SHANGHAI COMMERCIAL BANK

# 2017
## ANNUAL REPORT



Welcome to Shanghai Commercial Bank Limited's website

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# CONTENTS


| | |
|---|---|
| 2 | Corporate Profile |
| 3 | Five-Year Financial Summary |
| 4 | Notice of Annual General Meeting |
| 5-6 | Board of Directors |
| 7 | Management |
| 8-11 | Biographical Details of Directors and Senior Management |
| 12-17 | 2017 at a Glance |
| 18-20 | Message to Shareholders |
| 21-25 | Report of the Directors |
| 26-39 | Corporate Governance Report |
| 40-44 | Independent Auditor's Report |
| 45 | Consolidated Statement of Profit or Loss |
| 46 | Consolidated Statement of Comprehensive Income |
| 47 | Consolidated Statement of Financial Position |
| 48-49 | Consolidated Statement of Changes in Equity |
| 50-51 | Consolidated Statement of Cash Flows |
| 52-129 | Notes to the Consolidated Financial Statements |
| 130-138 | Supplementary Financial Information |
| 139-169 | Regulatory Disclosures |
| 170-172 | Branches and Subsidiaries |

# CORPORATE PROFILE

Established in November 1950, Shanghai Commercial Bank (the '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, insurance and wealth management services and corporate and personal loans.

In addition to over 40 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

| | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| **FOR THE YEAR (IN HK$ MILLION)** | | | | | |
| Net interest income | **3,100** | 2,637 | 2,481 | 2,518 | 2,206 |
| Other operating income | **1,504** | 1,222 | 1,147 | 980 | 1,144 |
| Operating expenses | **1,520** | 1,428 | 1,277 | 1,182 | 1,143 |
| Operating profit | **3,025** | 2,410 | 2,346 | 2,302 | 2,182 |
| Profit before other comprehensive income attributable to equity holders | **2,424** | 1,909 | 1,899 | 1,896 | 1,785 |
| Dividend | **940** | 940 | 940 | 940 | 880 |
| **AT YEAR END (IN HK$ MILLION)** | | | | | |
| Shareholders' funds | **25,468** | 24,308 | 22,572 | 21,679 | 20,438 |
| Total assets | **184,531** | 169,369 | 159,613 | 152,469 | 143,071 |
| Total deposits | **146,953** | 136,884 | 129,205 | 121,393 | 113,641 |
| Total loans and advances | **78,647** | 64,804 | 64,376 | 67,457 | 62,371 |
| **FINANCIAL RATIOS (IN PERCENTAGE %)** | | | | | |
| Capital adequacy ratio* | **18.9** | 18.7 | 19.9 | 19.0 | 19.6 |
| Average liquidity maintenance ratio/ liquidity ratio** | **45.6** | 49.3 | 53.1 | 46.0 | 55.3 |
| Loan to deposit ratio | **53.5** | 47.3 | 49.8 | 55.6 | 54.9 |
| Dividend payout ratio | **38.8** | 49.2 | 49.5 | 49.6 | 49.3 |
| Return on average assets | **1.4** | 1.2 | 1.2 | 1.3 | 1.3 |

* The capital adequacy ratios were calculated based on the Banking (Capital) Rules effective during the reporting periods.

** Average liquidity maintenance ratios for Year 2015 to Year 2017 were calculated in accordance with the Banking (Liquidity) Rules effective from 1st January 2015. The liquidity ratios for Year 2013 and Year 2014 were calculated in accordance with the repealed Section 102 of the Hong Kong Banking Ordinance.

# NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the Sixty-seventh Annual General Meeting of the Members of the Bank will be held at its Registered Office, Shanghai Commercial Bank Tower, 12 Queen's Road Central, Hong Kong on Wednesday, 18th April 2018 at 9:00 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 2017;
(2) To declare Dividend in respect of the year 2017;
(3) To re-elect Directors;
(4) To approve the payment of Directors' fees for the year ended 31st December 2017;
(5) To re-appoint Auditor and to authorise the Directors to fix their remuneration;
(6) To approve the revised edition of 取得或處分資產處理程序 ("Policy on the Acquisition and Disposal of Assets").

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 Wednesday, 11th April 2018 to Wednesday, 18th April 2018, both days inclusive.

By Order of the Board
**May Yuen-ling KWOK**
Corporate Secretary

Hong Kong, 24th January 2018

# BOARD OF DIRECTORS



Front row from left to right

Mr. Yung-Chang HO, Mr. Richard Jason Lloyd YORKE, Mr. Stephen Ching Yen LEE, Mr. Hung-ching YUNG, Madam DAI Lanfang, Mr. Yu JIN

Back row from left to right

Mr. E. Michael FUNG, Mr. Johnson Mou Daid CHA, Dr. Richard LEE, Mr. David Sek-chi KWOK, Mr. CHEN Yih Pin, Mr. Gordon Che Keung KWONG, Mr. John Con-sing YUNG

| | |
|---|---|
| **# Stephen Ching Yen LEE**<br>Chairman & Non-executive Director | |
| **^ David Sek-chi KWOK, *FHKIB, FCIB***<br>Managing Director & Chief Executive | |
| **# Hung-ching YUNG, *JP*** | |
| *** Dr. Richard LEE** | |
| *** Johnson Mou Daid CHA**<br>(Dr. LAM Chat Yu, Alternate) | (resigned on 1st March 2017) |
| **# CHEN Yih Pin** | |
| *** Gordon Che Keung KWONG, *FCA*** | |
| **# Richard Jason Lloyd YORKE**<br>(CHANG Hwa Ping, Alternate)<br>(Ignatius Wooi-kean CHOONG, Alternate) | (resigned on 10th April 2017)<br>(appointed on 10th April 2017 and resigned on 24th January 2018) |
| **# John Van Antwerp RINDLAUB**<br>(Ignatius Wooi-kean CHOONG, Alternate) | (resigned on 10th April 2017)<br>(resigned on 10th April 2017) |
| **# DAI Lanfang**<br>(YE Jun, Alternate) | (resigned on 24th January 2018) |
| *** E. Michael FUNG** | |
| **# JIN Yu**<br>(HUANG Tao, Alternate) | (resigned on 24th January 2018) |
| **# John Con-sing YUNG** | |
| **# HO Yung-Chang** | (appointed on 10th April 2017) |

^ Executive Director

* Independent Non-executive Directors

# Non-executive Directors

# MANAGEMENT

## EXECUTIVES

| | |
|---|---|
| **Chief Executive** | David Sek-chi KWOK |
| **Deputy Chief Executives** | Nai-pan TANG<br>Burton Chi-shan CHENG<br>Mong-ting CHONG |
| **Executive Vice Presidents** | Wendy Li-chien WENG<br>Ricky Chi-wai CHAN<br>Edmund Kin-sang LAI<br>Janet Hey CHONG<br>Michael Yiu-wing FUNG<br>Jenny Chui-yeung CHAU<br>Jerome Chee-keong GOH<br>Timothy Wai-tai LAW<br>Clara Chor-hing FUNG |
| **Senior Vice Presidents** | Stephen Wing-hing LAI<br>Denis Man-heung WONG<br>Steve Wai-fan TONG<br>Daniel Kwok-chung CHEUNG<br>Johnny Chung-pun CHOY<br>Christopher Lung-yuen YEONG<br>Ka-shing YEUNG<br>Wing-hung LAM |

## OVERSEAS BRANCHES

| | |
|---|---|
| **Los Angeles Branch**<br>**Executive Vice President & Manager** | Ching-hsing KAO |
| **New York Branch**<br>**Senior Vice President & Manager** | Timothy Kam-tim CHAN |
| **San Francisco Branch**<br>**Senior Vice President & Manager** | Philip She-hoi LEE |
| **London Branch**<br>**Manager** | Frederick Yan CHU |

## MAINLAND BRANCHES

| | |
|---|---|
| **Shenzhen Branch**<br>**Manager** | Vincent Chi-wing MAN |
| **Shanghai Branch**<br>**Manager** | Lydia Li-ying CHEN |

## DIRECTORS

### Mr. Stephen Ching Yen LEE

Aged 71. Chairman and Non-executive Director. Mr. LEE was appointed a Director of the Bank since June 2004 and was elected Chairman in April 2016. He is the Managing Director of The Shanghai Commercial & Savings Bank, Ltd. since 1979. Mr. LEE has extensive experience in aviation industry, finance, banking and investment. He is also the Chairman of SIA Engineering Company and NTUC Income Insurance Co-operative Limited, Managing Director of Great Malaysia Textile Investments Private Limited, a Director of CapitaLand Limited and Temasek Holdings (Private) Limited, and a member of the Council of Presidential Advisers of Singapore. He was the Chairman of Singapore Airline Limited from 2006 to 2016.

### Mr. David Sek-chi KWOK, FHKIB, FCIB

Aged 64. Managing Director and Chief Executive of the Bank. Joined the Bank in October 1971. Appointed a Director in October 2001. General Manager since July 2004, and Managing Director and Chief Executive since October 2007. He is also a Director of Bank of Shanghai.

### Mr. Hung-ching YUNG, JP

Aged 95. Appointed a Director of the Bank in March 1973. Managing Director of Nanyang Holdings Limited. Chairman of The Shanghai Commercial & Savings Bank, Ltd. and Paofoong Insurance Company (Hong Kong) Limited. A Director of The Wing On Enterprises, Limited.

### Dr. Richard LEE

Aged 80. 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 66. Appointed a Director of the Bank in September 2001. Director of Mingly Corporation, HKR International Limited, Hanison Construction Holdings Limited, China International Capital Corporation Limited and C.M. Capital Advisors (HK) Limited. A board member of Qiu Shi Science & Technologies Foundation, a founding member of Moral Education Concern Group and a member of the Finance Committee and of the Council of The Hong Kong University of Science and Technology.

### Mr. CHEN Yih Pin

Aged 78. 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. Managing Director of The Shanghai Commercial & Savings Bank, Ltd.

## Mr. Gordon Che Keung KWONG, FCA

Aged 68. 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, China Power International Development Limited and FSE Engineering Holdings Limited.

## Mr. Richard Jason Lloyd YORKE

Aged 50. Appointed a Director of the Bank in June 2011. Executive Vice President and Chief Operating Officer of Wholesale Banking Group, Wells Fargo & Company. A Director of Wells Fargo International Banking Corporation and Wells Fargo Bank International Unlimited Company.

## Madam DAI Lanfang

Aged 63. Appointed a Director of the Bank in September 2015. Chairperson of Shanghai United International Investment Limited and Sino-US United MetLife Insurance Company Limited.

## Mr. E. Michael FUNG

Aged 61. Appointed a Director of the Bank in December 2015. Chairman and Principal of SouthBay Investment Advisors Limited. A member of the Financial Services Development Council, Hong Kong from 17 January 2013 to 16 January 2017.

## Mr. JIN Yu

Aged 53. Appointed a Director of the Bank in January 2016. Chairman of Bank of Shanghai and Bank of Shanghai (Hong Kong) Limited. A Director of Shanghai United International Investment Limited.

## Mr. John Con-sing YUNG

Aged 49. Appointed a Director of the Bank in May 2016 and had served as an Alternate Director of the Bank from March 2013 to May 2016. Director, Executive Vice President and Chief Information Officer of The Shanghai Commercial & Savings Bank, Ltd. A Director of Nanyang Holdings Limited.

## Mr. HO Yung-Chang

Aged 59. Appointed a Director of the Bank in April 2017. Executive Vice President & Head of Greater China Business Development and Advisory, Wells Fargo Bank, Philadelphia.

## SENIOR MANAGEMENT

### Mr. David Sek-chi KWOK

(Biographical details are set out on page 8)

### Mr. Nai-pan TANG

Aged 56. Deputy Chief Executive, Chief Risk Officer of the Bank. Joined the Bank in September 2015.

### Mr. Burton Chi-shan CHENG

Aged 56. Deputy Chief Executive, Chief of Information Technology & Operations of the Bank. Rejoined the Bank in August 1996.

### Mr. Mong-ting CHONG

Aged 55. Deputy Chief Executive, Chief of Corporate Banking & China Business. Joined the Bank in October 2015.

### Ms. Wendy Li-chien WENG

Aged 48. Executive Vice President, Chief Financial Controller of the Bank. Joined the Bank in May 2012.

### Mr. Ricky Chi-wai CHAN

Aged 46. Executive Vice President, Chief of Traditional Products of the Bank. Joined the Bank in February 2014.

### Mr. Edmund Kin-sang LAI

Aged 57. Executive Vice President, Chief of Treasury of the Bank. Joined the Bank in December 2014.

### Ms. Janet Hey CHONG

Aged 48. Executive Vice President, Chief of Wealth Management. Joined the Bank in May 2017.

## Mr. Michael Yiu-wing FUNG

Aged 60. Executive Vice President, Chief Auditor of the Bank. Joined the Bank in September 1982.

## Mr. Jerome Chee-keong GOH

Aged 45. Executive Vice President, Chief of Property Development of the Bank. Joined the Bank in November 2013.

## Mr. Timothy Wai-tai LAW

Aged 41. Executive Vice President, Chief of Legal & Compliance of the Bank. Joined the Bank in May 2016.

## Ms. Clara Chor-hing FUNG

Aged 56. Executive Vice President, Chief of Human Resources of the Bank. Joined the Bank in August 2016.

## TRIBANK STRATEGIC ALLIANCE
## 三行策略聯盟

### The 18th Tripartite Partnership Conference
### 第十八屆滬港台「上海銀行」業務研討會

The 18th Tripartite Partnership Conference was held in Taipei in November 2017 with the participation of senior executives from the three allied banks in Mainland China, Hong Kong and Taiwan.

This year's symposium focussed on 'pooling competitive advantages', 'intellectual innovation' and 'value sharing' among the three banks. There were presentations and group discussions on corporate finance, personal finance, channels, IT and FinTech, and back-office support. Through these discussions, the objectives on business collaboration and exchange were confirmed for the year ahead.

第十八屆滬港台「上海銀行」業務研討會於2017年11月假台北舉行，有多位來自滬港台三行聯盟的高級行政人員共同參與。

今年的研討會以「匯聚優勢 • 智慧創新 • 價值共享」為主題，三行就企業融資、個人金融、渠道、資訊科技與金融科技及後勤支援議題展開報告和分組討論，以達成共識，確認下年度具體業務合作與交流目標。








## Enhancing Tripartite Collaboration
## 加強三行合作範疇

Leveraging the three banks' strategic alliance, the Bank jointly organized workshops for front-line and supporting units with the Bank of Shanghai and The Shanghai Commercial and Savings Bank throughout the year to reinforce business collaboration and facilitate knowledge sharing.

