	Level 3	Total
Financial assets held for trading				
Debt securities	206,842	125	–	206,967
Equity securities	132,566	–	–	132,566
Others	8,656	–	–	8,656
Derivative financial instruments				
Currency forwards	–	51,446	–	51,446
Available-for-sale investments				
Debt securities	7,669,160	17,657,868	2,754	25,329,782
Equity securities	108,926	–	1,473,375	1,582,301
Total Assets	8,126,150	17,709,439	1,476,129	27,311,718
Derivative financial instruments				
Currency forwards	–	39,891	–	39,891
Total Liabilities	–	39,891	–	39,891

The Bank As at 31st December 2011

	Level 1	Level 2	Level 3	Total
Financial assets held for trading				
Debt securities	181,191	140,167	–	321,358
Equity securities	116,452	–	–	116,452
Others	6,427	–	–	6,427
Derivative financial instruments				
Currency forwards	–	70,294	–	70,294
Available-for-sale investments				
Debt securities	8,762,446	11,582,281	2,754	20,347,481
Equity securities	78,492	–	1,462,726	1,541,218
Total Assets	9,145,008	11,792,742	1,465,480	22,403,230
Derivative financial instruments				
Currency forwards	–	45,409	–	45,409
Total Liabilities	–	45,409	–	45,409

There were no significant transfers of financial assets or liabilities between level 1 and level 2 fair value hierarchy classifications.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities (Continued)

(b) Fair value hierarchy (Continued)

The following table presents the changes in level 3 instruments for the year ended 31st December 2011 and 2012 respectively.

The Group and the Bank

	Available-for-sale investments		Total
	Equity securities	Debt securities	
At 1st January 2011	1,480,553	2,754	1,483,307
Total gains			
– Profit or loss	1,454	–	1,454
– Other comprehensive income	38,817	–	38,817
Purchases	269,423	–	269,423
Settlements	(326,155)	–	(326,155)
Exchange differences	(1,366)	–	(1,366)
At 31st December 2011	1,462,726	2,754	1,465,480
At 1st January 2012	**1,462,726**	**2,754**	**1,465,480**
Total gains			
– Profit or loss	**–**	**–**	**–**
– Other comprehensive income	**12,550**	**–**	**12,550**
Purchases	**1,302**	**–**	**1,302**
Settlements	**–**	**–**	**–**
Exchange differences	**(3,203)**	**–**	**(3,203)**
At 31st December 2012	**1,473,375**	**2,754**	**1,476,129**

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.5 Capital management

The Group's policy is to maintain a strong capital base to support the development of the Group's business and to ensure compliance with the statutory capital adequacy ratio requirement, a requirement used to assess the capital adequacy of banks. Capital is allocated to the various activities of the Group depending on the risk taken by each business division. Where the subsidiaries or branches are directly regulated by other regulators, they are required to maintain capital according to the rules of those regulators.

The Group's objectives when managing capital, which is a broader concept than the 'equity' on the face of statement of financial position, are:

– To comply with the capital requirements under the Banking (Capital) Rules of the Banking Ordinance;

– To safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders;

– To support the Group's stability and growth;

– To allocate capital in an efficient and risk based approach to optimise risk adjusted return to the shareholders; and

– To maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored daily by the Group's management, employing techniques based on the Banking (Capital) Rules. The required information is filed with the Hong Kong Monetary Authority ('HKMA') on a quarterly basis.

The HKMA requires each bank or banking group to maintain a ratio of total regulatory capital to the risk-weighted asset (the capital adequacy ratio) at or above the minimum of 8%. In addition, those individual banking subsidiaries or similar financial institutions not incorporated in Hong Kong are also directly regulated and supervised by their local banking supervisors, which may differ from country to country. Subsidiaries of the Group are also subject to statutory capital requirements from other regulatory authorities, such as the Securities and Futures Commission.

The regulatory capital requirements are strictly observed when managing economic capital. The Group's regulatory capital is managed by its central Group Treasury and comprises two tiers:

– Core capital: share capital, general reserve and retained earnings; and

– Supplementary capital: collective impairment allowances, regulatory reserve and available-for-sale investment revaluation reserve.

The table below summarises the ratios and the composition of regulatory capital of the Group for the years ended 31st December. During those two years, the individual entities within the Group and the Group complied with all of the externally imposed capital requirements by the HKMA.

	2012	2011
Capital adequacy ratio	18%	18%
Core capital ratio	18%	18%

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.5 Capital management (Continued)

The capital base after deductions used in the calculation of the above capital adequacy ratios as at 31st December and reported to the HKMA is analysed as follows:

The Group		
	2012	2011
Core capital:		
Paid up ordinary share capital	2,000,000	2,000,000
Reserves	13,028,417	12,096,361
Income statement	1,614,233	1,777,148
Less: net deferred tax assets	(61,401)	(74,990)
	16,581,249	15,798,519
Other deductions from core capital	(1,132,493)	(902,705)
Core capital after deductions	15,448,756	14,895,814
Supplementary capital:		
Collective impairment allowances for loans and advances	213,482	214,859
Regulatory reserve	490,741	462,370
Revaluation reserves for available-for-sale investments	603,517	368,816
	1,307,740	1,046,045
Other deductions from supplementary capital	(1,132,492)	(902,705)
Supplementary capital after deductions	175,248	143,340
Total capital base	15,624,004	15,039,154
Risk-weighted assets:		
Credit risk	79,524,623	75,819,963
Market risk	1,847,675	1,257,200
Operational risk	5,327,900	5,258,800
Total risk-weighted assets	86,700,198	82,335,963
Which consist of:		
On-balance sheet	82,423,996	77,896,965
Off-balance sheet	4,276,202	4,438,998

3.6 Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It is inherent in all material products, activities, processes and systems. The Operational Risk Management Committee oversees the Group's operational risk to ensure the operations are in accordance with the controls and procedures laid down in the operational risk management policy approved by the Executive Committee. The Risk Management Department is responsible for the central operational risk management function. Policies and procedures have been established to control exposures and to identify operational risk factors. Insurance policies are taken to mitigate unforeseeable operational risk. A Business Continuity Plan is established to ensure the Group's ability to operate on an ongoing basis and limit losses in the event of severe business disruption, particularly where the Group's physical, telecommunication, or information technology infrastructures have been damaged or made inaccessible.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS IN APPLYING ACCOUNTING POLICIES

4.1 Critical accounting estimates and assumptions

The Group's financial statements and its financial results are influenced by accounting policies, assumptions, estimates, and management judgment which necessarily have to be made in the course of preparation of the consolidated financial statements.

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

Accounting policies and management's judgments for certain items are especially critical for the Group's results and financial situation due to their materiality in amount.

(i) Impairment allowances on loans and advances

The Group reviews its loan portfolios 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 judgments 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 national or local 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.

(ii) Impairment of available-for-sale investments

The Group follows the guidance of HKAS 39 to determine when available-for-sale investments are impaired. This determination requires judgment. In making this judgment, the Group evaluates among other factors, the duration and extent to which the fair value of an investment is less than its cost; and the financial health of and near-term business outlook for the investee, including factors such as industry and sector performance, changes in technology and operational and financing cash flows.

(iii) 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 judgment. In making this judgment, 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 investments. The investments would therefore be measured at fair value not amortised cost.

(iv) Income taxes

The Group is subject to income taxes in numerous jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated tax audit 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 current and deferred income tax and deferred tax assets and liabilities in the period in which such determination is made.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS IN APPLYING ACCOUNTING POLICIE (CONTINUED)

4.1 Critical accounting estimates and assumptions (Continued)

(v) Amount recoverable from the Lehman Brothers minibonds

On 22nd July 2009, the Group and other distributing banks agreed with the Securities and Futures Commission and the Hong Kong Monetary Authority to make an offer to eligible customers to repurchase their holdings in all outstanding Minibonds subscribed through the Group ('the Repurchase Scheme'). The Group's charge to the 2009 income statement in respect of the Lehman Brothers minibonds ('Minibonds') took into account the aggregate amount paid under the Repurchase Scheme and the recoverable amount from the Minibonds. During the year, HK$41 million (2011: HK$146 million) has been recovered from the realisation of collateral of Minibonds.

4.2 Critical judgments in applying the Group's accounting policies

Distinction between investment property and owner-occupied property

The Group determines whether a property qualifies as investment property. In making its judgment, the Group considers whether the property generates cash flows largely independently of the other assets held by an entity. Owner-occupied properties generate cash flows that are attributable not only to property but also to other assets used in the production or supply process.

Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions can be sold separately (or leased out separately under a finance lease), the Group accounts for the portions separately. If the portions cannot be sold separately, the property is accounted for as investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes. Judgment is applied in determining whether ancillary services are so significant that a property does not qualify as investment property. The Group considers each property separately in making its judgment.

5 BUSINESS ACTIVITIES ANALYSIS

(a) By business activities

The Group is engaged predominantly in banking and related financial activities. It comprises retail and corporate banking, trade finance, treasury and other classes of business.

Retail banking - incorporating banking services to private individuals such as current accounts, savings accounts, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages.

Corporate banking - incorporating current accounts, deposits, overdrafts, loans and other credit facilities.

Trade finance - incorporating import & export bills services (including RMB business), invoice financing and invoice discounting.

Treasury - responsible for asset and liability management, managing the capital, liquidity, and the interest rate and foreign exchange positions of the Group.

The 'Others' business mainly comprises remittance, share dealing, provision of trustee, wealth management and insurance agency services.

For the purpose of assessing performance of business activity by class, the allocation of revenue, besides the direct revenue generated by the business, also includes the benefits of funding resources derived from the other businesses by way of internal fund transfer pricing mechanisms. Cost allocation is based on the direct cost incurred by the class of business and internal allocation of management overheads. Asset allocation is based on the assets directly attributable to the class of business and internal allocation of assets.

5 BUSINESS ACTIVITIES ANALYSIS (CONTINUED)

(a) By business activities (Continued)

The Group 2012

	Retail and corporate banking	Trade Finance	Treasury	Others	Total
Net interest income	1,194,326	129,258	599,373	1,846	1,924,803
Net fee and commission income	142,257	128,115	214	348,813	619,399
Net trading income	–	–	143,867	–	143,867
Net gains from disposal of available-for-sale investments	–	–	177,488	–	177,488
Profit before income tax	793,728	200,764	818,396	259,469	2,072,357
Operating assets	51,006,522	5,156,030	79,951,564	1,073,052	137,187,168
(Reversal)/ charge of impairment losses on loans and advances/ available-for-sale investments	(23,831)	(21,605)	6,187	–	(39,249)

The Group 2011

	Retail and corporate banking	Trade Finance	Treasury	Others	Total
Net interest income	1,310,701	87,704	583,554	–	1,981,959
Net fee and commission income	128,785	128,558	306	396,971	654,620
Net trading income	–	–	112,247	–	112,247
Net gains from disposal of available-for-sale investments	–	–	155,824	–	155,824
Profit before income tax	895,617	148,781	753,468	393,085	2,190,951
Operating assets	51,387,132	6,481,163	68,335,930	773,615	126,977,840
Reversal of impairment losses on loans and advances	(12,315)	(7,590)	–	–	(19,905)

(b) By geographical activities

The Group 2012

	Total assets	Total liabilities	Contingent liabilities and commitments	Total operating income	Profit before income tax	Capital expenditure
Hong Kong & Mainland China	124,837,400	110,256,394	40,165,162	2,636,023	1,795,837	478,413
Europe	2,140,847	2,223,890	50,303	24,659	8,083	124
America	10,208,921	5,393,905	3,013,407	325,446	268,437	312
Total	137,187,168	117,874,189	43,228,872	2,986,128	2,072,357	478,849

The Group 2011

	Total assets	Total liabilities	Contingent liabilities and commitments	Total operating income	Profit before income tax	Capital expenditure
Hong Kong & Mainland China	114,724,763	101,561,873	38,778,688	2,680,054	1,907,341	117,686
Europe	2,613,085	2,746,216	74,854	27,060	9,776	62
America	9,639,992	4,588,699	2,544,765	331,501	273,834	434
Total	126,977,840	108,896,788	41,398,307	3,038,615	2,190,951	118,182

6 NET INTEREST INCOME

Interest income

	The Group		The Bank	
	2012	2011	2012	2011
Cash and balances with banks	575,267	563,730	575,267	563,730
Investment securities				
– Available-for-sale	684,217	578,337	682,023	575,252
– Held-to-maturity	41,337	56,037	9,828	12,717
Loans and advances to customers	1,670,541	1,495,108	1,670,865	1,495,436
Others	9,252	9,345	9,252	9,345
	2,980,614	2,702,557	2,947,235	2,656,480

Interest expense

	The Group		The Bank	
	2012	2011	2012	2011
Deposits and balances from banks	18,804	20,110	18,804	20,110
Deposits from customers	1,033,455	696,810	1,034,297	696,913
Others	3,552	3,678	3,552	3,678
	1,055,811	720,598	1,056,653	720,701

Included within interest income

	The Group		The Bank	
	2012	2011	2012	2011
Interest income on listed investments	316,097	314,087	284,587	270,641
Interest income on unlisted investments	409,457	320,287	407,264	317,328
Interest income accrued on impaired financial assets	8,383	9,072	8,383	9,072

7 NET FEE AND COMMISSION INCOME

Fee and commission income

	The Group		The Bank	
	2012	2011	2012	2011
Commissions from bills	118,207	122,428	118,207	122,428
Nominees, custodian and securities brokerage commissions	193,487	237,180	172,911	211,313
Commissions from wealth management products	68,622	75,923	68,622	75,923
Commissions from remittance	53,361	51,730	53,361	51,730
Facility fees	85,743	68,863	85,743	68,863
Fees from credit cards	49,210	49,616	49,210	49,616
Commissions from retail banking	42,146	40,920	42,146	40,920
Commissions from insurance	33,801	33,311	46,754	42,356
Commissions from loans and advances	7,099	7,702	7,099	7,702
Trust and other commissions	3,709	5,097	213	306
	655,385	692,770	644,266	671,157

Fee and commission expense

	The Group		The Bank	
	2012	2011	2012	2011
Commissions on bills	3,223	3,334	3,223	3,334
Nominees, custodian and securities brokerage commissions paid	14,475	15,576	9,716	10,058
Commissions on retail banking	18,030	18,376	17,255	17,422
Fees on credit cards	116	115	116	115
Commissions on remittance	142	749	142	749
	35,986	38,150	30,452	31,678
Of which :				
Net fee and commission income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading nor designated at fair value				
– fee and commission income	260,259	248,609	260,259	248,609
– fee and commission expense	3,339	3,449	3,339	3,449
Net fee and commission income on trust and other fiduciary activities				
– fee and commission income	22,298	21,721	21,671	21,068

The Group provides custody, trustee and advisory services to third parties. Those assets that are held in a fiduciary capacity are not included in these financial statements.

8 DIVIDEND INCOME

	The Group		The Bank	
	2012	2011	2012	2011
Dividend income from investment securities				
– listed investments	3,076	2,421	2,511	1,729
– unlisted investments	26,910	26,178	26,910	26,178
	29,986	28,599	29,421	27,907
Dividend income from jointly controlled entities				
– unlisted investments	–	–	8,360	1,550
Dividend income from subsidiary companies				
– unlisted investments	–	–	32,900	46,120
	29,986	28,599	70,681	75,577

9 NET TRADING INCOME

	The Group		The Bank	
	2012	2011	2012	2011
Foreign exchange	106,241	119,808	106,275	119,830
Interest rate instruments	15,650	16,217	15,650	16,217
Equities	19,587	(28,529)	19,567	(28,711)
Other trading income	2,389	4,751	2,389	4,751
	143,867	112,247	143,881	112,087

'Foreign exchange' net trading income includes gains and losses from spot and forward contracts, swaps and translated foreign currency assets and liabilities, which are not designated as qualifying hedging relationship. 'Interest rate instruments' trading income includes the results of trading in government securities, corporate debt securities and money market instruments. 'Equities' trading income includes the results of trading in equity securities in local and overseas markets.

10 OTHER INCOME

(a) Other operating income

	The Group		The Bank	
	2012	2011	2012	2011
Gross rental income from investment properties	1,612	9,913	2,340	11,680
Others	64,984	74,850	71,845	87,650
	66,596	84,763	74,185	99,330

The Group did not have any direct operating expenses (2011: HK$2,062,000) arising from investment properties that generated rental income in 2012.

The Bank's direct operating expenses of HK$320,000 (2011: HK$2,377,000) arising from investment properties that generated rental income were included in operating expenses.

(b) Net earned insurance premium

	The Group	
	2012	2011
Insurance premium revenue	48,278	38,960
Insurance premium ceded to reinsurers	(9,494)	(8,140)
	38,784	30,820

The related net insurance claims incurred and movement in policyholders' liabilities of HK$14,499,000 (2011: HK$9,374,000) was shown after netted off with the insurance claims and loss adjustment expenses recovered from reinsurers of HK$1,504,000 (2011: HK$203,000).

11 OPERATING EXPENSES

	The Group		The Bank	
	2012	2011	2012	2011
Auditor's remuneration				
Statutory audit services	5,482	5,474	4,972	4,971
Non-statutory audit and other services (Note a)	3,538	3,925	3,167	3,710
Advertising costs	19,892	18,366	19,559	18,146
Depreciation expenses	52,385	59,210	54,262	64,358
Direct operating expenses arising from an investment property that did not generate rental income	–	362	–	362
Employee benefit expenses				
Wages and salaries and other costs (Note b)	623,582	609,168	602,792	590,159
Pension costs - defined contribution schemes	35,035	32,199	34,252	31,521
Pension costs - defined benefit schemes	32	31	32	31
Premises and equipment expenses, excluding depreciation				
Rental of premises	102,544	93,027	105,512	95,153
Building expenses	8,315	11,971	8,315	11,971
Building management fee	10,250	9,761	9,996	9,508
Other operating expenses				
Computer rental and licence	13,636	12,033	13,369	11,581
Credit card business promotion	19,730	15,598	19,730	15,598
Credit card service fee	10,279	10,163	10,279	10,163
Insurance	8,341	10,149	9,195	9,926
Legal and consultancy	(2,241)	16,419	(3,133)	15,222
Postage	12,156	12,850	12,131	12,820
Printing and stationery	8,857	8,431	8,797	8,417
Repair and maintenance	16,914	16,297	24,777	23,998
Telephone and communications	26,353	26,411	24,902	24,883
Travelling and transportation	5,684	5,511	4,944	5,422
Water, heat and light	14,335	14,243	14,087	14,021
Others (Note c)	(3,581)	(107,542)	(4,986)	(107,934)
	991,518	884,057	976,951	874,007

Note a:

Included in the non-statutory audit and other services is the fee paid for the full scope audit of the Group's financial information for the group reporting to the ultimate holding company in Taiwan under its local statutory requirements.

Note b:

Employee benefit expenses include directors' emoluments. The number of employees of the Group as at 31st December 2012 was 1,681 (31st December 2011: 1,657).

Note c:

During the year, there was a HK$41 million (2011: HK$146 million) recovery arising from the realisation of collateral of Minibonds and a reversal of provision of HK$13 million (2011: HK$14 million) in respect of other wealth management products.

12 DIRECTORS' EMOLUMENTS

The Group and the Bank	2012	2011
Fees	3,234	3,200
Basic salaries, allowances and bonus	25,524	24,903
Contributions to pension schemes	860	781
	29,618	28,884

13 REVERSAL OF IMPAIRMENT LOSSES ON LOANS AND ADVANCES TO CUSTOMERS

The Group and the Bank	2012	2011
Trade bills	516	14,860
Loans and advances to customers	44,920	5,045
	45,436	19,905
Net reversal of impairment losses		
– Individually assessed	43,947	18,281
– Collectively assessed	1,489	1,624
	45,436	19,905
Of which		
– new allowances	(73,294)	(90,643)
– releases	87,822	64,769
– recoveries	30,908	45,779
Net reversal to income statement	45,436	19,905

14 INCOME TAX EXPENSE

Hong Kong profits tax has been provided at the rate of 16.5% (2011: 16.5%) on the estimated assessable profits for the year. Taxation on overseas profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the countries in which the Group operates.

The amount of taxation charged to the income statement represents:

	The Group		The Bank	
	2012	2011	2012	2011
Current income tax:				
– Hong Kong profits tax	281,063	266,982	279,648	265,163
– Overseas taxation	118,099	106,792	118,100	106,414
– Under/ (over) provisions in respect of prior years	7,701	(533)	7,473	(522)
Total current income tax	406,863	373,241	405,221	371,055
Deferred income tax:				
– Hong Kong deferred tax	15,288	3,325	15,290	3,359
– Overseas deferred tax	(1,256)	12,271	(1,258)	12,271
Total deferred income tax	14,032	15,596	14,032	15,630
Income tax expense	420,895	388,837	419,253	386,685

14 INCOME TAX EXPENSE (CONTINUED)

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rates of the countries in which the Group operates as follows:

	The Group		The Bank	
	2012	2011	2012	2011
Profit before tax	2,072,357	2,190,951	2,033,397	2,163,134
Tax calculated at domestic tax rates applicable to profits in the respective countries	409,599	425,277	403,171	423,457
Tax effects of:				
Income not subject to tax	(23,418)	(33,261)	(18,058)	(33,299)
Expenses not deductible for tax purposes	27,632	4,585	27,286	4,280
Net effect of investments in partnerships	(619)	(7,231)	(619)	(7,231)
Under/ (over) provisions in respect of prior years	7,701	(533)	7,473	(522)
Tax expense	420,895	388,837	419,253	386,685

The income tax rate applicable to the majority of the Group and its subsidiaries' 2012 income is 16.5% (2011: 16.5%).

The Bank has entered into aircraft leverage lease arrangement, involving special purpose partnerships in which the Bank is the general partner. As at 31st December 2012, the unamortised carrying cost of the investments in such partnerships, which was included in 'Other assets', amounted to HK$730,110,000 (2011: HK$961,559,000). The Bank's tax benefit in these special purpose partnerships are amortised over the life of the individual partnerships.

15 INCOME TAX EFFECTS RELATING TO COMPONENTS OF OTHER COMPREHENSIVE INCOME

The Group

	2012			2011		
	Before-tax amount	Tax (expense)/ benefit	Net-of-tax amount	Before-tax amount	Tax (expense)/ benefit	Net-of-tax amount
Exchange differences on translation of foreign operations	3,278	–	3,278	24,393	–	24,393
Net fair value gains/ (losses) on available-for-sale investments	524,188	(86,540)	437,648	(67,228)	10,992	(56,236)
Share of investment revaluation reserve of jointly controlled entities	419	–	419	(103)	–	(103)
Other comprehensive income for the year (net presentation)	527,885	(86,540)	441,345	(42,938)	10,992	(31,946)

The Bank

	2012			2011		
	Before-tax amount	Tax (expense)/ benefit	Net-of-tax amount	Before-tax amount	Tax (expense)/ benefit	Net-of-tax amount
Exchange differences on translation of foreign operations	3,509	–	3,509	24,388	–	24,388
Net fair value gains/ (losses) on available-for-sale investments	521,854	(86,106)	435,748	(60,611)	10,001	(50,610)
Other comprehensive income for the year (net presentation)	525,363	(86,106)	439,257	(36,223)	10,001	(26,222)

16 DIVIDEND

The dividend payable to equity holders of the Bank attributable to the previous financial years, approved and paid during the years ended 2012 and 2011 were HK$860,000,000 (HK$43 per share) and HK$860,000,000 (HK$43 per share) respectively. A dividend in respect of 2012 of HK$41 per share, amounting to a total dividend of HK$820,000,000 is to be proposed at the Annual General Meeting on 25th April 2013. These consolidated financial statements do not reflect this dividend payable.

The Bank

	2012	2011
Dividend proposed to equity holders of the Bank attributable to the year		
Proposed final dividend of HK$41 (2011: HK$43) per ordinary share	820,000	860,000

17 CASH AND BALANCES WITH BANKS

	The Group		The Bank	
	2012	2011	2012	2011
Cash in hand	355,943	416,266	355,936	416,254
Balances with central banks and Hong Kong Monetary Authority	16,468,888	10,378,663	16,468,888	10,378,663
Balances with banks	13,064,838	16,944,163	13,064,838	16,944,163
	29,889,669	27,739,092	29,889,662	27,739,080

As at 31st December 2012, there was HK$1,500,000 (2011: HK$1,500,000) deposited in the name of the Director of Accounting Services Treasury Hong Kong placed by a subsidiary company of the Bank to comply with the statutory requirement.

As at 31st December 2012, there were HK$230,734,000 (2011: HK$339,526,000) of statutory deposits with the central banks in the countries the Group is operating the business for the purpose of complying with the statutory requirements of the countries.

18 PLACEMENTS WITH AND LOANS AND ADVANCES TO BANKS

The Group and the Bank

	2012	2011
Placements with banks maturing between one and twelve months	19,528,775	12,996,790
Loans and advances to banks maturing between one and twelve months	98,893	1,868,686
	19,627,668	14,865,476

As at 31st December 2012, HK$130,958,000 (2011: HK$130,290,000) was deposited with designated banks in the People's Republic of China to comply with the local statutory requirement. No impairment allowances were necessary to be provided for the placements with and loans and advances to banks.