利用三行的戰略聯盟優勢，本銀行於去年與上海銀行及上海商業儲蓄銀行一同為前線及後勤的部門舉辦工作坊，以加強業務合作及知識聯動互享。




Workshops were held for the three banks to reinforce business collaboration.

舉辦交流會加強三行業務合作。

## CORPORATE DEVELOPMENT
## 企業發展

On 29th November 2017, Shanghai Commercial Bank Limited issued its first corporate bond – the U.S.$250,000,000 Tier 2 subordinated notes, maturing in 2027 and with a coupon rate of 3.75% per annum. It was listed on the Hong Kong Stock Exchange on 30th November 2017. This milestone issue strengthens the Bank's capital base and branding.

上海商業銀行於2017年11月29日首次發行2.5億美元二級後償票據，並於2017年11月30日在香港聯合交易所上市。票據於2027年到期，票面年利率為3.75厘。此里程碑更提升了本銀行的資本基礎和品牌。

## AWARDS AND RECOGNITIONS
## 獎項及榮譽

### 2017 Hong Kong Life Top Producers Convention
### 2017 香港人壽傑出業務代表會議

In April 2017, Hong Kong Life Top Producers Convention was held in Gold Coast, Australia. The Bank was awarded the Four Stars Honor Award for the year for its outstanding sales performance.

2017年4月，香港人壽傑出業務代表會議於澳洲黃金海岸舉行。本銀行於過去一年在銷售方面表現卓越，榮獲四星榮譽大獎。






2017 Best SME's Partner Award — The Hong Kong General Chamber of Small and Medium Business (for the seventh consecutive year)

2017年中小企業最佳拍檔獎 — 香港中小型企業總商會（連續7年）



The Outstanding Brand Awards 2017 — Economic Digest

實力品牌大獎2017 — 經濟一週




'Hong Kong Leaders' Choice 2017 – Excellent Brand of Cross-Border Banking Services Award' — Metro Finance

「香港企業領袖品牌2017 — 卓越跨境企業銀行服務品牌獎」— 新城財經台及新城數碼財經台

## BRANCHES
## 分行




In April 2017, the Bank relocated West Point Branch, one of the best performing units, to Belcher's Street due to redevelopment of the building on Catchick Street.

因應本銀行西環吉席街物業重建，表現優秀的西環分行於2017年4月遷往卑路乍街並已投入服務。

Hennessy Road Branch
The best performing Branch in 2017.

軒尼詩道分行
2017年表現最卓越分行。






North Point Branch also performed well in 2017.

北角分行於2017年的表現亦屬優越。

## PRODUCTS AND SERVICES ENHANCEMENT
## 產品及服務提升

The Bank organized seminars and roadshows on Reverse Mortgage Programme across different districts in Hong Kong, helping customers understand an additional financial planning option to enhance their quality of life.

本銀行在香港各地區舉辦安老按揭計劃的研討會和路演，協助客戶了解其他財務策劃的方案，以提高他們的生活質素。




## New Products and Services
## 新產品及服務

Securities Service Promotion
證券服務推廣




Tax Loan Promotion
稅貸推廣




Trade Finance Services
貿易融資服務




Reverse Mortgage Promotion
安老按揭計劃推廣



Credit Card Promotion
信用卡推廣





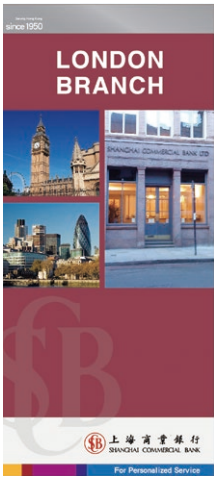








Overseas Branches
海外分行












# MESSAGE TO SHAREHOLDERS

The Board together with the management of Shanghai Commercial Bank Limited (the 'Bank') have notched a number of impressive accomplishments in 2017. We have focused on the execution of our 5-year strategic plan of 2017 to 2021.

In 2017, the consolidated profit after tax for 2017 hit a record high of HK$2,430 million, an increase of HK$518 million or 27.1% from that for 2016, largely attributable to increased contributions from net interest income, foreign exchange income, fee income as well as the stable and solid performance of the branches in the United States.

Total comprehensive income attributable to equity holders for the year ended 31st December 2017, however, decreased by HK$576 million or 21.5% to HK$2,100 million against 2016, mainly due to the mark-to-market valuation of the holdings in the listed Bank of Shanghai Co., Ltd. ('Bank of Shanghai') shares. On a year-on-year basis, total loans and advances increased significantly by 21.4%, and total customer deposits continued to grow by 7.4%. Our loan-to-deposit ratio rose to 54% at the end of 2017, compared with 47% at the end of 2016, while the impaired loan ratio also improved to 0.77% from 1.03% on a year-on-year basis, reflecting the Bank's determined efforts to improve and maintain good credit quality. Net interest income increased by 17.6% and net interest margin rose by 17 basis points to 1.86% for the year. Indicative of the satisfactory performance of our various business lines, net fee and commission income increased by 16.6%. An investment-friendly environment and a buoyant local stock market resulted in a 40.2% increase to HK$146 million from wealth management income while our securities brokerage registered corresponding growth of 41.3% to HK$216 million.

Corporate facility fees, trade financing and remittance income in aggregate grew by 9.8% to HK$280 million. However, life insurance noted a lower return at HK$42 million compared to that of last year, a decrease of 29.9%, mainly due to intense market competition.

The average yearly cost-to-income ratio improved to 33%, compared with that of 37% for 2016, mainly due to strong growth in operating income and relatively mild increase in operating expenses of 6.5% from that of the prior year. This increase reflected the Bank's efforts to enhance productivity and to ensure regulatory compliance with the support of the Board. These efforts also played a critical role in reinforcing our 'Three Lines of Defence' control system which was designed to combat and safeguard against anti-money laundering and various operational and technology risks, and to strengthen the Bank's risk governance framework.

The Bank's total assets at the end of 2017 amounted to HK$185 billion, representing an increase of 8.9% or HK$15 billion compared to that at the end of 2016. Returns on average total assets and average equity for the year were 1.4% and 9.7% respectively. Further, the Bank adhered to a prudent and robust asset and liability management strategy to help ensure our capital and liquidity levels continued to meet with both regulatory requirements and business growth objectives. The capital adequacy ratio was 18.9% at the end of 2017 while liquidity maintenance ratio averaged 45.6% for 2017, both at comfortable levels.

## Milestone

On 29th November 2017, the Bank successfully launched with positive market response, the maiden issuance of Tier 2 subordinated notes (the 'Notes') which are now listed under Stock Code 5043 on the Hong Kong Stock Exchange. The proceeds from the issuance are used to support the anticipated growth of the Bank's operations and to strengthen the capital base. The principal amount of the Notes is US$250,000,000 or HK$1.95 billion equivalent, and the coupon rate is 3.75% per annum. The Notes have 'BBB+' and 'Baa1' ratings assigned by Fitch and Moody's respectively. After the issuance of the Notes, the capital adequacy ratio of the Bank has grown by 1.4 percentage points, affording us additional ability to further expand our business.

On 20th March 2017, the Bank along with the other four shareholders of Hong Kong Life Insurance Ltd. ("Hong Kong Life") entered into an agreement with First Origin International Limited to sell to them our collective interest in Hong Kong Life for a total consideration of HK$7.1 billion. The closing of the transaction is subject to regulatory approvals.

We embarked on a number of initiatives to enhance both the Bank's corporate image and the intrinsic value of properties owned by the Bank and to bring in additional income streams as a result. We plan to redevelop our properties in West Point. This mixed-use project targeted for completion in 2021, will comprise residential flats for sale and commercial podium floors for leasing and our own use. In addition, design work is well underway for the refurbishment of our Mongkok building, with a target completion date in 2020.

## Business Strategies

We are positioned as a commercial bank with remarkable experience in trade financing and a niche in providing devoted personalized banking services to small and medium sized enterprises. Many of our customers have been banking with us for decades, and we leverage on our myriads of deep-rooted relationship to identify cross-selling opportunities benefitting both the Bank and the customers.

We shall continue to capitalize on the long-standing tri-bank strategic alliance with The Shanghai Commercial & Savings Bank, Ltd. in Taiwan and Bank of Shanghai in Mainland China and the extensive network to facilitate the provision of global business support and services to our customers in Hong Kong, and those of our branches in the Mainland China, the United Kingdom and United States.

We are also staying at the forefront in the development of Fintech and smart banking. In 2018, the Faster Payment System (FPS) and other related services will be implemented to interface with the Hong Kong Interbank Clearing Limited (HKICL) system in providing customers the capability to conduct transactions round-the-clock and in real-time on small money transfers, Store Value Facility (SVF) account top ups, electronic demand deposit accounts (eDDA) set up, and etc.

## Social Responsibility

The Bank strives to be a respected employer and corporate citizen. Over one-third of our staff have participated in serving the communities through our many charitable initiatives, which include volunteering, fundraising and corporate giving to organizations, as well as providing scholarship and internship opportunities to students of local universities and tertiary institutions. We have since 2015 continued to be the title sponsor of the Shanghai Commercial Pok Oi Cycle for Millions, with the objectives to raise funds for Pok Oi Hospital, promote environmentally friendly lifestyles, regular physical activities, and encouraging road and cycling safety.

## Looking Ahead

As the global economic outlook continues to improve, major advanced economies are likely to show moderate expansion in 2018 and the Hong Kong economy could continue to benefit. Meanwhile, a number of uncertainties remain in 2018, such as the impact of monetary policy normalization by major central banks worldwide including the US Federal Reserve, heightened geopolitical tensions and the recent rise of protectionist sentiment.

In the year ahead, we will continue to stay customer focused and improve service through investing in technology and upskilling our employees.

On behalf of the Board, we would like to welcome Mr. HO Yung-Chang, Executive Vice President and Head of Greater China Business Development and Advisory for Wells Fargo Bank, who joined our Board on 10th April 2017 as a Non-Executive Director, in place of Mr. John Van Antwerp RINDLAUB. We extend our deepest gratitude to Mr. RINDLAUB for his invaluable contributions to the Bank during his tenure on the Board from 2012 to 2017.

We also wish to express our appreciation to our fellow Directors for their wise counsel, to all staff members for their dedication and hard work, and to our customers and shareholders for their continuing support and confidence in the Bank.

**Stephen Ching Yen LEE**
Chairman

**David Sek-chi KWOK**
Managing Director & Chief Executive

Hong Kong, 19th March 2018

# REPORT OF THE DIRECTORS

The Directors have pleasure in presenting their report together with the audited consolidated financial statements for the year ended 31st December 2017.

## Principal activities

Shanghai Commercial Bank Limited (the 'Bank') and its subsidiaries (the 'Group') are engaged in the provision of banking and related financial services. The principal activities of the Bank's subsidiaries are set out in Note 24 to the consolidated financial statements.

## Business review

A fair review of the business and a discussion and analysis of the performance of the Group for the year ended 31st December 2017, particulars of important events affecting the Group that have occurred since the end of the year 2017 (if any) as well as an indication of likely future development in the business of the Group are provided in the Message to Shareholders of this Annual Report.

Description of the principal risks and uncertainties facing the Group can be found in the Message to Shareholders and in Note 3 to the consolidated financial statements for the year ended 31st December 2017.

Compliance with relevant laws and regulations which have a significant impact on the Group can be found in the Corporate Governance Report.

In addition, discussions on the Group's environmental policies and relationships with the key stakeholders that have a significant impact on the Group can be found in the Message to Shareholders and the Corporate Governance Report.

## Results and appropriations

The profits of the Group for the year ended 31st December 2017 are set out in the consolidated statement of profit or loss on page 45 of this Annual Report.

The Directors recommend the payment of a final dividend of HK$47 (2016: HK$47) per ordinary share totalling HK$940 million (2016: HK$940 million).

## Change of company status

By an ordinary resolution passed on 1st November 2017, the Bank has been converted from a private company to a public company.

## Share capital

The Bank did not issue any new share during the year. Details of the share capital of the Bank during the year are set out in Note 34 to the consolidated financial statements.

## Debentures issued

On 29th November 2017, the Bank had launched its first 10-year Basel III-compliant Tier-2 subordinated notes (the 'Notes') for US$250 million, with a coupon rate of 3.75% per annum payable semi-annually and maturing in 2027 (callable in 2022). The Notes, with credit rating of "BBB+" assigned by Fitch and "Baa1" assigned by Moody's, were publicly listed on The Stock Exchange of Hong Kong Limited on 30th November 2017. After deducting the issuance costs, the Bank received net proceeds from the issuance of approximately US$248 million (HK$1,938 million equivalent) which are used to strengthen the capital base and to fund the business growth of the Bank.

## Equity-linked agreements

During the year ended 31st December 2017, the Bank did not enter into any equity-linked agreement.

## Donations

Charitable and other donations made by the Group during the year amounted to HK$7,398,000 (2016: HK$9,739,000).

## Directors

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

| | |
|---|---|
| **# Hung-ching YUNG** | |
| *** Dr. Richard LEE** | |
| *** Johnson Mou Daid CHA** | |
| (Dr. LAM Chat Yu, Alternate) | (resigned on 1st March 2017) |
| **^ David Sek-chi KWOK** | |
| **+ Stephen Ching Yen LEE** | |
| **# CHEN Yih Pin** | |
| *** Gordon Che Keung KWONG** | |
| **# Richard Jason Lloyd YORKE** | |
| (CHANG Hwa Ping, Alternate) | (resigned on 10th April 2017) |
| (Ignatius Wooi-kean CHOONG, Alternate) | (appointed on 10th April 2017 and resigned on 24th January 2018) |
| **# John Van Antwerp RINDLAUB** | (resigned on 10th April 2017) |
| (Ignatius Wooi-kean CHOONG, Alternate) | (resigned on 10th April 2017) |
| **# DAI Lanfang** | |
| (YE Jun, Alternate) | (resigned on 24th January 2018) |
| *** E. Michael FUNG** | |
| **# JIN Yu** | |
| (HUANG Tao, Alternate) | (resigned on 24th January 2018) |
| **# John Con-sing YUNG** | |
| **# HO Yung-Chang** | (appointed on 10th April 2017) |

^ Executive Director

\+ Non-executive Chairman

\# Non-executive Director

* Independent Non-executive Director

## Directors (Continued)

On 10th April 2017, the Hong Kong Monetary Authority ('HKMA') gave written consent to the appointment of Mr. HO Yung-Chang as a Director of the Bank, which took effect on the same date. He retired in accordance with Article 95 of the Bank's Articles of Association at the Annual General Meeting held on 13th April 2017 and was re-elected as a Director of the Bank.