19 LOANS AND ADVANCES TO CUSTOMERS

(a) Analysis of loans and advances to customers

The Group and the Bank	2012	2011
Loans and advances to individuals		
– Overdrafts	563,758	535,531
– Credit cards	325,275	348,377
– Term loans and others	5,000,400	5,599,470
– Mortgages	6,961,485	6,939,016
Loans and advances to corporate entities		
– Large corporate customers and others	34,527,241	35,585,962
– SME	6,598,917	6,471,229
Gross loans and advances to customers	53,977,076	55,479,585
Less: impairment allowances		
– Individually assessed	(48,484)	(69,069)
– Collectively assessed	(213,482)	(214,860)
	53,715,110	55,195,656
Gross trade bills and other eligible bills, included within loans and advances to customers	2,146,921	3,159,470
Less: impairment allowances on trade bills		
– Collectively assessed	(906)	(1,422)
	2,146,015	3,158,048

The Group accepted listed securities at fair value of HK$2,977,749,000 (2011: HK$2,976,549,000) as collateral for shares financing facilities which were included in 'Term loans and others'. These securities are permitted to sell or re-pledge in the event of default by the borrowers.

As at 31st December 2012, certain of the Bank's branches in the United States have pledged their real estate loans of HK$59,445,000 (2011: HK$62,216,000) to the State of California and with the Office of the Comptroller of the Currency in compliance with local regulatory requirements.

19 LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

(b) Movement in impairment allowances on loans and advances to customers

The Group and the Bank

	Impairment allowances – Individual assessment				
	Overdrafts	Credit cards	Term loans and others	Mortgages	Total
Balance at 1st January 2012	57	1,314	4,767	256	6,394
Impairment losses	257	3,263	(2,782)	(832)	(94)
Loans written off as uncollectible	–	(4,010)	(39)	–	(4,049)
Recoveries of advances written off in previous years	101	907	767	763	2,538
At 31st December 2012	415	1,474	2,713	187	4,789
Balance at 1st January 2011	323	1,595	8,821	339	11,078
Impairment losses	(135)	3,101	(4,443)	(3,021)	(4,498)
Loans written off as uncollectible	(135)	(4,142)	(83)	–	(4,360)
Recoveries of advances written off in previous years	4	760	472	2,938	4,174
At 31st December 2011	57	1,314	4,767	256	6,394

	Impairment allowances – Individual assessment		
	Large corporate customers and others	SME	Total
Balance at 1st January 2012	55,110	7,565	62,675
Impairment losses	(41,891)	(1,962)	(43,853)
Loans written off as uncollectible	(2,054)	(1,380)	(3,434)
Recoveries of advances written off in previous years	27,168	1,202	28,370
Exchange adjustments	(63)	–	(63)
At 31st December 2012	38,270	5,425	43,695
Balance at 1st January 2011	84,897	8,710	93,607
Impairment losses	(11,708)	(289)	(11,997)
Loans written off as uncollectible	(57,918)	(2,629)	(60,547)
Recoveries of advances written off in previous years	39,832	1,773	41,605
Exchange adjustments	7	–	7
At 31st December 2011	55,110	7,565	62,675

	Impairment allowances – Collective assessment				
	Overdrafts	Credit cards	Term loans and others	Mortgages	Total
Balance at 1st January 2012	1,974	8,299	21,223	25,967	57,463
Impairment losses	154	(378)	(2,065)	570	(1,719)
Exchange adjustments	–	–	(5)	138	133
At 31st December 2012	2,128	7,921	19,153	26,675	55,877
Balance at 1st January 2011	1,679	7,838	19,391	25,379	54,287
Impairment losses	295	461	1,839	635	3,230
Exchange adjustments	–	–	(7)	(47)	(54)
At 31st December 2011	1,974	8,299	21,223	25,967	57,463

19 LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

(b) Movement in impairment allowances on loans and advances to customers (Continued)

The Group and the Bank

	Impairment allowances – Collective assessment		
	Large corporate customers and others	SME	Total
Balance at 1st January 2012	133,204	24,193	157,397
Impairment losses	(871)	1,101	230
Exchange adjustments	(48)	26	(22)
At 31st December 2012	132,285	25,320	157,605
Balance at 1st January 2011	138,221	24,114	162,335
Impairment losses	(4,934)	80	(4,854)
Exchange adjustments	(83)	(1)	(84)
At 31st December 2011	133,204	24,193	157,397

20 FINANCIAL ASSETS HELD FOR TRADING

The Group

	2012	2011
Debt securities		
Listed outside Hong Kong	206,842	181,191
Unlisted	125	140,167
Total debt securities	206,967	321,358
Equity securities		
Listed in Hong Kong	11,102	9,108
Listed outside Hong Kong	123,038	107,344
Total equity securities	134,140	116,452
Other financial assets held for trading	8,656	6,427
Total financial assets held for trading	349,763	444,237
Included within debt securities are:		
Government bonds	189,306	182,183
Certificates of deposit held	–	121,615
Other debt securities	17,661	17,560
	206,967	321,358
Financial assets held for trading are analysed by issuers as follows:		
Sovereigns	189,306	182,183
Banks	35,844	154,710
Corporates	124,613	107,344
	349,763	444,237

20 FINANCIAL ASSETS HELD FOR TRADING (CONTINUED)

The Bank

	2012	2011
Debt securities		
Listed outside Hong Kong	206,842	181,191
Unlisted	125	140,167
Total debt securities	206,967	321,358
Equity securities		
Listed in Hong Kong	9,528	9,108
Listed outside Hong Kong	123,038	107,344
Total equity securities	132,566	116,452
Other financial assets held for trading	8,656	6,427
Total financial assets held for trading	348,189	444,237
Included within debt securities are:		
Government bonds	189,306	182,183
Certificates of deposit held	–	121,615
Other debt securities	17,661	17,560
	206,967	321,358
Financial assets held for trading are analysed by issuers as follows:		
Sovereigns	189,306	182,183
Banks	35,844	154,710
Corporates	123,039	107,344
	348,189	444,237

21 DERIVATIVE FINANCIAL INSTRUMENTS

Currency forwards represent commitments to purchase foreign and domestic currency, including undelivered spot transactions.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the statement of financial position 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 or foreign exchange 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.

21 DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

The Group and the Bank As at 31st December 2012

	Contract amount	Fair values	
		Assets	Liabilities
Derivatives held for trading			
Exchange rate contracts			
Currency forwards	11,767,569	51,446	(39,891)
Total recognised derivative financial assets/ (liabilities)		51,446	(39,891)

The Group and the Bank As at 31st December 2011

	Contract amount	Fair values	
		Assets	Liabilities
Derivatives held for trading			
Exchange rate contracts			
Currency forwards	13,809,630	70,294	(45,409)
Total recognised derivative financial assets/ (liabilities)		70,294	(45,409)

The Group and the Bank

	Credit risk weighted amount	
	2012	2011
Exchange rate contracts	57,655	93,747

The contract amounts of these instruments indicate the volume of transactions outstanding as at the end of the reporting period, they do not represent the amounts at risk.

The credit risk weighted amounts as at 31st December 2012 and 2011 are the amounts that have been calculated in accordance with the Banking (Capital) Rules of the Banking Ordinance.

The Group did not enter into any bilateral netting arrangements during the year and accordingly the amounts disclosed are shown on a gross basis.

The Group uses the following derivative strategies:

– Trading purposes (customer needs)

The Group offers its customers derivatives in connection with their risk-management actions to transfer, modify or reduce their interest rate, foreign exchange and other market/credit risks or for their own trading purposes. As part of this process, the Group considers the customers' suitability for the risk involved, and the business purpose for the transaction. The Group also manages its derivative-risk positions through offsetting trade activities, controls focused on price verification, and daily reporting of positions to senior managers.

– Trading purposes (own account)

The Group trades derivatives for its own account. These derivatives entered into in order to take proprietary long positions. Trading limits and price verification controls are key aspects of this activity.

22 AVAILABLE-FOR-SALE INVESTMENTS

	The Group		The Bank	
	2012	2011	2012	2011
Debt securities:				
Listed in Hong Kong	3,207,463	1,332,068	3,207,463	1,332,068
Listed outside Hong Kong	4,461,697	7,433,563	4,461,697	7,430,378
Unlisted	17,701,122	11,682,044	17,660,622	11,585,035
	25,370,282	20,447,675	25,329,782	20,347,481
Equity securities:				
Listed in Hong Kong	44,330	60,582	37,933	40,815
Listed outside Hong Kong	70,993	37,677	70,993	37,677
Unlisted	1,473,375	1,462,726	1,473,375	1,462,726
	1,588,698	1,560,985	1,582,301	1,541,218
	26,958,980	22,008,660	26,912,083	21,888,699
Included within debt securities are:				
Certificates of deposit held	12,572,485	6,568,933	12,547,777	6,538,337
Government bonds	218,051	180,762	218,051	180,762
Other debt securities	12,579,746	13,697,980	12,563,954	13,628,382
	25,370,282	20,447,675	25,329,782	20,347,481
Available-for-sale investments are analysed by issuers as follows:				
Sovereigns	218,051	180,762	218,051	180,762
Public sector entities	230,540	250,940	230,540	250,940
Banks	20,675,616	18,669,457	20,635,687	18,567,972
Corporates	5,834,773	2,907,501	5,827,805	2,889,025
	26,958,980	22,008,660	26,912,083	21,888,699

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

The Group		
	2012	2011
As at 1st January	22,008,660	21,468,699
Exchange differences	72,816	(30,378)
Additions	15,474,702	9,997,853
Gains from changes in fair value	698,674	88,898
Disposals and redemptions	(11,300,362)	(9,488,738)
Amortisation	(24,865)	(31,490)
Others	29,355	3,816
As at 31st December	26,958,980	22,008,660

22 AVAILABLE-FOR-SALE INVESTMENTS (CONTINUED)

The Bank

	2012	2011
As at 1st January	21,888,699	21,250,970
Exchange differences	72,820	(30,376)
Additions	15,474,285	9,964,352
Gains from changes in fair value (Note 33)	697,100	95,515
Disposals and redemptions	(11,225,690)	(9,367,207)
Amortisation	(24,636)	(30,981)
Others	29,505	6,426
As at 31st December	26,912,083	21,888,699

23 HELD-TO-MATURITY INVESTMENTS

	The Group		The Bank	
	2012	2011	2012	2011
Debt securities:				
Listed in Hong Kong	2,110,813	2,119,682	39,056	39,112
Listed outside Hong Kong	386,017	645,101	364,564	623,254
	2,496,830	2,764,783	403,620	662,366
Market value of listed securities	2,557,121	2,800,071	404,802	658,316
Included within debt securities are:				
Government bonds	2,235,652	2,307,538	163,895	226,968
Other debt securities	261,178	457,245	239,725	435,398
	2,496,830	2,764,783	403,620	662,366
Held-to-maturity investments are analysed by issuers as follows:				
Sovereigns	2,235,652	2,307,538	163,895	226,968
Public sector entities	39,056	39,112	39,056	39,112
Banks	218,124	414,113	200,669	396,286
Corporates	3,998	4,020	–	–
	2,496,830	2,764,783	403,620	662,366

As at 31st December 2012, certain of the Bank's branches in the United States have pledged held-to-maturity investments amounting to HK$163,895,000 (2011: HK$148,049,000) to the State of California and with the Office of the Comptroller of the Currency in compliance with local regulatory requirements.

As at 31st December 2012, listed debt securities at amortised cost of HK$2,071,757,000 (2011: HK$2,080,571,000) comprising Exchange Fund Notes were pledged to the Hong Kong Monetary Authority to facilitate settlement operations. There were no related liabilities at the year end.