The Directors retiring by rotation in accordance with Article 104(A) of the Bank's Articles of Association are, Dr. Richard LEE, Mr. Johnson Mou-daid CHA, Mr. Gordon Che Keung KWONG and Mr. Richard Jason Lloyd YORKE who, being eligible, offer themselves for re-election at the forthcoming Annual General Meeting.

All the resigned Directors/Alternate Directors confirmed that they have no disagreement with the Board and that nothing relating to the affairs of the Bank needs to be brought to the attention of the shareholders of the Bank.

## Directors of subsidiaries

The names of all directors who have served on the boards of the subsidiaries of the Bank during the year and up to the date of this report are set out below:

Hung-ching YUNG, David Sek-chi KWOK, Ricky Chi-wai CHAN, Timothy Kam-tim CHAN, CHAN Pak Cheung*, Burton Chi-shan CHENG, CHENG Ming Ho, CHIOU Yi-jen, Janet Hey CHONG, Jerome Chee-keong GOH, Zachary Wing-kwong KWAN, Eric Wing-hong KO, Jason Chin-keung LAW*, Matthew Wai-hung LAW, Philip She-hoi LEE, Amanda Lai-yun LIU*, LI Yiu Ki, Brenda Fen LEE, Riggs Kwok-ching TAM, Right Honour Investments Limited, Wendy Li-chien WENG, Philip Wing-cheong WONG, Sammy Tak-keung WONG, Shanghai Commercial Bank Limited, Sharon Kam-wing WONG, William Wai-leung WONG

* Resigned/ceased as a director of the relevant subsidiary(ies) of the Bank.

## Directors' interests

At no time during the year was the Bank, or any of its holding company, subsidiaries or fellow subsidiaries a party to any arrangement to enable the Directors and the Chief Executive of the Bank (including their spouses and children under 18 years of age) to acquire benefits by means of the acquisition of any interests or short positions in the shares or underlying shares in, or debentures of, the Bank or any other body corporate.

## Directors' interests in transactions, arrangements or contracts

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

## Permitted indemnity provision

Pursuant to the Bank's Articles of Association, every Director or other officer of the Bank shall be entitled to be indemnified out of the assets of the Bank against all losses and liabilities (to the extent permitted by the Companies Ordinance) incurred by such Director or other officer in the execution of his/her duties or otherwise in relation thereto. Insurance cover has been arranged to indemnify the Directors and other officers of the Group.

## Management contracts

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

## Compliance with the Banking (Disclosure) Rules

The Bank has complied with the disclosure requirements set out in the 'Banking (Disclosure) Rules' and the 'Guideline on the Application of the Banking (Disclosure) Rules' contained in the Supervisory Policy Manual issued by the HKMA.

## Compliance with the Corporate Governance Code

Details of the Bank's corporate governance practices are set out in the Corporate Governance Report in this Annual Report.

## Auditor

The consolidated financial statements have been audited by PricewaterhouseCoopers who will retire at the forthcoming Annual General Meeting of the Bank and, being eligible, offer themselves for re-appointment.

On behalf of the Board
**Stephen Ching Yen LEE**
Chairman

Hong Kong, 19th March 2018

Shanghai Commercial Bank Limited (the 'Bank') and its subsidiaries (the 'Group') are committed to maintaining good corporate governance to safeguard the interests of the shareholders, depositors and other relevant stakeholders. The Bank is an authorized institution supervised by the Hong Kong Monetary Authority ('HKMA') under the Banking Ordinance. Throughout the year ended 31st December 2017, the Bank has followed the module on 'Corporate Governance of Locally Incorporated Authorized Institutions' of the Supervisory Policy Manual ('SPM CG-1') issued by the HKMA.

The Bank, after taking into consideration its particular circumstances as a non-listed public company, has also adopted the code provisions in the Corporate Governance Code (the 'CG Code') as stated in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the 'Listing Rules') that are relevant to the Bank. This Corporate Governance Report is prepared with reference to the CG Code.

## Board of Directors

The Board has collective responsibility for promoting the long-term sustainability and success of the Bank by directing and supervising its affairs within a framework of prudent and effective controls. The Board takes into account the legitimate interests of shareholders, customers, employees and other relevant stakeholders.

The Board is responsible for providing strategic direction and overseeing the implementation of strategic objectives and goals by the Management. The Board has established Board-level specialized committees with clear delegation of authority and formal terms of reference setting out the authorities, responsibilities and membership for the oversight of certain major functional areas. Each Board-level specialized committee, including the Executive Committee, Audit Committee, Nomination Committee, Remuneration Committee and Risk Committee (formerly known as Risk Management Committee), is provided with sufficient resources to perform its duties.

### Chairman and Chief Executive

The roles of Chairman of Board and Chief Executive are separate and are taken up by the different persons.

The Chairman, Mr. Stephen Ching Yen LEE who is a Non-executive Director, is responsible for leading the Board and monitoring the overall effective functioning of the Board, as well as ensuring all key and appropriate issues are discussed by the Board in a timely manner.

The Chief Executive, Mr. David Sek-chi KWOK who is an Executive Director, is responsible for implementing the strategies and policies as established by the Board. The Chief Executive is also responsible for the management and day-to-day running of the Bank's business and operations as well as leading and chairing the Executive Committee.

## Board Composition

The Board comprises Directors with a variety of backgrounds and a diverse range of business, banking and professional expertise. The Board also has a well-balanced composition of Executive Director, Non-executive Directors and Independent Non-executive Directors ('INEDs') to ensure the independence and objectivity of the decisions of the Board as well as the robustness and impartiality of the Board's oversight of the Management.

The Board currently comprises thirteen Directors, including eight Non-executive Directors, one Executive Director and four INEDs whose biographical details are individually set out in the 'Biographical Details of Directors and Senior Management' section of this Annual Report.

The Bank is in the process of fulfilling the requirement under SPM CG-1 of having sufficient number of INEDs to make up one-third of Board members. Further, the Bank has received from each of the INEDs an annual confirmation of his independence. The independence of the INEDs has been assessed in accordance with the guidelines set out in Rule 3.13 of the Listing Rules as well as the factors outlined in HKMA's circular on 'Empowerment of Independent Non-Executive Directors (INEDs) in the Banking Industry in Hong Kong' issued on 14 December 2016. The Board considers that all INEDs continue to be independent of the Management and free of any relationship that could materially interfere with the exercise of their independent judgment.

Among the eight Non-executive Directors of the Bank, Mr. Hung-ching YUNG is the grandfather of Mr. John Con-sing YUNG. Save as aforesaid, there is no relationship (including financial, business, family or other material/relevant relationship(s)) among Board members.

The Bank has maintained on its website (www.shacombank.com.hk) an updated List of Directors identifying their roles and functions and whether they are INEDs.

## Appointment and Re-election of Directors

The Board is empowered under the Articles to appoint any person as a Director either to fill a casual vacancy or as an addition to the Board. The Nomination Committee is responsible for reviewing any proposed appointment, mainly based on merits but also having due regard to the benefits of diversity of the Board, and making recommendation to the Board for consideration and approval. Pursuant to the relevant requirements in the Banking Ordinance, approval from the HKMA for any new appointment is required and will also be sought.

All new Directors appointed by the Board are subject to re-election by shareholders of the Bank at the next annual general meeting after their appointments have become effective. There is no specified term of appointment for all Directors. However, the Articles stipulate that at each annual general meeting one-third of the Directors (excluding the Executive Director holding the office as Chief Executive) who have been longest in office since their last election shall retire and shall be eligible for re-election.

## Board Process

The Board meets regularly to formulate objectives, strategies, business plans and annual budgets and to assess the Bank's performance, position and prospects throughout the year. All Directors have unfettered access to board papers and related materials which are provided in a timely manner. The Corporate Secretary keeps the minutes of Board meetings.

Schedule for regular Board and Committee meetings in each year is made available to all Directors before the end of the preceding year to facilitate their attendance. Directors have demonstrated strong commitment in attending meetings over the years. All Directors are also given an opportunity to propose matters in the meeting agenda. During the year, the Board held five meetings and discussed, among other things, the following important matters:

- half-yearly progress report on the 5-year plan for 2017-2021
- annual budget
- interim and annual financial statements
- annual compliance report
- risk appetite statement
- annual risk assessment report
- half-yearly summary report on stress tests
- various significant policies and plans including Credit Risk Policy, Customer Acceptance and Anti-money Laundering and Counter-terrorist Financing Policy, Compliance Policy, Capital Policy, Remuneration Policy, Recovery Plan and Business Continuity Planning Policy
- Internal Capital Adequacy Assessment Process
- implementation of corporate vision, mission and values

To enable Board members to have a fair understanding and hence assessment of the Bank's performance, review of the main economic changes in Hong Kong is provided to Board members at each regular Board meeting in addition to regular financial and business reports.

The Bank has arranged directors and officers liability insurance cover to indemnify the Directors and other officers against any potential liability arising from the Bank's business activities to which such Directors and officers may be held liable.

## Directors' Attendance Records

The attendance records of Board meetings and Annual General Meeting ("AGM") during the year ended 31st December 2017 are set out in the following table:

| | No. of meetings attended/No. of meetings held | |
|---|---|---|
| **Non-executive Directors** | Board | AGM |
| Mr. Stephen Ching Yen LEE – Chairman of the Board | 5/5 | 1/1 |
| Mr. Hung-ching YUNG | 4/5 | 1/1 |
| Mr. CHEN Yih Pin | 4/5 | 1/1 |
| Mr. Richard Jason Lloyd YORKE (Mr. CHANG Hwa Ping, Alternate who resigned on 10th April 2017) (Mr. Ignatius Wooi-kean CHOONG, Alternate with effect from 10th April 2017 who then resigned on 24th January 2018) | 5/5 | 1/1 |
| Mr. John Van Antwerp RINDLAUB (Mr. Ignatius Wooi-kean CHOONG, Alternate), resigned on 10th April 2017 | 1/1 *(Note 1)* | N/A |
| Madam DAI Lanfang (Mr. YE Jun, Alternate who resigned on 24th January 2018) | 5/5 | 1/1 |
| Mr. JIN Yu (Mr. HUANG Tao, Alternate who resigned on 24th January 2018) | 4/5 *(Note 2)* | 1/1 |
| Mr. John Con-sing YUNG | 5/5 | 1/1 |
| Mr. HO Yung-Chang, appointed on 10th April 2017 | 4/4 | 1/1 |
| **Executive Director** | | |
| Mr. David Sek-chi KWOK – Managing Director & Chief Executive | 5/5 | 1/1 |
| **Independent Non-executive Directors** | | |
| Dr. Richard LEE | 5/5 | 1/1 |
| Mr. Johnson Mou Daid CHA (Dr. LAM Chat Yu, Alternate who resigned on 1st March 2017) | 5/5 | 1/1 |
| Mr. Gordon Che Keung KWONG | 5/5 | 1/1 |
| Mr. E. Michael FUNG | 5/5 | 1/1 |

The Board has not adopted code provision A.6.6 of the CG Code in relation to the Directors' disclosure of time involved in public companies or organizations and other significant commitments as it is considered not applicable to the Bank for the time being but the matter would be evaluated whenever necessary.

*Notes*

1. *The alternate director to Mr. John Van Antwerp RINDLAUB attended one Board Meeting.*
2. *The alternate director to Mr. JIN Yu attended three Board Meetings.*

## Board-level Specialized Committees

The Board has established five Committees, namely, the Executive Committee, the Audit Committee, the Remuneration Committee, the Nomination Committee and the Risk Committee, to assist it in carrying out its responsibilities. Each of these Committees has specific written terms of reference, which set out in detail their authorities and responsibilities.

### Executive Committee

The Executive Committee operates as a general management committee under the direct authority of the Board to oversee the management and day-to-day running of the Bank in accordance with its terms of reference and such other policies and directives as the Board may determine from to time.

The Executive Committee provides regular updates to the Board on the business performance of the Bank by way of presenting quarterly reports on financial performance and half-yearly progress reports on business plans and budgets. Minutes of monthly meetings of the Executive Committee are also sent to all Directors for review.

The Executive Committee currently consists of four members including one Executive Director and three Non-executive Directors who are representatives from each of the three substantial shareholders.

A total of twelve monthly meetings of the Executive Committee were held in 2017 and attendance records thereof are set out below:

| | No. of meetings attended/No. of meetings held |
|---|---|
| Mr. David Sek-chi KWOK – Chairman | 12/12 |
| Mr. Hung-ching YUNG | 12/12 |
| Mr. John Van Antwerp RINDLAUB (Mr. Ignatius Wooi-kean CHOONG, Alternate), resigned on 10th April 2017 | 3/3 *(Note 1)* |
| Madam DAI Lanfang (Mr. YE Jun, Alternate who resigned on 24th January 2018) | 12/12 *(Note 2)* |
| Mr. HO Yung-Chang, appointed on 10th April 2017 | 9/9 |

*Notes*

1. *The alternate director to Mr. John Van Antwerp RINDLAUB attended three Executive Committee Meetings.*
2. *The alternate director to Madam DAI Lanfang attended one Executive Committee Meeting.*

## Audit Committee

The Audit Committee considers the nature and scope of audit reviews and reviews the Bank's financial statements, the findings of both internal and external auditors and the effectiveness of the internal control systems of the Bank. During the year, the Board has delegated its corporate governance functions as set out in code provision D.3.1 of the CG Code to the Audit Committee. The Bank has made available on its website the latest Terms of Reference of the Audit Committee.

The Audit Committee currently consists of three members, including one Non-executive Director and two INEDs, one of whom is the Chairman who possesses appropriate accounting qualifications and related financial management expertise.

The Audit Committee held four meetings in 2017 with the Bank's executives including the Chief Executive, Chief Financial Controller, Chief Auditor and representatives from the Bank's external auditor in attendance. The Audit Committee also met with the representatives of the Bank's external auditor in the absence of the Senior Management in accordance with its Terms of Reference.