23 HELD-TO-MATURITY INVESTMENTS (CONTINUED)

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

The Group

	2012	2011
As at 1st January	2,764,783	2,766,411
Exchange differences	(1,244)	(406)
Additions	241,367	972,194
Redemptions	(487,367)	(947,044)
Amortisation	(18,495)	(24,082)
Others	(2,214)	(2,290)
As at 31st December	2,496,830	2,764,783

The Bank

	2012	2011
As at 1st January	662,366	757,471
Exchange differences	(1,235)	(406)
Additions	117,051	55,012
Redemptions	(372,367)	(148,153)
Amortisation	(447)	(1,158)
Others	(1,748)	(400)
As at 31st December	403,620	662,366

24 INVESTMENTS IN AND LOANS TO JOINTLY CONTROLLED ENTITIES AND SUBSIDIARIES

(a) Investments in jointly controlled entities

The Group

	2012	2011
As at 1st January	189,308	174,473
Share of results, net of tax	38,498	16,488
Dividends paid	(8,360)	(1,550)
Other equity movement: available-for-sale investment revaluation reserve	419	(103)
As at 31st December	219,865	189,308

The Bank

	2012	2011
Unlisted shares, at cost	116,000	116,000

24 INVESTMENTS IN AND LOANS TO JOINTLY CONTROLLED ENTITIES AND SUBSIDIARIES (CONTINUED)

(a) Investments in jointly controlled entities (Continued)

The Group's interests in its jointly controlled entities , which are unlisted, are as follows:

2012

Name	Place of incorporation	Assets	Liabilities	Revenues	Profit/ (loss)	% interest held
Joint Electronic Teller Services Limited	Hong Kong	375,220	6,911	77,598	30,073	20% of 'A' shares [1]
Bank Consortium Holding Limited	Hong Kong	509,409	107,303	390,806	102,277	14.29% of 'A' shares [1]
BC Reinsurance Limited	Hong Kong	572,848	338,242	251,088	65,506	21%
Hong Kong Life Insurance Limited	Hong Kong	6,726,103	6,278,454	1,007,973	63,770	16.67%
i-Tech Solutions Limited	Hong Kong	6,192	636	6,272	(779)	50%
		8,189,772	6,731,546	1,733,737	260,847	

2011

Name	Place of incorporation	Assets	Liabilities	Revenues	Profit/ (loss)	% interest held
Joint Electronic Teller Services Limited	Hong Kong	376,030	2,795	82,039	34,774	20% of 'A' shares [1]
Bank Consortium Holding Limited	Hong Kong	564,429	209,725	364,403	95,453	14.29% of 'A' shares
BC Reinsurance Limited	Hong Kong	436,337	267,237	146,273	(37,262)	21% [1]
Hong Kong Life Insurance Limited	Hong Kong	5,272,010	4,890,387	879,767	63,217	16.67%
i-Tech Solutions Limited	Hong Kong	6,639	304	6,385	97	50%
		6,655,445	5,370,448	1,478,867	156,279	

[1] During the year, the Bank has received 2.88% and 13.33% of the dividends paid by the Joint Electronic Teller Services Limited and Bank Consortium Holding Limited respectively. In 2011, the Bank received 2.88% and 21% of the dividends paid by the Joint Electronic Teller Services Limited and BC Reinsurance Limited respectively.

Note: The balances with the jointly controlled entities arising from normal business transactions are included in Note 37.

(b) Investments in subsidiaries

The Bank

	2012	2011
Investments, at cost:		
Unlisted shares	193,160	193,188
Loans to subsidiary companies	3,529,354	3,050,789
Amounts due from subsidiary companies	1,428	813
Amounts due to subsidiary companies	(1,315,776)	(1,158,348)
	2,408,166	2,086,442

24 INVESTMENTS IN AND LOANS TO JOINTLY CONTROLLED ENTITIES AND SUBSIDIARIES (CONTINUED)

(b) Investments in subsidiaries (Continued)

The following is a list of the subsidiaries at 31st December 2012:

Name	Place of incorporation	Principal activities and place of operation	Particulars of issued share capital	Percentage of ordinary share capital held
Shanghai Commercial Bank (Nominees) Limited	Hong Kong	Nominee services Hong Kong	100 ordinary shares of HK$100 each	*100%
Shanghai Commercial Bank Trustee Limited	Hong Kong	Trustee services Hong Kong	1,000 ordinary shares of HK$10,000 each	*60%
Shacom Futures Limited	Hong Kong	Commodities trading Hong Kong	100,000 ordinary shares of HK$100 each	*100%
Shacom Investment Limited	Hong Kong	Investment in Exchange Fund Bills and Notes Hong Kong	10,000 ordinary shares of HK$100 each	*100%
Shacom Property Holdings (BVI) Limited	British Virgin Islands	Property holding British Virgin Islands	2 ordinary shares of US$1 each	*100%
Shacom Property (NY) Inc.	United States of America	Property holding United States of America	10 ordinary shares of US$1 each	*100%
Shacom Property (CA) Inc.	United States of America	Property holding United States of America	10 ordinary shares of US$1 each	*100%
Shacom Assets Investments Limited	Hong Kong	Investment in notes and bonds Hong Kong	10,000 ordinary shares of HK$1 each	*100%
Infinite Financial Solutions Limited	Hong Kong	I.T. application services provider Hong Kong	500,000 ordinary shares of US$1 each	*80%
Shacom Insurance Brokers Limited	Hong Kong	Insurance broker Hong Kong	1,000,000 ordinary shares of HK$1 each	*100%
Shacom Securities Limited	Hong Kong	Securities brokerage services Hong Kong	1,000,000 ordinary shares of HK$100 each	*100%
Hai Kwang Property Management Company Limited	Hong Kong	Property management Hong Kong	2 ordinary shares of HK$1 each	*100%
Paofoong Insurance Company (Hong Kong) Limited	Hong Kong	Insurance Hong Kong	500,000 ordinary shares of HK$100 each	*60%
Right Honour Investments Limited	British Virgin Islands	Property holding British Virgin Islands	1 ordinary shares of US$1 each	*100%
Glory Step Investments Limited	British Virgin Islands	Property holding British Virgin Islands	1 ordinary shares of US$1 each	100%
Silver Wisdom Investments Limited	British Virgin Islands	Property holding British Virgin Islands	1 ordinary shares of US$1 each	100%

* Shares held directly by the Bank.

(c) Loans to subsidiaries

The loans to subsidiaries are secured, interest free and have no fixed term of repayment. The carrying amounts of loans to subsidiaries are HK$3,529,354,000 (2011: HK$3,050,789,000) which approximate their fair values.

25 PROPERTIES AND EQUIPMENT

The Group

	Leasehold land	Bank premises	Furniture, fittings and equipment	Property under development: Leasehold land	Property under development: Development cost	Total
At 1st January 2011						
Cost	325,589	466,163	604,213	–	–	1,395,965
Accumulated depreciation	(66,207)	(194,991)	(526,183)	–	–	(787,381)
Net book amount	259,382	271,172	78,030	–	–	608,584
Year ended December 2011						
Opening net book amount	259,382	271,172	78,030	–	–	608,584
Additions	15,719	15,719	65,732	–	11,697	108,867
Transfers						
Cost	(2,500)	777	(777)	2,500	–	–
Accumulated depreciation	46	(766)	766	(46)	–	–
Transfers from investment properties (Note 26)						
Cost	–	–	–	1,381,406	–	1,381,406
Accumulated depreciation	–	–	–	(5,770)	–	(5,770)
Disposals/ write-off						
Cost	–	(4,155)	(70,399)	–	–	(74,554)
Accumulated depreciation	–	4,155	69,350	–	–	73,505
Depreciation charge	(4,837)	(9,252)	(37,075)	(826)	–	(51,990)
Exchange rate adjustments	–	(145)	261	–	–	116
Closing net book amount	267,810	277,505	105,888	1,377,264	11,697	2,040,164
At 31st December 2011						
Cost	338,808	478,284	599,058	1,383,906	11,697	2,811,753
Accumulated depreciation	(70,998)	(200,779)	(493,170)	(6,642)	–	(771,589)
Net book amount	267,810	277,505	105,888	1,377,264	11,697	2,040,164
Year ended December 2012						
Opening net book amount	267,810	277,505	105,888	1,377,264	11,697	2,040,164
Additions	195,072	–	38,340	–	25,779	259,191
Transfers from investment properties (Note 26)						
Cost	85,216	5,757	–	–	–	90,973
Accumulated depreciation	(102)	(1,333)	–	–	–	(1,435)
Disposals/ write-off						
Cost	–	(135)	(21,989)	–	–	(22,124)
Accumulated depreciation	–	135	21,402	–	–	21,537
Depreciation charge	(5,057)	(9,239)	(34,270)	(1,651)	–	(50,217)
Exchange rate adjustments	–	1,124	111	–	–	1,235
Closing net book amount	542,939	273,814	109,482	1,375,613	37,476	2,339,324
At 31st December 2012						
Cost	619,096	485,364	616,357	1,383,906	37,476	3,142,199
Accumulated depreciation	(76,157)	(211,550)	(506,875)	(8,293)	–	(802,875)
Net book amount	542,939	273,814	109,482	1,375,613	37,476	2,339,324

25 PROPERTIES AND EQUIPMENT (CONTINUED)

The Bank

	Leasehold land	Bank premises	Furniture, fittings and equipment	Property under development: Leasehold land	Property under development: Development cost	Total
At 1st January 2011						
Cost	297,513	422,835	667,708	–	–	1,388,056
Accumulated depreciation	(65,056)	(186,477)	(582,980)	–	–	(834,513)
Net book amount	232,457	236,358	84,728	–	–	553,543
Year ended December 2011						
Opening net book amount	232,457	236,358	84,728	–	–	553,543
Additions	15,719	15,719	71,140	–	11,697	114,275
Transfers						
Cost	(2,500)	777	(777)	2,500	–	–
Accumulated depreciation	46	(766)	766	(46)	–	–
Transfers from investment properties (Note 26)						
Cost	–	–	–	1,381,406	–	1,381,406
Accumulated depreciation	–	–	–	(5,770)	–	(5,770)
Disposals/ write-off						
Cost	–	(4,155)	(70,314)	–	–	(74,469)
Accumulated depreciation	–	4,155	69,267	–	–	73,422
Depreciation charge	(4,608)	(8,594)	(42,682)	(826)	–	(56,710)
Exchange rate adjustments	–	(55)	259	–	–	204
Closing net book amount	241,114	243,439	112,387	1,377,264	11,697	1,985,901
At 31st December 2011						
Cost	310,731	435,094	668,056	1,383,906	11,697	2,809,484
Accumulated depreciation	(69,617)	(191,655)	(555,669)	(6,642)	-	(823,583)
Net book amount	241,114	243,439	112,387	1,377,264	11,697	1,985,901
Year ended December 2012						
Opening net book amount	**241,114**	**243,439**	**112,387**	**1,377,264**	**11,697**	**1,985,901**
Additions	**–**	**–**	**42,969**	**–**	**25,779**	**68,748**
Transfers from investment properties (Note 26)						
Cost	**4,658**	**4,657**	**–**	**–**	**–**	**9,315**
Accumulated depreciation	**(11)**	**(233)**	**–**	**–**	**–**	**(244)**
Disposals/ write-off						
Cost	**–**	**(135)**	**(21,817)**	**–**	**–**	**(21,952)**
Accumulated depreciation	**–**	**135**	**21,234**	**–**	**–**	**21,369**
Depreciation charge	**(4,605)**	**(8,587)**	**(38,869)**	**(1,651)**	**–**	**(53,712)**
Exchange rate adjustments	**–**	**(132)**	**95**	**–**	**–**	**(37)**
Closing net book amount	**241,156**	**239,144**	**115,999**	**1,375,613**	**37,476**	**2,009,388**
At 31st December 2012						
Cost	**315,389**	**439,444**	**690,052**	**1,383,906**	**37,476**	**2,866,267**
Accumulated depreciation	**(74,233)**	**(200,300)**	**(574,053)**	**(8,293)**	**–**	**(856,879)**
Net book amount	**241,156**	**239,144**	**115,999**	**1,375,613**	**37,476**	**2,009,388**

Property under development represents the related costs paid as at 31st December 2012 and 2011 for the re-development of the Bank's new Head Office building in Central, Hong Kong.

25 PROPERTIES AND EQUIPMENT (CONTINUED)

The net book amount of leasehold land is analysed as follows:

	The Group		The Bank	
	2012	2011	2012	2011
In Hong Kong held on:				
Leases of over 50 years	1,765,398	1,487,556	1,463,615	1,460,860
Leases of between 10 to 50 years	153,154	157,518	153,154	157,518
	1,918,552	1,645,074	1,616,769	1,618,378

As at 31st December 2012, interests in freehold land outside Hong Kong amounted to HK$37,441,000 (2011: HK$36,670,000) for the Group, and HK$18,991,000 (2011: HK$19,035,000) for the Bank are included as bank premises above.

26 INVESTMENT PROPERTIES

The Group

	Leasehold land	Buildings	Total
At 1st January 2011			
Cost	1,381,406	62,739	1,444,145
Accumulated depreciation	(4,946)	(56,465)	(61,411)
Net book amount	1,376,460	6,274	1,382,734
Year ended December 2011			
Opening net book amount	1,376,460	6,274	1,382,734
Additions	4,658	4,657	9,315
Transfers to property under development (Note 25)			
Cost	(1,381,406)	–	(1,381,406)
Accumulated depreciation	5,770	–	5,770
Write-off			
Cost	–	(62,739)	(62,739)
Accumulated depreciation	–	62,739	62,739
Depreciation charge	(830)	(6,390)	(7,220)
Closing net book amount	4,652	4,541	9,193
At 31st December 2011			
Cost	4,658	4,657	9,315
Accumulated depreciation	(6)	(116)	(122)
Net book amount	4,652	4,541	9,193
Year ended December 2012			
Opening net book amount	4,652	4,541	9,193
Additions	216,136	3,522	219,658
Transfers to properties and equipment (Note 25)			
Cost	(85,216)	(5,757)	(90,973)
Accumulated depreciation	102	1,333	1,435
Depreciation charge	(250)	(1,918)	(2,168)
Closing net book amount	135,424	1,721	137,145
At 31st December 2012			
Cost	135,578	2,422	138,000
Accumulated depreciation	(154)	(701)	(855)
Net book amount	135,424	1,721	137,145

26 INVESTMENT PROPERTIES (CONTINUED)

The Bank

	Leasehold land	Buildings	Total
At 1st January 2011			
Cost	1,409,482	70,658	1,480,140
Accumulated depreciation	(6,096)	(57,455)	(63,551)
Net book amount	1,403,386	13,203	1,416,589
Year ended December 2011			
Opening net book amount	1,403,386	13,203	1,416,589
Additions	4,658	4,657	9,315
Transfers to property under development (Note 25)			
Cost	(1,381,406)	–	(1,381,406)
Accumulated depreciation	5,770	–	5,770
Write-off			
Cost	–	(62,739)	(62,739)
Accumulated depreciation	–	62,739	62,739
Depreciation charge	(1,060)	(6,588)	(7,648)
Closing net book amount	31,348	11,272	42,620
At 31st December 2011			
Cost	32,734	12,576	45,310
Accumulated depreciation	(1,386)	(1,304)	(2,690)
Net book amount	31,348	11,272	42,620
Year ended December 2012			
Opening net book amount	**31,348**	**11,272**	**42,620**
Transfers to properties and equipment (Note 25)			
Cost	**(4,658)**	**(4,657)**	**(9,315)**
Accumulated depreciation	**11**	**233**	**244**
Depreciation charge	**(235)**	**(315)**	**(550)**
Closing net book amount	**26,466**	**6,533**	**32,999**
At 31st December 2012			
Cost	**28,076**	**7,919**	**35,995**
Accumulated depreciation	**(1,610)**	**(1,386)**	**(2,996)**
Net book amount	**26,466**	**6,533**	**32,999**

The Group's investment properties were revalued for a value of HK$144,900,000 (2011: HK$7,500,000), and the Bank's investment properties were revalued for a total value of HK$84,000,000 (2011: HK$87,500,000) as at 31st December 2012 by independent, professionally qualified valuers on an open market value basis.

The carrying value of investment properties shown above comprises leasehold land and buildings situated in Hong Kong, which are held on long-term leases.

27 OTHER ASSETS

	The Group		The Bank	
	2012	2011	2012	2011
Repossessed assets	5,742	19,825	5,742	19,825
Accounts receivable and prepayments (Note)	1,273,847	1,497,379	858,675	1,316,293
Others	76,292	89,018	68,217	84,232
	1,355,881	1,606,222	932,634	1,420,350

Note: Included unamortised carrying costs of investment in special purpose partnerships as stated in Note 14.

28 DEPOSITS FROM CUSTOMERS

The Group and the Bank

	2012			
	Large corporate customers	SME	Retail	Total
Demand deposits and current accounts	4,572,144	1,593,179	3,290,760	9,456,083
Savings deposits	9,144,599	2,234,770	19,826,992	31,206,361
Time, call and notice deposits	29,583,653	1,858,120	38,189,955	69,631,728
Deposits from Hong Kong Government Exchange Fund	387,743	–	–	387,743
	43,688,139	5,686,069	61,307,707	110,681,915

The Group and the Bank

	2011			
	Large corporate customers	SME	Retail	Total
Demand deposits and current accounts	5,002,293	1,319,564	2,559,028	8,880,885
Savings deposits	8,426,083	2,362,071	17,425,952	28,214,106
Time, call and notice deposits	29,032,067	1,260,904	35,320,526	65,613,497
Deposits from Hong Kong Government Exchange Fund	388,708	–	–	388,708
	42,849,151	4,942,539	55,305,506	103,097,196

Deposits amounting to HK$69,763,793,000 (2011: HK$65,824,405,000) are at fixed interest rates, HK$40,662,444,000 (2011: HK$37,094,991,000) are at managed interest rates and all other deposits, amounting to HK$255,678,000 (2011: HK$177,800,000) are at variable rates.

29 OTHER LIABILITIES

	The Group		The Bank	
	2012	2011	2012	2011
Margin deposits	293,051	344,269	293,051	344,269
Accounts payable and accruals	553,211	396,109	146,865	283,248
Liabilities for insurance contracts (Note)	47,281	35,641	–	–
Others	363,564	432,250	359,698	362,841
	1,257,107	1,208,269	799,614	990,358

Note: Amounts recoverable from reinsurance of liabilities under insurance contracts issued amounting to HK$2,424,000 (2011: HK$1,267,000) are included in 'Other assets' in Note 27.

30 PROVISIONS

	The Group		The Bank	
	2012	2011	2012	2011
At 1st January	94,691	99,654	94,320	99,220
Additional provisions charged to income statement	155,863	163,285	154,185	161,418
Utilised during the year	(163,245)	(168,248)	(161,672)	(166,318)
At 31st December	87,309	94,691	86,833	94,320
Current	87,215	94,599	86,833	94,320
Non-current	94	92	–	–

Majority of the 2012 and 2011 balances represent provision for staff bonus.

31 DEFERRED INCOME TAX

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are as follows:

Deferred income tax liabilities

	The Group				
	Impairment allowances	Accelerated tax depreciation	Fair value gains on available-for-sale investments	Others	Total
At 1st January 2011	34,777	242	(145,743)	(2,322)	(113,046)
Credited/ (charged) to the income statement	380	(2,512)	–	(1,193)	(3,325)
Credited to equity	–	–	10,001	–	10,001
Reclassified to current income tax liabilities	–	–	–	1,260	1,260
Reclassified to deferred income tax assets	–	–	559	–	559
At 31st December 2011	35,157	(2,270)	(135,183)	(2,255)	(104,551)
Charged to the income statement	(6,911)	(8,276)	–	(101)	(15,288)
Charged to equity	–	–	(86,540)	–	(86,540)
Reclassified to current income tax liabilities	–	–	–	537	537
Reclassified from deferred income tax assets	–	–	432	–	432
At 31st December 2012	28,246	(10,546)	(221,291)	(1,819)	(205,410)

31 DEFERRED INCOME TAX (CONTINUED)

Deferred income tax liabilities

	The Bank				
	Impairment allowances	Accelerated tax depreciation	Fair value gains on available-for-sale investments	Others	Total
At 1st January 2011	34,777	309	(145,182)	(2,322)	(112,418)
Credited/ (charged) to the income statement	380	(2,546)	–	(1,193)	(3,359)
Credited to equity	–	–	10,001	–	10,001
Reclassified to current income tax liabilities	–	–	–	1,260	1,260
At 31st December 2011	35,157	(2,237)	(135,181)	(2,255)	(104,516)
Charged to the income statement	(6,911)	(8,277)	–	(102)	(15,290)
Charged to equity	–	–	(86,106)	–	(86,106)
Reclassified to current income tax liabilities	–	–	–	537	537
At 31st December 2012	28,246	(10,514)	(221,287)	(1,820)	(205,375)

Deferred income tax assets

	The Group				
	Impairment allowances	Accelerated tax depreciation	Fair value loss on available-for-sale investments	Others	Total
At 1st January 2011	39,851	(1,244)	–	18,049	56,656
Credited/ (charged) to the income statement	(7,922)	2,992	–	(7,341)	(12,271)
Credited to equity	–	–	991	–	991
Exchange differences	(52)	(5)	–	(5)	(62)
Reclassified from deferred income tax liabilities	–	–	(559)	–	(559)
At 31st December 2011	31,877	1,743	432	10,703	44,755
Credited/ (charged) to the income statement	276	(142)	–	1,122	1,256
Exchange differences	(54)	(1)	–	(37)	(92)
Reclassified to deferred income tax liabilities	–	–	(432)	–	(432)
At 31st December 2012	32,099	1,600	–	11,788	45,487

Deferred income tax assets

	The Bank				
	Impairment allowances	Accelerated tax depreciation	Fair value loss on available-for-sale investments	Others	Total
At 1st January 2011	39,851	(1,244)	–	18,049	56,656
Credited/ (charged) to the income statement	(7,922)	2,992	–	(7,341)	(12,271)
Exchange differences	(52)	(5)	–	(5)	(62)
At 31st December 2011	31,877	1,743	–	10,703	44,323
Credited/ (charged) to the income statement	276	(140)	–	1,122	1,258
Exchange differences	(54)	(1)	–	(39)	(94)
At 31st December 2012	32,099	1,602	–	11,786	45,487

31 DEFERRED INCOME TAX (CONTINUED)

The deferred taxation (charged)/ credited to equity during the year is as follows:

	The Group		The Bank	
	2012	2011	2012	2011
Available-for-sale investment revaluation reserve/ (deficit)				
– Reserves in shareholders' equity (Note 33)	(86,366)	10,596	(86,106)	10,001
– Reserves in non-controlling interests	(174)	396	–	–
	(86,540)	10,992	(86,106)	10,001

32 SHARE CAPITAL

The Group and the Bank

	2012	2011
Authorised:		
30,000,000 shares of HK$100 each	3,000,000	3,000,000
Issued and fully paid:		
20,000,000 shares of HK$100 each	2,000,000	2,000,000

33 OTHER RESERVES

The Group

	Regulatory reserve	Available-for-sale investment revaluation reserve	General reserve	Total
Balance at 1st January 2011	362,370	735,353	7,325,866	8,423,589
Change in fair value of available-for-sale investments	–	91,302	–	91,302
Realised on disposal of available-for-sale investments	–	(155,824)	–	(155,824)
Effect of deferred taxation (Note 31)	–	10,596	–	10,596
Currency translation differences	–	(302)	24,141	23,839
Transfer from retained earnings	100,000	–	–	100,000
Share of investment revaluation reserve of jointly controlled entities	–	(103)	–	(103)
Balance at 31st December 2011	462,370	681,022	7,350,007	8,493,399
Balance at 1st January 2012	462,370	681,022	7,350,007	8,493,399
Change in fair value of available-for-sale investments	–	697,925	–	697,925
Realised on disposal of available-for-sale investments	–	(177,792)	–	(177,792)
Effect of deferred taxation (Note 31)	–	(86,366)	–	(86,366)
Currency translation differences	–	(3,185)	6,310	3,125
Impairment losses on available-for-sale investments transferred to income statement	–	6,187	–	6,187
Share of investment revaluation reserve of jointly controlled entities	–	419	–	419
Transfer from retained earnings	28,371	–	–	28,371
Balance at 31st December 2012	490,741	1,118,210	7,356,317	8,965,268

33 OTHER RESERVES (CONTINUED)

The Bank

	Regulatory reserve	Available-for-sale investment revaluation reserve	General reserve	Total
Balance at 1st January 2011	362,370	734,720	7,325,781	8,422,871
Change in fair value of available-for-sale investments (Note 22)	–	95,515	–	95,515
Realised on disposal of available-for-sale investments	–	(155,824)	–	(155,824)
Effect of deferred taxation (Note 31)	–	10,001	–	10,001
Currency translation differences	–	(302)	24,159	23,857
Transfer from retained earnings	100,000	–	–	100,000
Balance at 31st December 2011	462,370	684,110	7,349,940	8,496,420
Balance at 1st January 2012	462,370	684,110	7,349,940	8,496,420
Change in fair value of available-for-sale investments (Note 22)	–	697,100	–	697,100
Realised on disposal of available-for-sale investments	–	(178,248)	–	(178,248)
Effect of deferred taxation (Note 31)	–	(86,106)	–	(86,106)
Currency translation differences	–	(3,185)	6,297	3,112
Impairment losses on available-for-sale investments transferred to income statement	–	6,187	–	6,187
Transfer from retained earnings	28,371	–	–	28,371
Balance at 31st December 2012	490,741	1,119,858	7,356,237	8,966,836

Nature and purpose of reserves:

(a) Regulatory reserve

The regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements of overseas branches for prudent supervision purpose. Any movements in the regulatory reserve for Hong Kong operation are made in consultation with the Hong Kong Monetary Authority.

(b) Available-for-sale investment revaluation reserve

Available-for-sale investment revaluation reserve represents the cumulative net change in the fair value of available-for-sale investments until the financial assets are derecognised or impaired as stated in the accounting policy for financial assets. (Note 2.9, Note 2.10, Note 2.12)

(c) General reserve

General reserve comprises previous years' transfers from retained earnings and translation reserve.