Attendance records of the Audit Committee are set out below:

| | No. of meetings attended/No. of meetings held |
|---|---|
| Mr. Gordon Che Keung KWONG – Chairman | 4/4 |
| Dr. Richard LEE | 4/4 |
| Mr. John Con-sing YUNG | 4/4 |

The following is a summary of the major work performed by the Audit Committee:

- Review and making recommendations to the Board for approval of the Terms of Reference of the Audit Committee
- Review and making recommendations to the Board for approval of the 2016 audited financial statements of the Group and the 2017 interim financial disclosure statement
- Review of the remuneration and terms of engagement of the external auditor and making recommendations to the Board for approval of their reappointment
- Review and approval of the Policy on Non-audit Services, review the non-audit services provided by the external auditor and other professional firms on a semi-annual basis
- Review of the independence, objectivity and effectiveness of the audit process of the external auditor and discussion of their audit work
- Review and approval of the Internal Audit Charter and Internal Audit Policy and Procedures
- Review and approval of the internal audit plan
- Review the internal audit report, including findings and recommendations
- Review of the annual compliance report for the year 2016 and approval of the compliance plan for the year 2017
- Review of the summary report from the Legal and Compliance Division of the Group on the HKMA examinations and regulatory concerns as well as management's actions in implementing the HKMA's recommendations
- Review of the Group's financial and accounting policies and practices and making recommendations to the Board for approval
- Review of the highlights of major new accounting and financial reporting standards and guidance issued by the Hong Kong Institute of Certified Public Accountants as well as impact to the Group on their adoption

## Remuneration Committee

The Remuneration Committee oversees the implementation of a sound remuneration policy including recommending to the Board on the remuneration of the Directors and Senior Management of the Bank, sometimes with the assistance of independent professional consultants. No Director or any of their associates is involved in deciding his/her own remuneration. The Bank has made available on its website the latest Terms of Reference of the Remuneration Committee.

The remuneration policy of the Group is reviewed by the Remuneration Committee and approved by the Board. Details of remuneration for senior management and key personnel of the Group during the year are disclosed in Section 5 'Supplementary Financial Information' of this Annual Report in accordance with SPM CG-5 Guideline on a Sound Remuneration System with the exception of details of remuneration by band for the Senior Management. The Board currently considers such disclosure inappropriate for the time being but would evaluate the matter whenever necessary.

The Remuneration Committee currently consists of three members including one Non-executive Director and two INEDs with one being the Chairman.

The Remuneration Committee held two meetings in 2017 with the Bank's Chief of Human Resources in attendance and attendance records thereof are set out below:

| | No. of meetings attended/No. of meetings held |
|---|---|
| Mr. Johnson Mou Daid CHA – Chairman[Note 1] | 2/2 |
| (Dr. LAM Chat Yu, Alternate who resigned on 1st March 2017) | |
| Mr. Hung-ching YUNG[Note 1] | 2/2 |
| Dr. Richard LEE | 2/2 |

The following is a summary of the major work performed by the Remuneration Committee:

- Review and making recommendations to the Board for approval of the Terms of Reference of Remuneration Committee and Remuneration Policy
- Review and making recommendations to the Board for approval of the remuneration packages of the Non-executive Chairman, Senior Management and key personnel of the Bank
- Review culture-related matters of the Bank and making recommendations to the Board for approval

*Note*

1. *Mr. Johnson Mou Daid CHA was appointed as Chairman of the Remuneration Committee of the Bank with effect from 16th August 2017 in place of Mr. Hung-ching YUNG.*

## Nomination Committee

The Nomination Committee considers the structure, size and composition of the Board and is responsible for recommending to the Board on matters relevant to appointments, re-appointments, removal and succession planning of Directors and Senior Management in accordance with the Bank's business strategies.

The Nomination Committee currently consists of three members including one Non-executive Director and two INEDs with one being the Chairman.

The Nomination Committee held two meetings in 2017 with the Bank's Chief of Human Resources in attendance. Attendance records of the Nomination Committee are set out below:

| | No. of meetings attended/No. of meetings held |
|---|---|
| Dr. Richard LEE – Chairman[Note 1] | 2/2 |
| Mr. Stephen Ching Yen LEE[Note 1] | 2/2 |
| Mr. Johnson Mou Daid CHA (Dr. LAM Chat Yu, Alternate who resigned on 1st March 2017) | 2/2 |

The following is a summary of the major work performed by the Nomination Committee:

- Review and making recommendations to the Board for approval of the Terms of Reference of the Nomination Committee
- Review of the structure, size and composition of the Board and its Board-level specialized committees
- Review of and making recommendations to the Board for approval of nomination and reappointment of Directors
- Review of the senior management organization structure, appointment of and promotion to senior management and making recommendations to the Board for approval of the succession plan of the Bank

*Note*

1. *Dr. Richard LEE was appointed as Chairman of the Nomination Committee of the Bank with effect from 16th August 2017 in place of Mr. Stephen Ching Yen LEE.*

## Risk Committee

The Risk Committee oversees the Bank's high-level risk related matters review and makes recommendations to the Board on risk management strategies as well as the risk tolerance and risk appetite of the Bank. On 25th October 2017, the Risk Committee changed to its present name from Risk Management Committee to better reflect its scope of work.

The Risk Committee currently consists of three members who are all INEDs.

The Risk Committee held four meetings in 2017 with the Bank's executives in attendance, including the Chief Executive, the Chief Risk Officer and the Chief Financial Controller. The Risk Committee also met with the Chief Risk Officer in the absence of the Executive Director and Senior Management in accordance with its Terms of Reference.

The attendance records of the Risk Committee are set out below:

| | No. of meetings attended/No. of meetings held |
|---|---|
| Mr. E. Michael FUNG – Chairman[Note 1] | 4/4 |
| Mr. Johnson Mou Daid CHA (Dr. LAM Chat Yu, Alternate who resigned on 1st March 2017)[Note 1] | 4/4 |
| Mr. Gordon Che Keung KWONG | 4/4 |

The following is a summary of the major work performed by the Risk Committee:

- Review and making recommendations to the Board for approval of the Terms of Reference of the Risk Committee, Asset and Liability Committee, Credit Committee and Operational Risk Management Committee
- Review of the quarterly report on risk exposures and risk management activities of the Bank
- Review and making recommendations to the Board for approval of the Risk Appetite Statement
- Review and making recommendations to the Board for approval of the Internal Capital Adequacy Assessment Process
- Review and making recommendations to the Board for approval of the Group Recovery Plan
- Review and making recommendations to the Board for approval of the high-level risk-related policies of the Bank
- Review of reports on anti-money laundering related matters
- Review and overseeing management of cybersecurity risk
- Review of the Whistleblowing Policy and the report from Chief Risk Officer on whistleblowing cases
- Review of the material regulatory requirements and examination reports from HKMA and the follow-up actions taken by the Management
- Review of reports on the independent assessment of the Bank's information and technology system related to its emerging and existing e-banking services

*Note*

1. *Mr. E. Michael FUNG was appointed as Chairman of the Risk Committee of the Bank with effect from 16th August 2017 in place of Mr. Johnson Mou Daid CHA.*

## Delegation by the Board

In addition to the Executive Committee, Audit Committee, Remuneration Committee, Nomination Committee and Risk Committee (formerly known as Risk Management Committee) as described above, the Board has also established the following management-level key specialized committees, each of which has specific written Terms of Reference in order to ensure that they discharge their functions properly and that their meeting minutes are sent to all Directors for review.

Information on these committees is set out below:

### Asset and Liability Committee

The Asset and Liability Committee meets at least monthly to deal with issues related to the market, interest rate and liquidity risks of the Bank and reports directly to the Executive Committee and Risk Committee.

The members of the Asset and Liability Committee are the Chief Executive (Chairman), the Chief Risk Officer and Chiefs/Heads of divisions responsible for compliance, risk management, financial control, treasury, corporate banking, local and overseas branches administration, regulated and traditional products and human resources of the Bank.

### Credit Committee

The Credit Committee meets at least monthly to deal with all credit risk-related issues of the Group such as establishing credit policies, monitoring loan portfolio quality, ensuring compliance with statutory and internal lending limits, evaluating credit applications, making credit decisions, etc. The Credit Committee reports directly to the Executive Committee and Risk Committee.

The members of the Credit Committee are the Chief Executive (Chairman), the Chief Risk Officer, Head of Credit, Head of Credit Appraisal, Head of Credit Control and other Chiefs/Heads of divisions responsible for treasury, corporate banking, local and overseas branches administration, regulated and traditional products of the Bank.

### Operational Risk Management Committee

The Operational Risk Management Committee meets at least once every two months to deal with the major aspects of the Bank's operational risk as a distinct category of risk and to define the operational risk strategy within the Bank's overall business objectives. The Operational Risk Management Committee reports directly to the Executive Committee and Risk Committee.

The members of the Operational Risk Management Committee are the Chief Executive (Chairman), the Chief Risk Officer and Chiefs/Heads of divisions responsible for legal matters, compliance, risk management, treasury, corporate banking, local and overseas branches administration, information technology, operations centres, regulated and traditional products, human resources and property/premises of the Bank.

## Directors' Securities Transactions

The Board has not adopted code provision A.6.4 of the CG Code in relation to the setting up of written guidelines for Directors and relevant employees in respect of their dealings in the Bank's securities as the Bank's shares are not publicly listed.

## Induction and training for Directors

Each newly appointed Director receives an information package on the scope of duties and obligations to be observed by a Director. Further, to enable the Directors to have a proper understanding of the Bank's operations and business, their responsibilities under applicable laws and regulations as well as the development trends in the industry, the Bank arranges and provides trainings and timely information to Directors on corporate structure and profile, board composition, senior management profile, Anti-money Laundering, legal, regulatory and compliance updates, changes in accounting standards, etc. During the year, the Bank arranged trainings for Directors on Anti-money Laundering and International Financial Reporting Standard 9 "Financial Instruments". Directors are also informed of and encouraged to attend outside talks, trainings and, seminars organized by professional bodies at the Bank's expenses to enrich their knowledge in discharging their duties as a director. The training attendance records of the Directors for each year are maintained by the Corporate Secretary.

The key areas of training received by current Directors of the Bank to update and develop their skills and knowledge during the year 2017 are summarized as follows:

| | Training areas | |
|---|---|---|
| **Directors** | **Regulatory updates** | **Events/ Seminars/ Conferences relevant to the Bank's business and corporate governance** |
| **Non-executive Directors** | | |
| Mr. Stephen Ching Yen LEE | ✓ | ✓ |
| Mr. Hung-ching YUNG | ✓ | ✓ |
| Mr. CHEN Yih Pin | ✓ | ✓ |
| Mr. Richard Jason Lloyd YORKE | ✓ | ✓ |
| Madam DAI Lanfang | ✓ | ✓ |
| Mr. JIN Yu | ✓ | ✓ |
| Mr. John Con-sing YUNG | ✓ | ✓ |
| Mr. HO Yung-Chang | ✓ | ✓ |
| **Executive Director** | | |
| Mr. David Sek-chi KWOK | ✓ | ✓ |
| **Independent Non-executive Directors** | | |
| Dr. Richard LEE | ✓ | ✓ |
| Mr. Johnson Mou Daid CHA | ✓ | ✓ |
| Mr. Gordon Che Keung KWONG | ✓ | ✓ |
| Mr. E. Michael FUNG | ✓ | ✓ |

## Accountability and Audit

### Directors' Responsibility in relation to Financial Reporting

The Directors are responsible for presenting a balanced, clear and comprehensive assessment of the Bank's performance, position and prospects. As such, the Management assists the Directors to discharge their duties through the submission of monthly financial and business updates of the Bank. Representatives of the Senior Management of core business lines or control functions are invited to attend Board/Board Committee meetings as appropriate to provide sufficient explanation and information, critical insights and analyses of the Bank's affairs relating to their areas of expertise to the Directors.

The Directors acknowledge their responsibility for preparing the financial statements of the Group in accordance with statutory requirements and applicable accounting standards. The Group's annual and interim results are reviewed by the Audit Committee and announced in a timely manner. As at 31st December 2017, the Directors of the Bank were not aware of any material uncertainties relating to events which may cast significant doubt upon the Group's ability to continue as a going concern. Accordingly, the Group's financial statements have been prepared on a going concern basis.

The statement of the Bank's external auditor concerning its reporting responsibilities on the Bank's consolidated financial statements and the key audit matters identified during the course of the audit are set out in the Independent Auditor's Report attached to the Bank's 2017 Consolidated Financial Statements.

### Risk Management and Internal Controls

The Board is responsible for overseeing risk management and internal control systems including financial, operational and compliance controls and reviewing their effectiveness to achieve business objectives and safeguard shareholders' interests and the Group's assets.

Well-established organizational structure and comprehensive policies and procedures are in place for ensuring effective checks and balances; managing possible gaps in achieving behind business objectives; safeguarding assets against unauthorized use or disposition; maintaining proper accounting records and ensuring the reliability of financial information used within the business or for publication. The procedures, providing reasonable but not absolute assurance against material errors, losses or fraud, are designed to ensure compliance with applicable laws, rules and regulations.

The Group has set up specialized committees and related departments which are responsible for identifying, assessing and managing key risks facing the Bank including credit risk, market risk, liquidity risk, operational risk, interest rate risk, strategic risk, legal and compliance risk and reputation risk through implementing appropriate policies and procedures. Periodic reports on risk exposure and risk management activities are submitted to the Executive Committee and Risk Committee through the Asset and Liability Committee, Credit Committee and Operational Risk Management Committee and ultimately to the Board for monitoring the risk management and internal control systems. The Group's risk management strategies, risk tolerance and risk appetite are reviewed by the Risk Committee and approved by the Board.

The Audit Committee reviews the external auditor's reports in connection with the annual audit and the recommendations on internal control arising therefrom.

## Risk Management and Internal Controls (Continued)

In view of the fact that banking is one of the highly regulated industries in Hong Kong and is subject to various laws and regulations including but not limited to the Banking Ordinance, Anti-money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance, Personal Data (Privacy) Ordinance, Foreign Account Tax Compliance Act and Common Reporting Standard on Automatic Exchange of Financial Account Information in Tax Matters, the Group has put in place a robust control framework to ensure compliance with applicable laws, rules, regulations and supervisory standards. Latest regulatory requirements are promptly brought to the attention of responsible units with revised guidelines and advices delivered for their implementation and strict adherence. Key compliance alerts and information are regularly reported to the Senior Management and the Board. Sufficient resources are also made available to ensure proper legal and regulatory compliance.

Whistleblowing Policy has been established for employees to raise their genuine concerns in good faith about malpractice, impropriety, misconduct or unethical activity that they are aware of and which could compromise the interests of the customers, staff, shareholders, the public and/or the Group's image and reputation. All information received is treated confidentially and the identity and interests of all whistle-blowers are protected.