34 CASH AND CASH EQUIVALENTS

For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprise the following balances with less than three months' maturity from the date of acquisition and that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

The Group

	2012	2011
Cash and balances with banks	28,430,252	24,561,638
Placements with and loans and advances to banks	1,515,813	2,087,183
	29,946,065	26,648,821

35 CONTINGENT LIABILITIES AND COMMITMENTS

(a) Capital commitments

Capital expenditure at the end of the reporting period but not yet incurred is as follows:

	The Group		The Bank	
	2012	2011	2012	2011
Properties and equipment				
Contracted but not provided for	104,606	35,128	98,392	37,824
Authorised but not contracted for	67,633	85,115	67,633	85,115
	172,239	120,243	166,025	122,939

(b) Operating lease commitments

Where a group company is the lessee, the future minimum lease payments under non-cancellable operating leases are as follows:

	The Group		The Bank	
	2012	2011	2012	2011
No later than 1 year	97,416	88,621	99,920	89,818
Later than 1 year and no later than 5 years	157,896	190,075	167,913	190,075
Later than 5 years	–	70	4,173	70
	255,312	278,766	272,006	279,963

Where a group company is the lessor, the future minimum lease receivables under non-cancellable operating leases are as follows:

	The Group		The Bank	
	2012	2011	2012	2011
No later than 1 year	1,615	556	492	556
Later than 1 year and no later than 5 years	771	–	215	–
	2,386	556	707	556

(c) Credit commitments

The contract amounts of the Group's off-balance sheet instruments that commit it to extend credit to customers:

The Group and The Bank		
	2012	2011
Direct credit substitutes	2,197,874	2,330,130
Trade-related contingencies	3,417,746	3,406,417
Other commitments with an original maturity of:		
– under 1 year	1,355,706	1,128,087
– 1 year and over	2,506,275	2,848,244
– unconditionally cancellable	33,751,271	31,685,429
	43,228,872	41,398,307

The credit risk weighted amount of credit commitments is HK$4,218,547,000 (2011: HK$4,345,251,000).

(d) Other contingent liabilities

The Group is involved in legal actions which are in relation to its normal business operations. No material provision was made for those actions against the Group because the management believes that the Group has adequate grounds to defend against the claimants or the amounts involved in those actions are not expected to be material.

36 LOANS TO OFFICERS

Particulars of loans made by the Bank to officers and companies related to officers and disclosed pursuant to Section 161B of the Hong Kong Companies Ordinance are as follows:

	Balance outstanding at 31st December		Maximum balance during the year	
	2012	2011	2012	2011
Aggregate amount outstanding in respect of principal and interest	510,052	720,627	733,798	737,016

37 RELATED PARTY TRANSACTIONS

A number of banking transactions were entered into with related parties by the Group or the Bank in the normal course of business and at arm's length basis. These include loans, deposits, trade finance transactions and foreign currency transactions. The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

Included in the following statement of financial position captions are balances with the ultimate holding company:

The Group and the Bank		
	2012	2011
Cash and balances with banks	265,062	468,022
Available-for-sale investments	93,202	96,855
	358,264	564,877
Deposits and balances from banks at 1st January	646,676	524,279
Deposits and balances from banks received during the year	28,621	190,076
Deposits and balances from banks repaid during the year	(184,638)	(67,679)
Deposits and balances from banks at 31st December	490,659	646,676
Interest income on balances with the ultimate holding company	1,399	5,556
Interest expense on deposits from the ultimate holding company	4,617	3,980
Contingent liabilities and other commitments	108,745	262,469

Included in the following statement of financial position captions are balances with subsidiary companies of the ultimate holding company:

The Group and the Bank		
	2012	2011
Deposits from customers at 1st January	310,161	305,308
Deposits from customers received during the year	15,161	7,022
Deposits from customers repaid during the year	(6,623)	(2,169)
Deposits from customers at 31st December	318,699	310,161
Interest expense on deposits from the subsidiary companies of the ultimate holding company	2,025	2,001

37 RELATED PARTY TRANSACTIONS (CONTINUED)

Included in the following statement of financial position captions are balances with other shareholders:

The Group and the Bank	2012	2011
Cash and balances with banks	65,011	40,441
Available-for-sale and held-to-maturity investments	38,757	586,355
	103,768	626,796
Deposits from customers at 1st January	121,557	19,082
Deposits from customers received during the year	165,301	113,523
Deposits from customers repaid during the year	(112,655)	(11,048)
Deposits from customers at 31st December	174,203	121,557
Interest income on loans and advances to other shareholders	1,770	2,292
Interest expense on deposits from other shareholders	938	523

Included in the following statement of financial position captions are balances with jointly controlled entities:

The Group and the Bank	2012	2011
Loans and advances to customers at 1st January	37,600	43,553
Loans and advances to customers repaid during the year	(23,263)	(5,953)
Loans and advances to customers at 31st December	14,337	37,600
Collectively assessed impairment allowances	57	150
Deposits from customers at 1st January	296,583	194,477
Deposits from customers received during the year	89,128	149,381
Deposits from customers repaid during the year	(114,063)	(47,275)
Deposits from customers at 31st December	271,648	296,583
Interest income on loans and advances to the jointly controlled entities	319	333
Interest expense on deposits from the jointly controlled entities	3,425	1,695
Contingent liabilities and other commitments	2,000	2,000

Amounts due from/ (to) subsidiary companies are included in Note 24(b).

37 RELATED PARTY TRANSACTIONS (CONTINUED)

Included in the following statement of financial position captions are balances with the Directors of the Bank and the ultimate holding company and their relatives:

The Group and the Bank

	2012	2011
Loans and advances to customers at 1st January	382,728	222,954
Loans and advances to customers granted during the year	6,237	167,021
Loans and advances to customers repaid during the year	(125,542)	(7,247)
Loans and advances to customers at 31st December	263,423	382,728
Collectively assessed impairment allowances	1,076	1,557
Deposits from customers at 1st January	100,676	90,452
Deposits from customers received during the year	190,038	38,728
Deposits from customers repaid during the year	(42,660)	(28,504)
Deposits from customers at 31st December	248,054	100,676
Interest income on loans and advances to the Directors and their relatives	7,593	6,864
Interest expense on deposits from the Directors and their relatives	849	568
Contingent liabilities and other commitments	156,240	24,954

Included in the following statement of financial position captions are balances with companies controlled by the Directors of the Bank and the ultimate holding company and their relatives:

The Group and the Bank

	2012	2011
Loans and advances to customers at 1st January	321,494	296,989
Loans and advances to customers granted during the year	23,124	31,242
Loans and advances to customers repaid during the year	(98,362)	(6,737)
Loans and advances to customers at 31st December	246,256	321,494
Collectively assessed impairment allowances	985	1,286
Deposits from customers at 1st January	227,702	223,180
Deposits from customers received during the year	99,371	74,348
Deposits from customers repaid during the year	(123,178)	(69,826)
Deposits from customers at 31st December	203,895	227,702
Interest income on loans and advances to the companies controlled by the Directors and their relatives	11,610	12,073
Interest expense on deposits from the companies controlled by the Directors and their relatives	2,441	2,007
Contingent liabilities and other commitments	492,461	244,280

37 RELATED PARTY TRANSACTIONS (CONTINUED)

Included in the following statement of financial position captions are balances with the key management personnel, other than Directors of the Bank and the ultimate holding company and their relatives:

The Group and the Bank		
	2012	2011
Loans and advances to customers at 1st January	9,663	10,603
Loans and advances to customers granted during the year	754	1,424
Loans and advances to customers repaid during the year	(7,485)	(2,364)
Loans and advances to customers at 31st December	2,932	9,663
Collectively assessed impairment allowances	42	80
Deposits from customers at 1st January	29,880	18,775
Deposits from customers received during the year	12,125	20,782
Deposits from customers repaid during the year	(6,170)	(9,677)
Deposits from customers at 31st December	35,835	29,880
Interest income on loans and advances to the key management personnel of the Bank and the ultimate holding company and their relatives	103	721
Interest expense on deposits from the key management personnel of the Bank and the ultimate holding company and their relatives	534	252
Contingent liabilities and other commitments	2,750	5,498
The compensation of Directors and key management personnel of the Bank: Salaries and other short-term employee benefits	66,115	52,910

Note: The aggregate movement of revolving loans is shown in its net position during the year.

38 ULTIMATE HOLDING COMPANY

The ultimate holding company is The Shanghai Commercial & Savings Bank, Ltd.

SUPPLEMENTARY FINANCIAL INFORMATION

(All amounts in HK dollar thousands unless otherwise stated)

The following information is disclosed as part of the accompanying information to the consolidated financial statements and does not form part of the audited financial statements.

1 Liquidity ratio

	2012	2011
Liquidity ratio	61%	47%

The liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio for the twelve months of the financial year of the Bank's Hong Kong offices and overseas branches computed in accordance with the Hong Kong Banking Ordinance.

2 Non-bank mainland exposures

The Bank As at 31st December 2012

	On-balance sheet exposures	Off-balance sheet exposures	Total	Individually assessed impairment allowances
Types of counterparties				
Mainland entities	1,920,539	195,789	2,116,328	–
Companies and individuals outside Mainland where the credit is granted for use in Mainland	2,403,881	289,435	2,693,316	2,562
Other counterparties the exposures to whom are considered by the Group to be non-bank Mainland exposures	104,669	543,104	647,773	–
	4,429,089	1,028,328	5,457,417	2,562

The Bank As at 31st December 2011

	On-balance sheet exposures	Off-balance sheet exposures	Total	Individually assessed impairment allowances
Types of counterparties				
Mainland entities	1,876,989	355,778	2,232,767	–
Companies and individuals outside Mainland where the credit is granted for use in Mainland	2,260,451	313,802	2,574,253	12,677
Other counterparties the exposures to whom are considered by the Group to be non-bank Mainland exposures	148,842	207,493	356,335	1,075
	4,286,282	877,073	5,163,355	13,752

3 Currency concentrations

The Group

Equivalent in Hong Kong dollars	2012 Spot assets	Spot liabilities	Forward purchases	Forward sales	Net long/ (short) position	Net structural position
US Dollars	45,786,000	(41,485,000)	6,896,000	(7,008,000)	4,189,000	3,642,000
Pound Sterling	2,205,000	(2,220,000)	73,000	(35,000)	23,000	9,000
Renminbi	13,529,000	(12,589,000)	3,024,000	(2,736,000)	1,228,000	151,000
Canadian Dollars	1,767,000	(1,778,000)	35,000	(17,000)	7,000	–
Australian Dollars	5,729,000	(5,865,000)	880,000	(748,000)	(4,000)	–
Other currencies and gold	2,558,000	(2,509,000)	770,000	(781,000)	38,000	–
	71,574,000	(66,446,000)	11,678,000	(11,325,000)	5,481,000	3,802,000

Equivalent in Hong Kong dollars	2011 Spot assets	Spot liabilities	Forward purchases	Forward sales	Net long/ (short) position	Net structural position
US Dollars	39,234,000	(39,118,000)	7,462,000	(8,464,000)	(886,000)	3,412,000
Pound Sterling	2,031,000	(2,032,000)	45,000	(29,000)	15,000	10,000
Renminbi	10,189,000	(9,507,000)	3,871,000	(3,900,000)	653,000	107,000
Canadian Dollars	1,744,000	(1,746,000)	31,000	(18,000)	11,000	–
Australian Dollars	6,455,000	(6,587,000)	1,221,000	(1,177,000)	(88,000)	–
Other currencies and gold	3,059,000	(3,065,000)	300,000	(306,000)	(12,000)	–
	62,712,000	(62,055,000)	12,930,000	(13,894,000)	(307,000)	3,529,000

Net structural position includes structural positions of the Bank's overseas branches and subsidiaries. Structural assets and liabilities include:

– investments in properties and equipment, net of depreciation;

– capital, statutory reserves and unremitted profits of overseas branches; and

– investments in overseas subsidiaries and related company.

The above disclosure is based on the significance of the Group's foreign currency exposures of the current year.