## Internal Audit

The Internal Audit Function plays an important role in reinforcing the "Three Lines of Defence" risk management structure of the Bank. As the third line of defence, the Internal Audit function provides independent assurance to the Audit Committee and the Board as to whether the internal control system of the Group is adequate and effective. It has unfettered access to Senior Management for seeking information and explanation on audit matters. The Chief Auditor of the Bank who leads a team with professional expertise reports directly to the Audit Committee.

The Internal Audit function adopts a risk-based approach in its auditing activities. It sets its internal audit plan annually based on risk assessment methodology which assists in prioritizing audit resources and focusing on higher risk areas. The review results are reported regularly to the Audit Committee. The Internal Audit function also verifies the implementation effectiveness of the recommendations on internal controls made by external auditors and regulatory bodies.

## External Auditor

The Group's external auditor is PricewaterhouseCoopers. The Audit Committee is primarily responsible for making recommendations to the Board on the appointment, reappointment and removal of the external auditor, including their remuneration and terms of engagement. The Audit Committee also regularly reviews and monitors the independence and objectivity as well as the effectiveness of the audit process of the external auditor.

To safeguard the independence of the external auditor, the Bank has established the Policy on Non-audit Services, setting out the criteria for appointing the external auditor to provide non-audit services. For the year ended 31st December 2017, fees payable to the external auditor of the Group amounts to HK$20,102,000 (2016: HK$15,920,000), of which HK$9,354,000 (2016: HK$7,283,000) is for statutory audit and HK$10,748,000 (2016: HK$8,637,000) is for non-statutory audit along with other main services such as tax, computer system audit and independent assessments on ad hoc projects.

The Board, on recommendation by the Audit Committee, will propose that PricewaterhouseCoopers be re-appointed as auditor of the Group at the Annual General Meeting of the Bank to be held on 18th April 2018.

## Company Secretary

The company secretary is an employee of the Bank who provides support to the Board by ensuring timely information flow; Board procedures are followed; and the Bank's Articles of Association, relevant rules and regulations including SPM CG-1 and the CG Code are complied with. The company secretary also advises the Board on corporate governance matters and facilitates the induction programme of new Directors and the continuous professional development of existing Directors.

During the year, the company secretary undertook over 15 hours of relevant professional training.

## Employees

As of 31st December 2017, the total headcount of the Group was 1,792.

Staff members are regarded by the Bank as the most important and valuable asset, and the key to its success. As a caring employer, the Bank strives to build an engaged workforce through maintaining the well-being of individuals as well as their families. In addition to offering competitive remuneration package, recognition and career advancement, the Bank has introduced various family-friendly initiatives including organizing/sponsoring recreational activities and corporate social responsibility events which help promote a healthy work-life balance.

On the training side, comprehensive induction programmes are provided to staff to help them understand the Bank's history, vision, mission, values, related regulatory requirements and procedural guidelines, etc. Specialized trainings in respect of operations, compliance and credit risks are also provided to enhance their knowledge in general banking operations, new products and services, selling skills and communication, regulatory updates, compliance and risk management, anti-money laundering, etc. Education sponsorship is also available to support the staff in their acquisition of relevant professional/academic qualifications.

## Shareholders' Rights

Each shareholder currently has director representation on the Board through which effective communication with shareholders regarding the business and affairs of the Bank is maintained. Shareholders are well informed of their rights to call an extraordinary general meeting of the Bank, the procedures by which enquiries may be put to the Board and proposals may be put forward at shareholders' meetings as stipulated under Sections 566 to 568 and 615 of the Companies Ordinance. The Corporate Secretary acts as the contact to enable these enquiries or proposals to be properly directed.

The Chairman of the Board is committed to maintaining constant communication with the shareholders to ensure that they have fair and timely access to the Bank's information. All announcements, regulatory disclosures, annual/interim reports and press releases of the Bank are available on the corporate website (www.shacombank.com.hk). Press conference is held to disseminate half-yearly and annual financial results of the Bank. As the Bank is a non-listed public company and the four shareholders meet and communicate regularly, the Board considers it unnecessary for the time being to adopt CG Code provision E.1.4 but the matter would be evaluated whenever necessary.

## Amendments to Constitutional Documents

On 1st November 2017, the Shareholders of the Bank passed, by way of written resolutions, an ordinary resolution to approve the conversion of the company status of the Bank from a private company to a public company and the corresponding special resolution to approve the deletion of Article 3 of the Bank's Articles of Association in its entirety in order to be qualified as a public company with an aim to take advantage of flexible capital planning going forward.

Hong Kong, 19th March 2018

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

(Incorporated in Hong Kong with limited liability)

## Opinion

*What we have audited*

The consolidated financial statements of Shanghai Commercial Bank Limited (the 'Bank') and its subsidiaries (the 'Group') set out on pages 45 to 129, which comprise:

- the consolidated statement of financial position as at 31st December 2017;
- the consolidated statement of profit or loss for the year then ended;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

*Our opinion*

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31st December 2017, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ('HKFRSs') issued by the Hong Kong Institute of Certified Public Accountants ('HKICPA') and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

## Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ('HKSAs') issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report.

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

*Independence*

We are independent of the Group in accordance with the HKICPA's Code of Ethics for Professional Accountants ('the Code'), and we have fulfilled our other ethical responsibilities in accordance with the Code.

## Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The key audit matter identified in our audit is related to the impairment of loans and advances to customers.

**Impairment of loans and advances to customers**

As at 31st December 2017, the Group recorded loan impairment allowances of HK$350 million, with HK$37 million as individual impairment allowances and HK$313 million as collective impairment allowances in respect of the total gross loan balance of HK$78,647 million. Refer to Note 18 to the consolidated financial statements.

## Key Audit Matters (Continued)

For individual impairment allowances, management judgement is required to help determine when an impairment event has occurred and to determine reliably measurable future cashflows from realisation of collaterals and/or other operating cashflows using appropriate discounted factors.

For collective impairment allowances, management is required to establish a methodology which is based on historical loss experience and adjustment to reflect current economic conditions through relevant economic judgmental factors.

The audit focused on loan impairment allowances due to the materiality of the balances and the significant management judgement and accounting estimates inherent in the identification of impairment events and the underlying variables within the calculations for both individual and collective impairment allowances.

In addition, new Expected Credit Loss ('ECL') model is introduced under 'HKFRS 9 Financial Instruments', which becomes effective for annual reporting periods beginning on or after 1st January 2018. For ECL calculation, management judgement is required in determining impairment methodology, various model inputs and post model adjustments.

As at 31st December 2017, the impact of HKFRS 9 to the impairment allowance assessed by management is not expected to be material. Refer to Note 2.1 for the disclosure over the estimated impact in accordance with HKAS 8.

However, given the significant judgement decisions taken by management over impairment methodology, model inputs and post model adjustments, we consider this as part of the key audit matter.

*How our audit addressed the Key Audit Matter*

We tested the key controls that management has established to support their individual and collective impairment calculations:

- For individual impairment allowances, this included
  - Credit Committee's oversight and regular monitoring of the overall credit quality;
  - regular reviews of the credit facilities by monitoring units which are independent from the loan initiation units;
  - evaluation of the potential impact of economic environmental changes on the credit quality of the loan portfolio with particular focus on key risk indicators including higher risk industries;
  - controls over timely identification of non-performing loans and maintenance of key data for impairment calculation (including collateral value); and
  - controls over the approval of significant individual impairment allowances.

- For collective impairment allowances, this included controls over the appropriateness of methodology used for calculation of impairment allowances, management oversight in determining the key assumptions and economic judgmental factors as well as the scoping of loans to be included within the calculation; and

- Independent assessment of the criteria established by the management for determining when an impairment event has occurred with reference to regulatory requirements and industry practice.

We tested, on a sample basis, the discounted cash flow calculation of individual impairment allowances by challenging management's assumptions in deriving the future cashflows based on the borrowers' circumstances, objective evidence of inputs for impairment calculation (including valuation of collateral) and our industry knowledge.

We assessed the appropriateness of the methodology used for the collective impairment allowances and the consistency of the methodology as compared to the prior period. This included challenging the key assumptions and economic judgmental factors adopted based on our industry knowledge, macroeconomic data, and market practices.

## Key Audit Matters (Continued)

Based on the results of the above testing, management's identification of impairment events and the variables used in the impairment calculation for loans and advances to customers are supported with the evidence we obtained.

In respect of the impact of HKFRS 9 on the impairment allowance as disclosed in the financial statements, we performed the following procedures:

- Assessed the impairment methodology and ECL model inputs with the assistance of our internal modelling specialists;
- Assessed the ECL model validation procedures and reconciliation process of system interfaces performed by management;
- Tested data integrity, on a sample basis, used in the impairment calculation; and
- Assessed the basis of the post model adjustments determined by management for their reasonableness.

On the basis of the work carried out by us, we found the disclosure on the estimated impact of implementation of HKFRS 9 ECL is supported by available evidence.

## Other Information

The Directors of the Bank are responsible for the other information. The other information comprises all of the information included in the annual report other than the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## Responsibilities of Directors and the Audit Committee for the Consolidated Financial Statements

The Directors of the Bank are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA 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.

In preparing the consolidated financial statements, the Directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The Audit Committee is responsible for overseeing the Group's financial reporting process.

## Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body, in accordance with Section 405 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. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.

- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

## Auditor's Responsibilities for the Audit of the Consolidated Financial Statements (Continued)

From the matters communicated with the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Mr Poon Tak Cheong, Raymond.

**PricewaterhouseCoopers**
Certified Public Accountants

Hong Kong, 19th March 2018

# CONSOLIDATED STATEMENT OF PROFIT OR LOSS

(All amounts in HK dollar thousands unless otherwise stated)

| | | Year ended 31st December | |
|---|---|---|---|
| | Note | 2017 | 2016 |
| Interest income | 6 | 4,344,275 | 3,694,969 |
| Interest expense | 6 | (1,244,212) | (1,058,139) |
| **Net interest income** | | 3,100,063 | 2,636,830 |
| Fee and commission income | 7 | 812,151 | 695,571 |
| Fee and commission expense | 7 | (46,150) | (38,330) |
| **Net fee and commission income** | | 766,001 | 657,241 |
| Net trading income | 8 | 419,463 | 242,985 |
| Net gains from disposal of available-for-sale investments | | 45,489 | 181,639 |
| Dividend income from available-for-sale investments | | 112,294 | 12,029 |
| Net losses from disposal of equipment | | (4,576) | (1,854) |
| Other operating income | 9 | 147,105 | 110,480 |
| Net earned insurance premium | 10 | 40,254 | 43,336 |
| Net insurance claims incurred and movement in policyholders' liabilities | 10 | (22,326) | (24,182) |
| Operating expenses | 11 | (1,519,835) | (1,427,688) |
| Charge of impairment losses on loans and advances to customers | 13 | (59,354) | (20,431) |
| **Operating profit** | | 3,024,578 | 2,410,385 |
| Share of net profits of joint ventures | 25 | 54,180 | 33,564 |
| **Profit before income tax** | | 3,078,758 | 2,443,949 |
| Income tax expense | 14 | (648,241) | (530,971) |
| **Profit for the year** | | 2,430,517 | 1,912,978 |
| **Attributable to:** | | | |
| Equity holders of the Bank | | 2,424,453 | 1,909,158 |
| Non-controlling interests | | 6,064 | 3,820 |
| | | 2,430,517 | 1,912,978 |

The notes on pages 52 to 129 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 2017 | 2016 |
|---|---|---|---|
| **Profit for the year** | | **2,430,517** | 1,912,978 |
| **Other comprehensive income** | | | |
| **Items that may be reclassified subsequently to profit or loss** | | | |
| **Exchange differences on translation of foreign operations** | | **142,782** | (98,020) |
| **Net gains/(losses) on available-for-sale investments** | | | |
| Fair value changes on available-for-sale investments taken to equity | | **(590,472)** | 1,269,147 |
| Exchange differences on translation of available-for-sale investments | | **71,124** | (32,685) |
| Fair value changes transferred to statement of profit or loss on disposal of available-for-sale investments | 35 | **(45,489)** | (181,639) |
| Deferred income tax | 33 | **93,198** | (174,046) |
| **Share of reserves of joint ventures** | 35 | **4,371** | (16,283) |
| **Other comprehensive income for the year, net of tax** | | **(324,486)** | 766,474 |
| **Total comprehensive income for the year** | | **2,106,031** | 2,679,452 |
| **Attributable to:** | | | |
| Equity holders of the Bank | | **2,099,917** | 2,675,932 |
| Non-controlling interests | | **6,114** | 3,520 |
| **Total comprehensive income for the year** | | **2,106,031** | 2,679,452 |

The notes on pages 52 to 129 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 2017 | 2016 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with banks | 16 | **28,755,012** | 24,620,495 |
| Placements with and loans and advances to banks | 17 | **17,633,246** | 26,562,967 |
| Loans and advances to customers | 18 | **78,296,688** | 64,519,998 |
| Financial assets held for trading | 19 | **1,975,108** | 526,401 |
| Derivative financial instruments | 20 | **141,006** | 239,247 |
| Available-for-sale investments | 21 | **50,167,009** | 45,462,697 |
| Held-to-maturity investments | 22 | **2,386,864** | 2,515,363 |
| Properties for sale | 23 | **373,529** | 358,788 |
| Investments in joint ventures | 25 | **338,914** | 303,571 |
| Properties and equipment | 26 | **2,389,569** | 2,336,588 |
| Investment properties | 27 | **1,020,504** | 1,027,780 |
| Deferred income tax assets | 33 | **40,523** | 55,860 |
| Other assets | 28 | **1,012,616** | 839,515 |
| **TOTAL ASSETS** | | **184,530,588** | 169,369,270 |
| **LIABILITIES** | | | |
| Deposits and balances from banks | | **6,780,932** | 5,901,152 |
| Deposits from customers | 29 | **146,953,042** | 136,884,334 |
| Derivative financial instruments | 20 | **146,196** | 221,120 |
| Subordinated debt | 30 | **1,947,028** | – |
| Other liabilities | 31 | **2,196,853** | 1,372,306 |
| Provisions | 32 | **156,571** | 94,612 |
| Current income tax liabilities | | **422,206** | 39,177 |
| Deferred income tax liabilities | 33 | **382,438** | 476,878 |
| **TOTAL LIABILITIES** | | **158,985,266** | 144,989,579 |
| **EQUITY** | | | |
| **CAPITAL AND RESERVES ATTRIBUTABLE TO EQUITY HOLDERS** | | | |
| Share capital | 34 | **2,000,000** | 2,000,000 |
| Retained earnings | | **13,446,235** | 11,950,747 |
| Reserves | 35 | **10,022,093** | 10,357,664 |
| | | **25,468,328** | 24,308,411 |
| Non-controlling interests in equity | | **76,994** | 71,280 |
| **TOTAL EQUITY** | | **25,545,322** | 24,379,691 |
| **TOTAL EQUITY AND LIABILITIES** | | **184,530,588** | 169,369,270 |

Approved and authorised for issue by the Board of Directors on 19th March 2018.