4 Loans and advances to customers

(a) Gross loans and advances to customers by loan usage

The Group

	2012		2011	
	Gross loans and advances	Amount covered by collateral	Gross loans and advances	Amount covered by collateral
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development	1,742,505	876,465	1,916,158	1,049,683
– Property investment	10,107,076	9,861,456	11,519,801	10,698,444
– Financial concerns	130,991	127,205	70,471	69,178
– Stockbrokers	80,570	69,953	16,048	14,249
– Wholesale and retail trade	911,436	619,345	1,010,922	633,777
– Manufacturing	2,048,598	1,424,641	1,778,685	1,100,288
– Transport and transport equipment	731,252	455,982	793,162	347,681
– Information technology – telecommunication	6,417	5,921	2,159	861
– Hotels, boarding houses and catering	890,789	874,423	941,579	927,034
– Others	5,591,454	4,196,186	4,183,634	2,951,769
Individuals				
– Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme or their respective successor schemes	229,017	228,031	263,119	261,995
– Loans for the purchase of other residential properties	3,928,236	3,921,971	4,269,934	4,261,578
– Credit card advances	291,704	–	323,162	–
– Others	5,174,506	4,960,556	5,739,932	5,519,857
Trade finance	5,594,761	3,918,751	5,932,944	2,974,036
Loans for use outside Hong Kong	14,370,843	12,705,423	13,558,405	11,884,108
	51,830,155	44,246,309	52,320,115	42,694,538

4 Loans and advances to customers (Continued)

(b) Impairment allowances on loans and advances to customers by loan usage

For those industry sectors to which the Bank's total amount of loans and advances constitute not less than 10% of the Bank's total amount of loans and advances, their corresponding amount of individually assessed impaired loans and advances, overdue loans and advances, individual impairment allowances, collective impairment allowances is analysed as follows:

The Group

	2012			
	Impaired loans and advances	Overdue loans and advances	Individual impairment allowances	Collective impairment allowances
Industrial, commercial and financial – Property investment	26,103	118,307	105	40,324

	2011			
	Impaired loans and advances	Overdue loans and advances	Individual impairment allowances	Collective impairment allowances
Industrial, commercial and financial – Property investment	27,319	152,581	111	45,970

The Group

	2012		
	New provisions	Loans written off as uncollectible	Recoveries of advances written off in previous years
Industrial, commercial and financial – Property investment	80	–	388

	2011		
	New provisions	Loans written off as uncollectible	Recoveries of advances written off in previous years
Industrial, commercial and financial – Property investment	–	–	440

5 Segmental information

(a) Overdue and impaired loans and advances to customers by geographical areas

The Group

	2012		
	Individually assessed impaired loans and advances	Individual impairment allowances	Collective impairment allowances
Hong Kong	250,443	27,931	–
Asia Pacific excluding Hong Kong	3,876	16	–
North America	199,448	20,537	–
	453,767	48,484	–

	2012		
	Overdue loans and advances	Individual impairment allowances	Collective impairment allowances
Hong Kong	718,230	24,774	2,566
Asia Pacific excluding Hong Kong	80,144	16	312
North America	721,807	6,201	2,441
Western Europe	54,068	–	217
	1,574,249	30,991	5,536

The Group

	2011		
	Individually assessed impaired loans and advances	Individual impairment allowances	Collective impairment allowances
Hong Kong	323,791	38,212	–
Asia Pacific excluding Hong Kong	–	–	–
North America	596,404	30,857	–
	920,195	69,069	–

	2011		
	Overdue loans and advances	Individual impairment allowances	Collective impairment allowances
Hong Kong	684,902	31,425	2,242
Asia Pacific excluding Hong Kong	25,633	16	83
North America	678,702	17,496	2,003
Western Europe	24,130	–	97
	1,413,367	48,937	4,425

5 Segmental information (Continued)

(b) Cross-border claims

The information on cross-border claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties after taking into account any transfer of risk.

The Group

	2012			
	Banks and other financial institutions	Public sector entities	Others	Total
Asia Pacific excluding Hong Kong	37,452,000	196,000	1,795,000	39,443,000
North America	2,024,000	189,000	252,000	2,465,000
Western Europe	739,000	–	233,000	972,000

	2011			
	Banks and other financial institutions	Public sector entities	Others	Total
Asia Pacific excluding Hong Kong	32,685,000	161,000	1,705,000	34,551,000
North America	2,821,000	181,000	353,000	3,355,000
Western Europe	3,751,000	78,000	303,000	4,132,000

6 Corporate governance

(a) The Bank has fully complied with the requirements set out in the guideline on 'Corporate Governance of Locally Incorporated Authorized Institutions' issued by the Hong Kong Monetary Authority.

(b) Key specialised committees established under the Board of Directors (the 'Board')

(i) Executive Committee

The Executive Committee meets monthly and operates as a general management committee under the direct authority of the Board to review the management and performance of the Bank. The members of the Executive Committee are Mr. David Sek-chi Kwok (Chairman), Mr. Hung-ching Yung, Mr. David Allen Hoyt, Madam Ning Li Ming and Mr. Edward Kawah Chu.

(ii) Audit Committee

The Audit Committee meets quarterly to consider the nature and scope of audit reviews, as well as to review the Bank's financial statements, the findings of both internal and external auditors and the effectiveness of the internal control systems of the Bank. The members of the Audit Committee are Mr. Gordon Che Keung Kwong (Chairman), Mr. Lincoln Chu Kuen Yung and Dr. Richard Lee.

(iii) Remuneration Committee

The Remuneration Committee meets at least once a year to oversee the implementation of a sound remuneration policy including the recommendations to the Board on the remuneration of the directors and senior management of the Bank. The members of the Remuneration Committee are Mr. Hung-ching Yung (Chairman), Dr. Richard Lee and Mr. Johnson Mou Daid Cha.

(iv) Nomination Committee

Set up in December 2012, the Nomination Committee meets at least once a year to review the structure, size, composition of the Board, to identify, consider and select individuals qualified for recommendations to the Board for their appointments, re-appointment and succession planning as Directors and senior management in order to complement the Bank's business strategies. The members of the Nomination Committee are Mr. Lincoln Chu Kuen Yung (Chairman), Dr. Richard Lee and Mr. Johnson Mou Daid Cha.

(v) Asset and Liability Committee

The Asset and Liability Committee meets at least monthly to oversee the Bank's operations relating to interest rate risk, liquidity risk, foreign exchange risk and etc. and in particular to ensure that the Bank has adequate funds to meet its obligations. The members of the Asset and Liability Committee are Mr. David Sek-chi Kwok (Chairman), Mr. Edward Kawah Chu, Mr. Paul Kun-kow Wong, Mr. Stephen Siu-fung Lee, Mr. Frank Shui-sang Jin, Mr. Hon-ming Mak, Mr. Danny Kong-keung Tsang and Ms. Wendy Li-chien Weng.

(vi) Credit Committee

The Credit Committee meets at least monthly to ensure that the Bank's credit policies are adequate and lending activities are conducted in accordance with established policies and relevant laws and regulations. The Credit Committee is also responsible for establishing credit policies, monitoring loan portfolio quality, ensuring compliance with statutory and internal lending limits, and evaluating credit applications and making credit decisions. The members of the Credit Committee are Mr. David Sek-chi Kwok (Chairman), Mr. Edward Kawah Chu, Mr. Paul Kun-kow Wong, Mr. Stephen Siu-fung Lee, Mr. Frank Shui-sang Jin, Mr. Hon-ming Mak, Mr. Danny Kong-keung Tsang, Mr. Ho-kei Wan and Mr. Sau-man Hui.

(vii) Operational Risk Management Committee

The Operational Risk Management Committee meets at least bi-monthly to establish and to review operational risk management policies, processes and procedures for managing operational risk in all of the Bank's material products, activities, processes and systems. The Operational Risk Management Committee is also responsible for overseeing the identification, assessment, monitoring and control of operational risk exposures. The members of the Operational Risk Management Committee are Mr. David Sek-chi Kwok (Chairman), Mr. Edward Kawah Chu, Mr. Paul Kun-kow Wong, Mr. Daniel Kwok-hung Chan, Mr. Burton Chi-shan Cheng, Mr. Stephen Siu-fung Lee, Mr. Frank Shui-sang Jin, Mr. Hon-ming Mak, Mr. Danny Kong-keung Tsang, Mr. Pui-man Yeung, Mr. Zachary Wing-kwong Kwan and Mr. Francis Yue-cheong Wong.

7 Capital charges for credit, market and operational risks

The capital adequacy ratio in Note 3.5 to the financial statements represents the consolidated ratio that comprises the positions of the Bank and certain of its subsidiaries as specified by the Hong Kong Monetary Authority for regulatory purposes as at 31st December computed in accordance with the Banking (Capital) Rules. For accounting purposes, the basis of consolidation is described in Note 2.2 to the consolidated financial statements.

The capital requirements for each class of exposures are summarised as follows:

(a) Capital charge for credit risk

Capital requirement

	2012	2011
Sovereign exposures	3,735	35,970
Public Sector Entity exposures	4,313	4,645
Bank exposures	1,786,710	1,592,651
Securities Firm exposures	3,223	642
Corporate exposures	2,720,960	2,469,871
Cash items	7,492	9,616
Regulatory Retail exposures	271,930	266,676
Residential Mortgage Loans	529,913	558,576
Other exposures which are not past due exposures	659,833	729,977
Past due exposures	31,764	41,853
Total capital charge for on-balance sheet exposures	6,019,873	5,710,477
Direct credit substitutes	172,449	183,169
Trade-related contingencies	54,181	53,892
Other commitments	110,854	110,559
Exchange rate contracts	4,612	7,500
Total capital charge for off-balance sheet exposures	342,096	355,120
Total capital charge for credit risk	6,361,969	6,065,597

The Group uses the Standardised Approach for calculating credit risk.

This disclosure is made by multiplying the Group's risk-weighted amount derived from the relevant calculation approach by 8%, not the Group's actual 'regulatory capital'.

(b) Capital charge for market risk

Capital charge

	2012	2011
Interest rate exposures (including options)	8,128	14,762
Equity exposures (including options)	19,686	17,174
Foreign exchange exposures (including gold and options)	120,000	68,640
Capital charge for market risk	147,814	100,576

The Group uses the Standardised Approach for calculating market risk.

(c) Capital charge for operational risk

	2012	2011
Capital charge for operational risk	426,232	420,704

The Group uses the Basic Indicator Approach for calculating operational risk.

8 Risk management

(a) Credit risk

(i) Credit risk exposures

Standard & Poor's Ratings Services, Moody's Investors Service, Fitch Ratings and Rating and Investment Information, Inc. are the ECAIs that the Group has used in relation to each and all classes of credit risk exposures below. The process it used to map ECAI issuer ratings to exposures booked in its banking book is a process as prescribed in Part 4 of the Banking (Capital) Rules.

The Group As at 31st December 2012

	Total exposures	Exposures after recognised credit risk mitigation		Risk-weighted amounts		Total risk-weighted amounts
		Rated	Unrated	Rated	Unrated	
A. On-balance Sheet						
1 Sovereign	18,927,156	18,927,156	–	46,687	–	46,687
2 Public Sector Entity	269,596	269,596	–	53,919	–	53,919
3 Multilateral Development Bank	17,455	17,455	–	–	–	–
4 Bank	54,058,267	50,916,372	3,141,895	20,945,977	1,387,893	22,333,870
5 Securities Firm	80,563	–	80,563	–	40,282	40,282
6 Corporate	35,984,289	4,827,548	31,156,741	2,855,254	31,156,741	34,011,995
7 Cash Items	383,739	–	1,391,388	–	93,647	93,647
8 Regulatory Retail	4,532,173	–	4,532,173	–	3,399,130	3,399,130
9 Residential Mortgage Loan	10,432,097	–	10,432,097	–	6,623,915	6,623,915
10 Other exposures which are not Past Due Exposures	8,247,919	–	8,247,919	–	8,247,919	8,247,919
11 Past Due Exposures	389,214	–	389,214	–	397,057	397,057
B. Off-balance Sheet						
1 Off-balance sheet exposures other than OTC derivative transactions	4,405,702	226,368	4,179,334	97,211	4,121,336	4,218,547
2 OTC derivative transactions	165,589	148,854	16,735	41,400	16,255	57,655

The Group As at 31st December 2011

	Total exposures	Exposures after recognised credit risk mitigation		Risk-weighted amounts		Total risk-weighted amounts
		Rated	Unrated	Rated	Unrated	
A. On-balance Sheet						
1 Sovereign	14,786,610	14,786,610	–	449,624	–	449,624
2 Public Sector Entity	290,329	290,329	–	58,066	–	58,066
3 Multilateral Development Bank	28,279	28,279	–	–	–	–
4 Bank	50,239,298	45,938,126	4,301,172	18,076,229	1,831,913	19,908,142
5 Securities Firm	16,045	–	16,045	–	8,023	8,023
6 Corporate	32,539,033	3,317,270	29,221,763	1,651,625	29,221,763	30,873,388
7 Cash Items	442,849	–	1,609,809	–	120,193	120,193
8 Regulatory Retail	4,444,600	–	4,444,600	–	3,333,451	3,333,451
9 Residential Mortgage Loan	10,913,655	–	10,913,655	–	6,982,200	6,982,200
10 Other exposures which are not Past Due Exposures	9,124,710	–	9,124,710	–	9,124,710	9,124,710
11 Past Due Exposures	516,785	–	516,785	–	523,168	523,168
B. Off-balance Sheet						
1 Off-balance sheet exposures other than OTC derivative transactions	4,661,153	433,383	4,227,770	176,517	4,168,734	4,345,251
2 OTC derivative transactions	206,469	153,613	52,856	48,483	45,264	93,747

As at 31st December 2012, the credit risk to corporate and past due exposures are covered by recognised collateral of HK$1,007,649,000 (2011: HK$1,166,960,000) and HK$368,232,000 (2011: HK$501,141,000) respectively.

As at 31st December 2012, the credit risk to corporate and off-balance sheet exposures other than OTC derivative transactions are covered by recognised guarantees of HK$480,031,000 (2011: HK$845,666,000) and HK$173,125,000 (2011: HK$299,469,000) respectively.

8 Risk management (Continued)

(a) Credit risk (Continued)

(ii) Counterparty credit risk exposures

The following table summarises the Group's main credit exposures arising from OTC derivative transactions:

The Group	2012	2011
OTC derivatives:		
Gross total positive fair value	51,446	70,294
Credit equivalent amounts	165,589	206,469
Risk weighted amounts	57,655	93,747

The breakdown of the credit equivalent amounts and the risk-weighted amounts is summarised as follows:

The Group	2012	2011
Notional amounts:		
– Banks	10,095,172	10,623,343
– Corporates	1,121,723	2,329,721
– Others	85,590	856,566
	11,302,485	13,809,630
Credit equivalent amounts:		
– Banks	140,367	153,613
– Corporates	24,064	43,815
– Others	1,158	9,041
	165,589	206,469
Risk-weighted amounts:		
– Banks	37,156	48,483
– Corporates	19,630	38,249
– Others	869	7,015
	57,655	93,747

(b) Asset securitisation

There are no such exposures for the year ended 31st December 2012 and 2011.

(c) Equity exposures in banking book

Gains related to equity exposures are as follows:

The Group	2012	2011
Realised gains from sales during the year	11,920	20,502
Unrealised revaluation gains at year ended:		
– Amount included in reserves but not through income statement	1,066,712	987,466
– Amount added to core/ supplementary capital	480,020	446,545

8 Risk management (Continued)

(d) Interest rate exposures in banking book

2012

	Currency				
Equivalent in Hong Kong Dollars	Hong Kong Dollars	US Dollars	Renminbi	Others	Total
Interest rate risk shock (200 basis points upward) Increase/ (decline) in earnings	(77,404)	(36,748)	(1,071)	(3,459)	(118,682)

2011

	Currency				
Equivalent in Hong Kong Dollars	Hong Kong Dollars	US Dollars	Renminbi	Others	Total
Interest rate risk shock (200 basis points upward) Increase/ (decline) in earnings	23,172	(78,142)	(9,890)	(3,815)	(68,675)

For 2012 and 2011, the effect of decline in earnings and increase in earnings with interest rate risk shock of 200 basis points downward are contra to that with interest rate risk shock of 200 basis points upward.

9 Disclosure on Remuneration

GUIDING PRINCIPLES

The Bank is committed to sustaining long-term capital preservation and financial strength for the benefits of all stakeholders. The Remuneration Policy of the Bank is designed to promote fairness and consistency in the compensation approach; to attract, motivate and retain talents, as well as to help achieve the business goals under prudent risk management principles.

The Remuneration Policy applies to the Bank in Hong Kong and its subsidiaries, where appropriate. While the basic principles are applicable to foreign branches, they are also subject to their local regulatory requirements in respective jurisdictions.

REMUNERATION COMMITTEE

The Remuneration Committee is established with written Terms of Reference defining its authority and duties to oversee the formulation and implementation of a sound remuneration policy by the Bank, and to ensure its consistency with the best practices and applicable legal and regulatory requirements.

Directly appointed by the Board of the Bank, majority of the members of the Committee are Independent Non-executive Directors. The Committee is chaired by Mr. Hung-ching Yung. The other members are Dr. Richard Lee and Mr. Johnson Mou Daid Cha.

The Remuneration Committee reviews the remuneration policy and its structure of the Bank at least annually and had held two meetings in 2012.

REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

The Remuneration Committee is responsible for making recommendations to the Board on the formulation and review of the remuneration packages for the Directors, the Chief Executive and Senior Management, with reference to the Bank's financial condition and future prospect, risk management framework, reward and people strategies. Such packages are subject to the final approval of the Board.

No individual Director/ Staff or any of his/ her alternates shall be involved in deciding his/ her own remuneration package.

9 Disclosure on Remuneration (Continued)

REMUNERATION STRUCTURE

The remuneration package is a combination of fixed and variable remuneration. Fixed remuneration consists of basic salary, allowances, double pay and pension contribution. Variable remuneration takes into account the overall performance of the Bank and various business units, individual performance measured against the established key performance indicators, adherence to risk management policies, compliance with legal and regulatory requirements and ethical standards. The variable remuneration is awarded in the form of cash bonus.

A proportion of the variable remuneration will be deferred and the vesting criteria of the deferred payment are subject to the impact of financial and non-financial factors over a period of time.

PERFORMANCE MEASUREMENTS AND THE DISTRIBUTION OF VARIABLE REMUNERATION

The Bank maintains a performance evaluation scheme to ensure individual staff performance would be differentiated into various levels, and be adequately and effectively evaluated. Final approval of the discretionary bonus is determined by various quantitative and qualitative assessment criteria set out in the performance appraisal system.

The employees within risk control functions are remunerated independently. The performance of business units where they oversee does not affect their remuneration.

When deciding the remuneration measures, the Bank shall also take into account certain key risk factors such as its asset quality, liquidity position, business environments, respective staff performance, the overall business results as well as long-term financial position. The timing and the portion of the performance-related bonus distribution are vested in the Remuneration Committee and finally with the Board.

DEFERRAL ARRANGEMENTS

In view of the Bank's existing business model and organisation structure, a portion of the discretionary bonus payment of senior management will be deferred and may be subject to a vesting period for a number of years in order to align with long-term value creation and the time horizons of risk.

SENIOR MANAGEMENT AND KEY PERSONNEL REMUNERATION

Aggregate quantitative information on remuneration for the Bank's senior management and key personnel for the financial year of 2012:

Senior Management		
Total value of remuneration awards for the current financial year	Non-deferred	Deferred
Fixed remuneration		
• Cash-based	28,672	Nil
Variable remuneration		
• Cash-based	24,694	2,666
Deferred remuneration		
• Vested cash		1,706
• Unvested cash		5,232

Notes:

(i) The unvested deferred remuneration relates to the 2011 and 2012 variable remuneration.

(ii) A senior management personnel will be awarded with guaranteed bonus for the financial year 2012, upon the completion of 12 months' service.

(iii) Number of senior management staff as at 31st December 2012 was 13.

(iv) Number of key personnel other than those senior management described above: Nil.

BRANCHES AND SUBSIDIARY COMPANIES

Management and Administration

35/F., Gloucester Tower, The Landmark, 15 Queen's Road Central, Hong Kong
Telephone: (852) 2841 5415
Fax: (852) 2810 4623
Telex: 73650 SCBK HX
SWIFT: SCBK HK HH
Web Site: http://www.shacombank.com.hk

Hong Kong Island Branches

Retail Banking Operations - Central	Basement, Manning House, 48 Queen's Road Central
Aberdeen Branch	118 Aberdeen Main Road, Aberdeen
Causeway Bay Branch	18 Pennington Street, Causeway Bay
Hennessy Road Branch	Shop LG16, C. C. Wu Building, 302 Hennessy Road, Wanchai
North Point Branch	486 King's Road, North Point
President Theatre Branch	Shop A, G/F., 517 Jaffe Road, Causeway Bay
Shaukiwan Branch	136 Shaukiwan Main Street East, Shaukiwan
Sheung Wan Branch	G/F., 41-47 Jervois Street, Sheung Wan
Siu Sai Wan Branch	Shop 9, G/F., Harmony Garden, 9 Siu Sai Wan Road, Chai Wan
Taikoo Shing Branch	G502 Tai Yue Avenue, Taikoo Shing, Quarry Bay
Victoria Centre Branch	G7 Victoria Centre, 15 Watson Road, Causeway Bay
Wanchai Branch	19-21 Hennessy Road, Wanchai
West Point Branch	47 Catchick Street, West Point

Kowloon Branches

Jordan Road Branch	Shop 2, G/F., Sino Cheer Plaza, 23 Jordan Road, Jordan
Kowloon Bay Branch	Telford House, 16 Wang Hoi Road, Kowloon Bay
Kowloon Tong Branch	G28 Franki Centre, 320 Junction Road, Kowloon Tong
Kwun Tong Branch	57-61 Hong Ning Road, Kwun Tong
Laichikok Branch	Shops 5-8, G/F., Lai Kwan Court, 438 Castle Peak Road
Mei Foo Sun Chuen (Stage 1) Branch	29D Broadway, Mei Foo Sun Chuen, Laichikok
Mei Foo Sun Chuen (Stage 4) Branch	83B Broadway, Mei Foo Sun Chuen, Laichikok
Mody Road Branch	Unit 101-103, 1/F., Wing On Plaza, 62 Mody Road, Tsimshatsui East
Mongkok Branch	666 Nathan Road, Mongkok
Ping Shek Estate Branch	115 Tsuen Shek House, Ping Shek Estate, Ngau Chi Wan
Sanpokong Branch	28 Hong Keung Street, Sanpokong
Sham Shui Po Branch	141 Cheung Sha Wan Road, Sham Shui Po
Tokwawan Branch	60 Tokwawan Road, Tokwawan
Tsimshatsui Branch	7 Hankow Road, Tsimshatsui
Tsimshatsui East Branch	G27 Houston Centre, 63 Mody Road, Tsimshatsui East
Waterloo Road Branch	84K Waterloo Road, Homantin
Whampoa Garden Branch	Shop 9, Palm Mansions, Whampoa Garden, Site 4, Hunghom
Wong Tai Sin Branch	Shop LG4, Lung Cheung Plaza, 136 Lung Cheung Road, Wong Tai Sin

New Territories and Outlying Island Branches

Kingswood Villa Branch	Shop G08, G/F., Phase 2, Kingswood Ginza, 18 Tin Yan Road, Tin Shui Wai
Kwai Chung Branch	Shop 3, Hutchison Estate, 482 Castle Peak Road, Kwai Chung
Ma On Shan Branch	Shop 308, Level 3, Ma On Shan Plaza, 608 Sai Sha Road, Ma On Shan
Shatin Branch	Shop 70B, Level 3, Shatin Centre, Wang Pok Street, Shatin
Sheung Shui Branch	82 San Fung Avenue, Sheung Shui
Tai Po Branch	Shop 54, Level 1, Uptown Plaza, 9 Nam Wan Road, Tai Po
Texaco Road Branch	Shops B128-131, East Asia Commercial Centre, 36-60 Texaco Road, Tsuen Wan
Tseung Kwan O Branch	Shops G1-2, G/F., Metro City Plaza III, The Metropolis, 8 Mau Yip Road, Tseung Kwan O
Tsuen Wan Branch	405 Castle Peak Road, Tsuen Wan
Tuen Mun Branch	Shop 2183, 2/F., Tuen Mun Town Plaza Phase 1, 1 Tuen Shing Street, Tuen Mun
Tung Chung Branch	Shops 1-2, Block 5, Tung Chung Crescent, Tung Chung, Lantau
TVB Office	2/F., Workshop Block, TVB City, 77 Chun Choi Street, Tseung Kwan O Industrial Estate
Yuen Long Branch	17 Hong Lok Road, Yuen Long

Overseas Branches

London Branch	65 Cornhill, London, EC3V 3NB, U.K.
Los Angeles Branch	383 East Valley Boulevard, Alhambra, CA 91801, U.S.A.
New York Branch	125 East 56th Street, New York, NY 10022, U.S.A.
San Francisco Branch	231 Sansome Street, San Francisco, CA 94104, U.S.A.

Mainland Branches

Shanghai Branch	Room 913, China Merchants Tower, 161 Lu Jia Zui Road (E), Pu Dong, Shanghai 200120, P.R.C.
Shenzhen Branch	Room 01-03, 20/F, Tower One, Kerry Plaza, No.1 Zhong Xin Si Road, Futian District, Shenzhen 518048, China

Wholly-owned Subsidiary Companies

Glory Step Investments Limited
Hai Kwang Property Management Company Limited
Right Honour Investments Limited
Shacom Assets Investments Limited
Shacom Futures Limited
Shacom Insurance Brokers Limited
Shacom Investment Limited
Shacom Property (CA) Inc.
Shacom Property (NY) Inc.
Shacom Property Holdings (BVI) Limited
Shacom Securities Limited
Shanghai Commercial Bank (Nominees) Limited
Silver Wisdom Investments Limited

Subsidiary Companies

Infinite Financial Solutions Limited
Shanghai Commercial Bank Trustee Limited
Paofoong Insurance Company (Hong Kong) Limited