**Stephen Ching Yen LEE**
Chairman

**Hung-ching YUNG**
Director

**Gordon Che Keung KWONG**
Director

**David Sek-chi KWOK**
Managing Director & Chief Executive

The notes on pages 52 to 129 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 equity holders | | | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|
| | | Share capital | Reserves | Retained earnings (including proposed dividends) | | |
| **As at 1st January 2016** | | 2,000,000 | 9,568,495 | 11,003,984 | 68,160 | 22,640,639 |
| Profit for the year | | – | – | 1,909,158 | 3,820 | 1,912,978 |
| **Other comprehensive income** | | | | | | |
| Fair value gains, net of tax: | | | | | | |
| – available-for-sale investments | 35 | – | 1,095,401 | – | (300) | 1,095,101 |
| Currency translation differences | 35 | – | (117,718) | (12,987) | – | (130,705) |
| Share of reserves of joint ventures | 35 | – | (16,283) | – | – | (16,283) |
| Realised on disposal of available-for-sale investments | 35 | – | (181,639) | – | – | (181,639) |
| **Total other comprehensive income** | | – | 779,761 | (12,987) | (300) | 766,474 |
| Transfer from retained earnings | 35 | – | 9,408 | (9,408) | – | – |
| Payment of dividend relating to 2015 | | – | – | (940,000) | (400) | (940,400) |
| **As at 31st December 2016** | | 2,000,000 | 10,357,664 | 11,950,747 | 71,280 | 24,379,691 |

| | Note | Attributable to equity holders | | | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|
| | | Share capital | Reserves | Retained earnings (including proposed dividends) | | |
| **As at 1st January 2017** | | **2,000,000** | **10,357,664** | **11,950,747** | **71,280** | **24,379,691** |
| Profit for the year | | – | – | **2,424,453** | **6,064** | **2,430,517** |
| **Other comprehensive income** | | | | | | |
| Fair value gains, net of tax: | | | | | | |
| – available-for-sale investments | 35 | – | **(497,324)** | – | **50** | **(497,274)** |
| Currency translation differences | 35 | – | **169,468** | **44,438** | – | **213,906** |
| Share of reserves of joint ventures | 35 | – | **4,371** | – | – | **4,371** |
| Realised on disposal of available-for-sale investments | 35 | – | **(45,489)** | – | – | **(45,489)** |
| **Total other comprehensive income** | | – | **(368,974)** | **44,438** | **50** | **(324,486)** |
| Transfer from retained earnings | 35 | – | **33,403** | **(33,403)** | – | – |
| Payment of dividend relating to 2016 | | – | – | **(940,000)** | **(400)** | **(940,400)** |
| **As at 31st December 2017** | | **2,000,000** | **10,022,093** | **13,446,235** | **76,994** | **25,545,322** |

| | Year ended 31st December | |
|---|---|---|
| | **2017** | 2016 |
| **Proposed dividend included in retained earnings** | **940,000** | 940,000 |

The notes on pages 52 to 129 are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CASH FLOWS

(All amounts in HK dollar thousands unless otherwise stated)

| | Note | Year ended 31st December 2017 | 2016 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit before income tax | | **3,078,758** | 2,443,949 |
| Share of net profits of joint ventures | 25 | **(54,180)** | (33,564) |
| Charge of impairment losses on loans and advances to customers | 13 | **59,354** | 20,431 |
| Depreciation expenses | 11 | **117,676** | 100,751 |
| Net losses from disposal of equipment | | **4,576** | 1,854 |
| Net gains from disposal of available-for-sale investments | | **(45,489)** | (181,639) |
| Interest income on held-to-maturity and available-for-sale investments | 6 | **(1,137,281)** | (1,015,279) |
| Dividend income | | **(112,294)** | (12,029) |
| Hong Kong profits tax paid | | **(1,771)** | (363,100) |
| Overseas tax paid | | **(245,254)** | (219,860) |
| **Cash flows from operating activities before changes in operating assets and liabilities** | | **1,664,095** | 741,514 |
| Changes in operating assets and liabilities: | | | |
| – Net (increase)/decrease in cash and balances with banks with original maturity beyond 3 months | | **(387,660)** | 177,721 |
| – Net decrease/(increase) in placements with and loans and advances to banks with original maturity beyond 3 months | | **8,749,461** | (12,665,774) |
| – Net increase in financial assets held for trading | | **(1,448,707)** | (93,746) |
| – Net decrease/(increase) in derivative financial instruments | | **23,317** | (20,029) |
| – Net increase in loans and advances to customers | | **(13,840,738)** | (436,631) |
| – Net increase in other assets | | **(177,194)** | (141,397) |
| – Net increase/(decrease) in deposits and balances from banks | | **879,780** | (87,053) |
| – Net increase in deposits from customers | | **8,454,471** | 7,679,423 |
| – Net increase in other liabilities and provisions | | **893,320** | 298,522 |
| **Net cash flows from operating activities** | | **4,810,145** | (4,547,450) |

| | Note | Year ended 31st December 2017 | 2016 |
|---|---|---|---|
| **Cash flows from investing activities** | | | |
| Interest received on held-to-maturity and available-for-sale investments | | 1,114,305 | 996,867 |
| Dividends received on available-for-sale investments | | 112,294 | 11,489 |
| Dividends received from joint ventures | 25 | 20,590 | 18,150 |
| Purchases of properties and equipment | 26 | (164,375) | (146,353) |
| Additions of investment properties | 27 | (1,028) | (50,528) |
| Additions of properties for sale | | (14,741) | – |
| Proceeds from sale of equipment | | 165 | 16 |
| Purchases of available-for-sale investments | | (24,416,066) | (14,716,473) |
| Purchases of held-to-maturity investments | | (3,933,566) | (2,194,810) |
| Proceeds from liquidation of a joint venture | | 2,633 | – |
| Proceeds from sale and redemption of available-for-sale investments | | 19,930,883 | 8,819,882 |
| Proceeds from redemption of held-to-maturity investments | | 4,064,031 | 2,181,734 |
| **Net cash flows from investing activities** | | (3,284,875) | (5,080,026) |
| **Cash flows from financing activities** | | | |
| Issue of subordinated debt | 36(a) | 1,937,597 | – |
| Dividend paid to equity holders | | (940,000) | (940,000) |
| Dividend paid to non-controlling interests | | (400) | (400) |
| **Net cash flows from financing activities** | | 997,197 | (940,400) |
| **Net increase/(decrease) in cash and cash equivalents** | | 2,522,467 | (10,567,876) |
| Cash and cash equivalents at beginning of the year | | 24,483,010 | 34,663,066 |
| Effect of exchange rate changes on cash and cash equivalents | | 810,383 | 387,820 |
| **Cash and cash equivalents at end of the year** | 36(b) | 27,815,860 | 24,483,010 |
| Cash flows from operating activities and investing activities included: | | | |
| Interest received | | 4,248,212 | 3,643,109 |
| Interest paid | | (1,122,473) | (1,083,373) |

The notes on pages 52 to 129 are an integral part of these consolidated financial statements.

# 1 GENERAL INFORMATION

Shanghai Commercial Bank Limited (the 'Bank') and its subsidiaries (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 Shanghai Commercial Bank Tower, 12 Queen's Road Central, Hong Kong.

The ultimate holding company is The Shanghai Commercial & Savings Bank, Ltd., which is incorporated in the Republic of China (Taiwan).

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 19th March 2018.

# 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 have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ('HKFRSs') and the requirements of the Hong Kong Companies Ordinance Cap. 622. The consolidated financial statements 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, which are carried 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) The following standards, amendments and interpretations, which became effective in 2017, are relevant to the Group:**

**Annual improvements to HKFRSs**
Annual improvements to HKFRSs contain numerous amendments to HKFRSs which the Hong Kong Institute of Certified Public Accountants ('HKICPA') considers not urgent but necessary. They comprise amendments that result in accounting changes for presentation, recognition or measurement purpose as well as terminology or editorial amendments related to a variety of individual HKFRSs. The adoption of these improvements does not have a material impact on the Group's financial statements.

**Amendments to HKAS 7 'Statement of cash flows' – Disclosure initiative**
Amendments to HKAS 7 'Statement of cash flows' – Disclosure initiative introduce an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities, including cash flow and non-cash changes, a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities with sufficient information for users of financial statements to link items included in the reconciliation to the statement of financial position and the statement of cash flow. Disclosures relating to the reconciliation of liabilities arising from financing activities are shown in Note 36(a).

**Amendments to HKAS 12 'Income taxes' – Recognition of deferred tax assets for unrealised losses**
Amendments to HKAS 12 'Recognition of deferred tax assets for unrealised losses' clarify the accounting for deferred tax when an asset is measured at fair value and that fair value is below the asset's tax base. The amendments do not have material impact on the Group's consolidated financial statements as the Group has currently taken into account the unrealised losses on assets measured at fair value when calculating deferred tax assets.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.1 Basis of preparation (Continued)

**(b) Amendments, new standards and interpretations issued but not yet effective for the year ended 31st December 2017**

The HKICPA has issued a few amendments and new standards which are not yet effective for the year ended 31st December 2017 and which have not been adopted in these consolidated financial statements. These include the following which may be relevant to the Group.

| | Effective for accounting periods beginning on or after |
|---|---|
| Amendments to HKFRS 4 'Insurance contracts' on applying HKFRS 9 'Financial instruments' | 1st January 2018 |
| HKFRS 9 'Financial instruments' | 1st January 2018 |
| HKFRS 15 'Revenue from contracts with customers' and the related amendments | 1st January 2018 |
| Amendments to HKAS 40 'Investment property' | 1st January 2018 |
| HK(IFRIC)-Int 22 'Foreign currency transactions and advance consideration' | 1st January 2018 |
| HKFRS 16 'Leases' | 1st January 2019 |
| Amendments to HKFRS 10 'Consolidated financial statements' and HKAS 28 'Investments in associates and joint ventures' on the sale or contribution of assets between an investor and its associate or joint venture | To be determined |
| HK(IFRIC) 23 'Uncertainty over income tax treatments' | 1st January 2019 |
| HKFRS 17 'Insurance contracts' | 1st January 2021 |

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.1 Basis of preparation (Continued)

**(b) Amendments, new standards and interpretations issued but not yet effective for the year ended 31st December 2017 (Continued)**

The Group is assessing the financial impacts of the amendments, new standards and interpretations and the timing of their application. So far it has concluded that the adoption of these standards is unlikely to have a significant impact on the consolidated financial statements except for the following:

**HKFRS 9 'Financial instruments'**
The Group has reviewed its financial assets and liabilities and is expecting the following impact from the adoption of the new standard on 1st January 2018:

- all debt instruments that are currently classified as available-for-sale ('AFS') will be designated as fair value through other comprehensive income ('FVOCI') and be measured on the same basis under HKFRS 9;
- 99.9% equity instruments currently classified as AFS will be designated as FVOCI;
- 0.1% equity instruments currently as AFS will be classified as fair value through profit or loss ('FVPL') under HKFRS 9;
- equity instruments currently measured at FVPL which will continue to be measured on the same basis under HKFRS 9;
- debt instruments currently classified as held-to-maturity and measured at amortised cost which meet the conditions for classification at amortised cost under HKFRS 9; and
- loans and receivables measured at amortised cost which meet the conditions for classification at amortised cost under HKFRS 9.

Accordingly, the Group does not expect the new guidance to affect the classification and measurement of these financial assets significantly. However, gains or losses realised on the sale of equity instruments at FVOCI will no longer be transferred to profit or loss on sale, but instead reclassified below the line from the FVOCI reserve to retained earnings. During the 2017 financial year, no such gains or losses were recognised in profit or loss in relation to the disposal of available-for-sale equity instruments.

There will be no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Group does not have any such liabilities. The derecognition rules have been transferred from HKAS 39 and have not been changed.

The new impairment model requires the recognition of impairment provisions based on expected credit losses ('ECL') rather than only incurred credit losses as is the case under HKAS 39. It applies to financial assets classified at amortised cost, debt instruments measured at FVOCI, contract assets under HKFRS 15, lease receivables, loan commitments and certain financial guarantee contracts. The Group does not expect material impact on the impairment allowance as at 1st January 2018 with an estimate of 3.2% increase in loss allowance for financial assets.

The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Group's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

HKFRS 9 will be effective for financial years commencing on or after 1st January 2018. The Group will apply the new rules retrospectively from 1st January 2018, with the practical expedients permitted under the standard. Comparatives for 2017 will not be restated.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.1 Basis of preparation (Continued)

**(b) Amendments, new standards and interpretations issued but not yet effective for the year ended 31st December 2017 (Continued)**

**HKFRS 15 'Revenue from contracts with customers' and the related amendments**
HKFRS 15 'Revenue from contracts with customers' and the related amendments are effective for accounting period beginning on or after 1st January 2018. The standard contains a single model that applies to contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The Group has assessed the impact and expect it will not have significant impact on the consolidated financial statements and the Group will adopt the standard and the related disclosure requirements accordingly.

**HKFRS 16 'Leases'**
HKFRS 16 'Leases' is effective for the accounting period beginning on or after 1st January 2019. The standard will result in almost all leases being recognised on the statement of financial position, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the lease item) and a financial liability to pay rentals are recognised. The only exceptions are short-term and low-value leases. The accounting for lessors will not significantly changed. The standard will affect primarily the accounting for the Group's operating leases.

As at the reporting date, the Group has non-cancellable operating lease commitments of HK$209,608,000, see Note 37(b). However, the Group has not yet determined to what extent these commitments will result in the recognition of an asset and a liability for future payments and how this will affect the Group's profit and classification of cash flows. Some of the commitments may be covered by the exception for short-term and low value leases and some commitments may relate to arrangements that will not qualify as leases under HKFRS 16. At this stage, the Group does not intend to adopt the standard before its effective date.

**Amendments to HKFRS 10 'Consolidated financial statements'and HKAS 28 'Investments in associates and joint ventures' on the sale or contribution of assets between an investor and its associate or joint venture**
The amendments are made to resolve the inconsistency between HKFRS 10 'Consolidated financial statements' and HKAS 28 'Investment in associates and joint ventures'. The amendments require different treatments for transactions involving assets that constitute a business and those that do not. Gain or loss resulting from transactions involving assets that do not constitute a business between an entity and its associate or joint venture are recognised in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. The Group is in the process of assessing the financial and disclosure impact on the adoption of the standard.

**HKFRS 17 'Insurance contracts'**
HKFRS 17 'Insurance contracts' is effective for the accounting period beginning on or after 1st January 2021. It establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard and to replace the HKFRS 4 'Insurance contract'. The objective of HKFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. HKFRS 17 defines clear and consistent rules that will significantly increase the comparability of financial statements. The general model under HKFRS 17 requires an entity to measure an insurance contract at initial recognition at the total of the fulfilment cash flows and the contractual service margin. Aside from this general model, the standard provides, as a simplification, the premium allocation approach. The Group is in the process of assessing the financial and disclosure impact on the adoption of the standard.

# 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 2017.

**(a) Subsidiaries**

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

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) Joint ventures**

A joint venture is an arrangement whereby the Group and other parties contractually agree to share control of the arrangement and have right to the net assets of the arrangement. Joint ventures are accounted for using the equity method.

Under the equity method of accounting, interests in joint ventures are initially recognised at cost and adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses and movements in other comprehensive income. When the Group's share of losses in a joint venture equals or exceeds its interests in the joint venture (which includes any long-term interests that, in substance, form part of the Group's net investment in the joint venture), the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the joint venture.

Unrealised gains on transactions between the Group and its joint ventures are eliminated to the extent of the Group's interest in the joint ventures. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

# 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. 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 rate 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 the reporting date of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of profit or loss.

All foreign exchange gains and losses recognised in the statement of profit or loss are presented net in the statement of profit or loss 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 positions of all the Group's entities 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 reporting date;
- Income and expenses for each statement of profit or loss 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, 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 statement of profit or loss 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 statement of profit or loss 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 Rental income

Rental income from investment properties is recognised in the consolidated statement of profit or loss on a straight-line basis over the terms of the leases.

## 2.7 Dividend income

Dividends are recognised in the statement of profit or loss when the entity's right to receive payment is established.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.8 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 statement of profit or loss 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.

## 2.9 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. The land is depreciated over the lease term. The depreciation of the buildings is based on management's appraisal of their conditions, which includes estimations of the remaining useful lives, which are not expected to exceed 40 years.

Interest in freehold land is stated at cost.

**(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 are calculated to write off the costs of the assets over their estimated useful lives on a straight line basis over 4 to 10 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 statement of profit or loss during the financial period in which they are incurred.

**(c) Property under development**

Leasehold land for property 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 2.9(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 2.24). 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 statement of profit or loss.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.10 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. It also includes properties that are being constructed or developed for future use as investment properties. 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.

## 2.11 Properties for sale

Properties for sale are carried at the lower of cost and net realisable value. Net realisable value takes into account the price ultimately expected to be realised and the anticipated costs to completion.

## 2.12 Financial assets

### 2.12.1 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 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 statement of profit or loss. Gains and losses arising from changes in fair value are included directly in the statement of profit or loss 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'. 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 consist of debt hosts and embedded derivatives that must be separated.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.12 Financial assets (Continued)

### 2.12.1 Classification (Continued)

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

Financial assets for which the fair value option is applied are recognised in the 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'.

**(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 statement of profit or loss 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 or customers and recognised in the statement of profit or loss as impairment losses on loans and advances to banks or 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 is included in the statement of profit or loss and is 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 statement of profit or loss as impairment charges on held-to-maturity investments.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.12 Financial assets (Continued)

### 2.12.1 Classification (Continued)

**(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 statement of profit or loss. However, interest calculated using the effective interest method on monetary assets classified as available-for-sale investments is recognised in the statement of profit or loss. Dividends on available-for-sale equity instruments are recognised in the statement of profit or loss as 'Dividend income' when the Group's right to receive payment is established.

### 2.12.2 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.

### 2.12.3 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 statement of profit or loss. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognised when they are extinguished – that is, when the obligation is discharged, cancelled or expires.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.12 Financial assets (Continued)

### 2.12.3 Recognition and measurement (Continued)

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 statement of profit or loss 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 statement of profit or loss.

## 2.13 Offsetting financial instruments

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

## 2.14 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.

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 management for each identified portfolio. In general, the periods used vary between 3 months and 12 months; in exceptional cases, longer periods are warranted.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.14 Impairment of financial assets (Continued)

**(a) Assets carried at amortised cost (Continued)**

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 statement of profit or loss. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

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

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (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.

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 statement of profit or loss.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.14 Impairment of financial assets (Continued)

**(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 the statement of profit or loss – is removed from equity and recognised in the statement of profit or loss.

Impairment losses recognised in the statement of profit or loss on equity instruments are not reversed through the statement of profit or loss. 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 the statement of profit or loss, the impairment loss is reversed through the statement of profit or loss.

## 2.15 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 statement of profit or loss.

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; or

(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 statement of profit or loss.

**(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 statement of profit or loss over the period of the other financial liabilities using the effective interest method.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.16 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 end of each reporting period.

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.

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.

## 2.17 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 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.18 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the statement of profit or loss, 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 reporting date 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 at the reporting date 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.

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 joint ventures, 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 statement of profit or loss together with the deferred gain or loss upon disposal.

## 2.19 Employee benefits

**(a) Retirement benefit costs**

The Group operates 2 retirement benefit schemes comprising of a Mandatory Provident Fund Scheme and a defined benefit scheme that are available to the Group's employees. However, the principal scheme that the Group contributes to is the Mandatory Provident Fund Scheme.The assets of the Group's Mandatory Provident Fund Scheme and the defined benefit scheme are held separately from those of the Group in independently administered funds.

The Group's contributions to the Mandatory Provident Fund Scheme are charged to the statement of profit or loss.

The defined benefit scheme is funded by payments from the Group's Hong Kong Office 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 statement of profit or loss 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 3 years.

# 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 2.19 Employee benefits (Continued)

**(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 or when the entity recognises costs for a restructuring that is within the scope of HKAS 37 and involves payment of termination benefits. 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 reporting date are discounted to present value.

## 2.20 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.

## 2.21 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.

## 2.22 Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than 3 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.

## 2.23 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.

## 2.24 Impairment of investment in subsidiaries, joint ventures 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)

## 2.25 Provisions

Provisions 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.

## 2.26 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 approximates the consideration received 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 statement of profit or loss within other operating expenses.

## 2.27 Segment reporting

Operating segments, and the amounts of each segment item reported in the consolidated financial statements, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

# 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.

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. 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 Risk Committee, the Executive Committee, the Asset and Liability Committee, the Credit Committee and the Operational Risk Management Committee for the supervision of major functional areas. 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 Division is responsible for monitoring the overall risk management of the Group's operations. 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 Committee before submission to the management for approval. All of the above arrangements ensure that the risk management processes are operating effectively.

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 reporting date.

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:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Loans and advances (%) | Impairment allowances (%) | Loans and advances (%) | Impairment allowances (%) |
| 1 – pass | 95.48 | 0.40 | 89.04 | 0.41 |
| 2 – special mention | 3.75 | 0.41 | 9.93 | 0.33 |
| 3 – sub-standard | 0.63 | 0.63 | 0.84 | 2.09 |
| 4 – doubtful | 0.13 | 30.83 | 0.17 | 6.58 |
| 5 – loss | 0.01 | 60.07 | 0.02 | 60.50 |
| | 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.

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.1 Credit risk (Continued)

### 3.1.2 Impairment and provisioning policies (Continued)

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 reporting date 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.

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

| | Maximum exposure | |
|---|---|---|
| | **2017** | 2016 |
| Credit risk exposures relating to on-balance sheet assets are as follows: | | |
| Balances with central banks and Hong Kong Monetary Authority | **8,877,217** | 7,322,108 |
| Balances with banks | **19,522,114** | 16,938,910 |
| Placements with and loans and advances to banks | **17,633,246** | 26,562,967 |
| Loans and advances to customers | **78,296,688** | 64,519,998 |
| Financial assets held for trading: debt securities | **1,936,798** | 401,748 |
| Derivative financial instruments | **141,006** | 239,247 |
| Available-for-sale investments: debt securities | **46,050,694** | 41,153,492 |
| Held-to-maturity investments | **2,386,864** | 2,515,363 |
| Other assets | **1,012,616** | 822,635 |
| Credit risk exposures relating to off-balance sheet items are as follows: | | |
| – Financial guarantees | **2,700,899** | 2,405,324 |
| – Off-balance sheet commitments and other credit related contingent liabilities | **44,063,312** | 42,074,356 |
| As at 31st December | **222,621,454** | 204,956,148 |

The above table represents a worst case scenario of credit risk exposures to the Group as at 31st December 2017 and 2016, 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 Group could be required to pay if the guarantees are called upon. For off-balance sheet 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 2017, the collateral coverage of advances to customers is 82% (2016: 85%). As at 31st December 2017, 57% (2016: 69%) 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 37. 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 Concentration of risks of financial assets with credit risk exposure

**International claims**

The following table shows the Group's international claims by major country or geographical segment, each representing not less than 10% of the Group's total international claims. International claims refer to exposures to counterparties on which the ultimate risk lies, and are derived according to the location of the counterparties after taking into account any recognised risk transfer. In general, transfer of risk from one country to another is recognised if the claims against a counterparty are guaranteed by another party in a different country or if the claims are on an overseas branch of a bank whose head office is located in a different country.

As at 31st December 2017

| | | | Non-bank private sector | | |
|---|---|---|---|---|---|
| | Banks | Official sector | Non-bank financial institutions | Non-financial private sector | Total |
| Developed countries | 21,072,000 | 868,000 | 3,439,000 | 1,029,000 | 26,408,000 |
| Offshore centres | 2,083,000 | – | 1,251,000 | 14,327,000 | 17,661,000 |
| – of which Hong Kong | 1,353,000 | – | 821,000 | 10,912,000 | 13,086,000 |
| Developing Asia-Pacific | 51,153,000 | 64,000 | 185,000 | 4,863,000 | 56,265,000 |
| – of which China | 44,980,000 | 64,000 | 185,000 | 3,781,000 | 49,010,000 |

As at 31st December 2016

| | | | Non-bank private sector | | |
|---|---|---|---|---|---|
| | Banks | Official sector | Non-bank financial institutions | Non-financial private sector | Total |
| Developed countries | 21,286,000 | 167,000 | 985,000 | 1,056,000 | 23,494,000 |
| Offshore centres | 4,745,000 | – | 1,394,000 | 12,889,000 | 19,028,000 |
| – of which Hong Kong | 4,272,000 | – | 1,034,000 | 10,637,000 | 15,943,000 |
| Developing Asia-Pacific | 51,327,000 | 37,000 | 73,000 | 3,250,000 | 54,687,000 |
| – of which China | 43,158,000 | 37,000 | 73,000 | 2,051,000 | 45,319,000 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.1 Credit risk (Continued)

### 3.1.5 Loans and advances

| | 2017 | 2016 |
|---|---|---|
| Loans and advances are summarised as follows: | | |
| Neither past due nor impaired | 75,658,894 | 62,070,038 |
| Past due but not impaired | 2,378,745 | 2,065,183 |
| Impaired | 609,417 | 668,553 |
| Gross loans and advances | 78,647,056 | 64,803,774 |
| Less: impairment allowances | (350,368) | (283,776) |
| Net loans and advances | 78,296,688 | 64,519,998 |

Further information on individual and collective impairment allowances for loans and advances to customers is provided in Note 18.

**(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.

**As at 31st December 2017**

| | 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 | 416,239 | 232,520 | 6,145,610 | 8,250,842 | 53,008,683 | 4,807,057 | 72,860,951 |
| 2 – special mention | 96,449 | 5,634 | 166,793 | 504,958 | 1,422,625 | 601,484 | 2,797,943 |
| Total | 512,688 | 238,154 | 6,312,403 | 8,755,800 | 54,431,308 | 5,408,541 | 75,658,894 |

**As at 31st December 2016**

| | 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 | 516,793 | 231,220 | 5,185,781 | 7,684,621 | 37,669,666 | 4,640,043 | 55,928,124 |
| 2 – special mention | 135,996 | 6,570 | 436,137 | 757,162 | 3,614,552 | 1,191,497 | 6,141,914 |
| Total | 652,789 | 237,790 | 5,621,918 | 8,441,783 | 41,284,218 | 5,831,540 | 62,070,038 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.1 Credit risk (Continued)

### 3.1.5 Loans and advances (Continued)

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

Loans and advances less than 3 months 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:

**As at 31st December 2017**

| | Individuals | | | | |
|---|---|---|---|---|---|
| | Overdrafts | Credit cards | Term loans and others | Mortgages | Total |
| Past due up to 1 month | – | 2,720 | 46,453 | 188,208 | 237,381 |
| Past due over 1 month but less than 2 months | 202 | 463 | 15 | 11,726 | 12,406 |
| Past due over 2 months but less than 3 months | – | – | – | 263 | 263 |
| Past due over 3 months | – | – | – | – | – |
| Total | 202 | 3,183 | 46,468 | 200,197 | 250,050 |

| | Corporate entities | | |
|---|---|---|---|
| | Large corporate customers and others | SME | Total |
| Past due up to 1 month | 2,051,319 | 23,817 | 2,075,136 |
| Past due over 1 month but less than 2 months | 23,773 | 7,308 | 31,081 |
| Past due over 2 months but less than 3 months | 12,590 | 9,888 | 22,478 |
| Past due over 3 months | – | – | – |
| Total | 2,087,682 | 41,013 | 2,128,695 |

**As at 31st December 2016**

| | Individuals | | | | |
|---|---|---|---|---|---|
| | Overdrafts | Credit cards | Term loans and others | Mortgages | Total |
| Past due up to 1 month | – | 2,798 | 30,620 | 105,181 | 138,599 |
| Past due over 1 month but less than 2 months | – | 409 | 104 | 8,982 | 9,495 |
| Past due over 2 months but less than 3 months | – | – | 188 | 354 | 542 |
| Past due over 3 months | – | – | – | 2,145 | 2,145 |
| Total | – | 3,207 | 30,912 | 116,662 | 150,781 |

| | Corporate entities | | |
|---|---|---|---|
| | Large corporate customers and others | SME | Total |
| Past due up to 1 month | 1,658,119 | 66,472 | 1,724,591 |
| Past due over 1 month but less than 2 months | 68,826 | 3,115 | 71,941 |
| Past due over 2 months but less than 3 months | 12,916 | 67,756 | 80,672 |
| Past due over 3 months | 37,198 | – | 37,198 |
| Total | 1,777,059 | 137,343 | 1,914,402 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.1 Credit risk (Continued)

### 3.1.5 Loans and advances (Continued)

**(c) Loans and advances by industry sector**

The following table shows the breakdown of the Group's loans and advances (excluding trade bills and other eligible bills) by industry sector according to the usage of loans based on the categories and definitions set by the Hong Kong Monetary Authority ('HKMA').

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Gross loans and advances | % covered by collateral | Gross loans and advances | % covered by collateral |
| Loans for use in Hong Kong | | | | |
| Industrial, commercial and financial | | | | |
| – Property development | 6,690,435 | 62% | 3,936,278 | 50% |
| – Property investment | 7,318,387 | 97% | 7,922,262 | 98% |
| – Financial concerns | 1,122,949 | 93% | 746,663 | 91% |
| – Stockbrokers | 1,142,377 | 79% | 528,887 | 90% |
| – Wholesale and retail trade | 3,731,677 | 24% | 980,769 | 91% |
| – Manufacturing | 1,762,583 | 66% | 1,771,106 | 78% |
| – Transport and transport equipment | 442,861 | 91% | 507,175 | 91% |
| – Recreational activities | 162,654 | 89% | 181,661 | 92% |
| – Information technology – telecommunication | 4,960 | 49% | 4,045 | 90% |
| – Hotels, boarding houses and catering | 1,325,478 | 89% | 1,284,830 | 97% |
| – Others | 5,044,507 | 78% | 3,998,898 | 81% |
| 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 | 102,003 | 100% | 107,512 | 100% |
| – Loans for the purchase of other residential properties | 4,265,525 | 100% | 4,312,877 | 100% |
| – Credit card advances | 217,623 | 0% | 217,802 | 0% |
| – Others | 6,673,254 | 94% | 6,003,960 | 93% |
| Trade finance | 6,467,319 | 69% | 5,622,332 | 75% |
| Loans for use outside Hong Kong | 31,592,758 | 89% | 26,003,137 | 83% |
| | 78,067,350 | 82% | 64,130,194 | 85% |

As at 31st December 2017, the Bank did not have exposures to individual industry sector constituting 10% or more of the Group's total amount of loans and advances. As at 31st December 2016, the industry sectors to which the amount of loans and advances constitute 10% or more of the Group's total amount of loans and advances, their corresponding amount of individually assessed impaired loans and advances, overdue loans and advances, individual impairment allowances and collective impairment allowances are analysed as follows:

| | 2016 | | | |
|---|---|---|---|---|
| | Impaired loans and advances | Loans and advances overdue for over 3 months | Individual impairment allowances | Collective impairment allowances |
| Industrial, commercial and financial | | | | |
| – Property investment | 21,122 | 18,982 | 538 | 31,674 |

| | 2016 | | |
|---|---|---|---|
| | New provisions | Loans written off as uncollectible | Recoveries of advances written off in previous years |
| Industrial, commercial and financial | | | |
| – Property investment | 455 | – | 2 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.1 Credit risk (Continued)

### 3.1.5 Loans and advances (Continued)

**(d) Loans and advances by geographical area**

The information concerning the breakdown of the gross amount of loans and advances to customers by country or geographical area is derived according to the location of the customers after taking into account any transfer of risk. In general, such transfer of risk takes place if the loans and advances are guaranteed by a party in a country which is different from that of the customers.

**As at 31st December 2017**

| | Gross loans and advances to customers | Individually assessed impaired loans and advances | Loans and advances overdue for over 3 months | Total individual impairment allowances | Total collective impairment allowances |
|---|---|---|---|---|---|
| Hong Kong | **49,963,282** | **557,434** | **444,408** | **23,358** | **199,999** |
| Mainland China | **6,541,734** | **30,274** | **27,698** | **13,859** | **25,077** |
| United States | **17,842,895** | **–** | **–** | **–** | **71,310** |
| Others | **4,299,145** | **21,709** | **20,480** | **80** | **16,685** |
| | **78,647,056** | **609,417** | **492,586** | **37,297** | **313,071** |
| % of total loans and advances to customers | | **0.77** | | | |
| Fair value of collateral | | **1,382,505** | | | |

**As at 31st December 2016**

| | Gross loans and advances to customers | Individually assessed impaired loans and advances | Loans and advances overdue for over 3 months | Total individual impairment allowances | Total collective impairment allowances |
|---|---|---|---|---|---|
| Hong Kong | 42,137,319 | 637,053 | 126,641 | 18,997 | 168,854 |
| Mainland China | 4,168,594 | 21,783 | 21,784 | 7,000 | 15,399 |
| United States | 15,219,994 | 7,994 | 7,994 | 32 | 60,870 |
| Others | 3,277,867 | 1,723 | 37,197 | – | 12,624 |
| | 64,803,774 | 668,553 | 193,616 | 26,029 | 257,747 |
| % of total loans and advances to customers | | 1.03 | | | |
| Fair value of collateral | | 1,552,500 | | | |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.1 Credit risk (Continued)

### 3.1.5 Loans and advances (Continued)

**(e) Loans and advances overdue for more than 3 months**

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | | % of gross loans and advances to customers | | % of gross loans and advances to customers |
| Gross loans and advances which have been overdue for: | | | | |
| – 6 months or less but over 3 months | 413,731 | 0.53 | 63,264 | 0.10 |
| – 1 year or less but over 6 months | 48,147 | 0.06 | 10,885 | 0.02 |
| – over 1 year | 30,708 | 0.04 | 119,467 | 0.18 |
| | 492,586 | 0.63 | 193,616 | 0.30 |
| Current market value of collateral | 1,177,535 | | 355,625 | |
| Covered portion by collateral | 465,751 | | 174,311 | |
| Uncovered portion by collateral | 26,835 | | 19,305 | |
| Individually assessed impairment allowances | 23,579 | | 18,552 | |

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

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

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | | % of gross loans and advances to customers | | % of gross loans and advances to customers |
| Rescheduled loans and advances | 23,219 | 0.03 | 23,803 | 0.04 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.1 Credit risk (Continued)

### 3.1.6 Repossessed assets

During the year, the Group had obtained assets by taking possession of collateral held as security, as follows:

| | Carrying amount | |
|---|---|---|
| | 2017 | 2016 |
| Nature of assets | | |
| Industrial property | – | 6,100 |
| Residential property | – | 8,280 |
| Commercial property | – | 2,500 |
| | – | 16,880 |

As at 31st December 2016, the fair value of the repossessed assets amounted to HK$16,880,000.

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' in Note 28.

### 3.1.7 Debt securities

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

**As at 31st December 2017**

| | Financial assets held for trading | Available-for-sale investments | Held-to-maturity investments | Total |
|---|---|---|---|---|
| AAA | – | – | 15,464 | 15,464 |
| AA- to AA+ | 1,936,798 | 6,199,350 | 2,371,400 | 10,507,548 |
| A- to A+ | – | 30,643,133 | – | 30,643,133 |
| BBB- to BBB+ | – | 6,232,046 | – | 6,232,046 |
| Unrated | – | 2,976,165 | – | 2,976,165 |
| Total | 1,936,798 | 46,050,694 | 2,386,864 | 50,374,356 |

**As at 31st December 2016**

| | Financial assets held for trading | Available-for-sale investments | Held-to-maturity investments | Total |
|---|---|---|---|---|
| AAA | – | – | 2,048,889 | 2,048,889 |
| AA- to AA+ | 397,095 | 12,449,385 | 311,046 | 13,157,526 |
| A- to A+ | – | 20,682,860 | 77,714 | 20,760,574 |
| BBB- to BBB+ | – | 5,443,973 | 77,714 | 5,521,687 |
| Unrated | 4,653 | 2,577,274 | – | 2,581,927 |
| Total | 401,748 | 41,153,492 | 2,515,363 | 44,070,603 |

There were no overdue debt securities in the years of 2017 and 2016.

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 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 foreign exchange and equity contracts, that comprise transactions initiated for the Group's own account and customer needs. The Group's positions are managed by the Treasury Division 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 and the Risk Committee. The Risk Management Division is responsible for monitoring the transactions to ensure the activities are within the relevant limits and guidelines.

### 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 (and also Risk Committee for the measuring procedures). Limits on notional, stop loss and sensitivity are set for trading positions which are marked-to-market daily.

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, the Asset and Liability Committee, the Executive Committee, the Risk Committee and the Board of Directors.

### 3.2.2 Market risk sensitivity summary for 2017 and 2016

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 foreign exchange rate and interest rate contracts which are typically made over-the-counter and are managed within limits approved by the Executive Committee and the Risk Committee. The policy on the use of derivatives is reviewed by the Risk Committee and recommended changes and amendments are approved by the Executive Committee or the Risk Committee.

**Interest rate risk**
As at 31st December 2017, if market interest rates had been 100 basis points higher (2016: 100 basis points higher) with other variables held constant, profit before tax for the year would have been HK$40,924,000 higher (2016: HK$19,339,000 lower). Available-for-sale investments revaluation gain shown as other comprehensive income would have been reduced by HK$249,812,000 (2016: reduced by HK$234,410,000).

**Foreign exchange risk**
As at 31st December 2017, over 92% (2016: over 91%) of the net on-balance sheet position of the Group were denominated in HKD and USD. There is internal control on the limit for foreign exchange risk arising from the translation of foreign-currency denominated financial assets and financial liabilities into HKD.

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.2 Market risk (Continued)

### 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 Division and monitored by the Risk Management Division, management and the Asset and Liability Committee within position limits set in the foreign exchange risk management policy approved by the Executive Committee and the Risk 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 on daily basis. The table below summarises the Group's exposure to foreign currency exchange rate risk as 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

| As at 31st December 2017 | HKD | USD | RMB | Other | Total |
|---|---|---|---|---|---|
| Assets | | | | | |
| Cash and balances with banks | 15,044,335 | 7,271,169 | 4,488,170 | 1,951,338 | 28,755,012 |
| Placements with and loans and advances to banks | 7,690,489 | 6,650,044 | 1,221,959 | 2,070,754 | 17,633,246 |
| Loans and advances to customers | 45,379,946 | 26,190,150 | 3,568,642 | 3,157,950 | 78,296,688 |
| Financial assets held for trading | 38,166 | 1,936,798 | – | 144 | 1,975,108 |
| Derivative financial instruments | 5,108 | 3,350 | 122,683 | 9,865 | 141,006 |
| Available-for-sale investments | 20,965,935 | 17,125,284 | 9,029,595 | 3,046,195 | 50,167,009 |
| Held-to-maturity investments | 2,042,359 | 344,505 | – | – | 2,386,864 |
| Other assets | 603,476 | 373,795 | 7,206 | 28,139 | 1,012,616 |
| Total | 91,769,814 | 59,895,095 | 18,438,255 | 10,264,385 | 180,367,549 |
| Liabilities | | | | | |
| Deposits and balances from banks | 945,743 | 3,907,660 | 1,109,642 | 817,887 | 6,780,932 |
| Deposits from customers | 74,963,899 | 47,158,336 | 15,760,925 | 9,069,882 | 146,953,042 |
| Derivative financial instruments | 3 | 8,740 | 130,834 | 6,619 | 146,196 |
| Subordinated debt | – | 1,947,028 | – | – | 1,947,028 |
| Other liabilities | 1,421,417 | 699,193 | 33,197 | 43,046 | 2,196,853 |
| Total | 77,331,062 | 53,720,957 | 17,034,598 | 9,937,434 | 158,024,051 |
| Net on-balance sheet position | 14,438,752 | 6,174,138 | 1,403,657 | 326,951 | 22,343,498 |
| Credit commitments | 27,560,116 | 16,712,404 | 1,911,552 | 580,139 | 46,764,211 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.2 Market risk (Continued)

### 3.2.3 Foreign exchange risk (Continued)

| As at 31st December 2016 | HKD | USD | RMB | Other | Total |
|---|---|---|---|---|---|
| Assets | | | | | |
| Cash and balances with banks | 8,870,180 | 10,540,206 | 1,717,249 | 3,492,860 | 24,620,495 |
| Placements with and loans and advances to banks | 11,914,872 | 11,376,549 | 1,484,153 | 1,787,393 | 26,562,967 |
| Loans and advances to customers | 35,880,273 | 24,008,006 | 2,329,044 | 2,302,675 | 64,519,998 |
| Financial assets held for trading | 124,547 | 401,854 | – | – | 526,401 |
| Derivative financial instruments | – | 4,016 | 201,587 | 33,644 | 239,247 |
| Available-for-sale investments | 20,439,926 | 13,558,014 | 8,541,573 | 2,923,184 | 45,462,697 |
| Held-to-maturity investments | 2,048,890 | 466,473 | – | – | 2,515,363 |
| Other assets | 765,838 | 65,833 | 2,709 | 5,135 | 839,515 |
| Total | 80,044,526 | 60,420,951 | 14,276,315 | 10,544,891 | 165,286,683 |
| Liabilities | | | | | |
| Deposits and balances from banks | 684,644 | 3,812,141 | 755,733 | 648,634 | 5,901,152 |
| Deposits from customers | 66,966,962 | 48,769,115 | 11,872,397 | 9,275,860 | 136,884,334 |
| Derivative financial instruments | – | 10,019 | 189,809 | 21,292 | 221,120 |
| Other liabilities | 993,670 | 300,661 | 37,940 | 40,035 | 1,372,306 |
| Total | 68,645,276 | 52,891,936 | 12,855,879 | 9,985,821 | 144,378,912 |
| Net on-balance sheet position | 11,399,250 | 7,529,015 | 1,420,436 | 559,070 | 20,907,771 |
| Credit commitments | 25,532,673 | 16,770,569 | 1,619,257 | 557,181 | 44,479,680 |

### 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 Division 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 and the Risk 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.

| As at 31st December 2017 | 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 | 18,370,758 | – | – | – | – | 10,384,254 | 28,755,012 |
| Placements with and loans and advances to banks | – | 8,231,498 | 9,318,105 | – | – | 83,643 | 17,633,246 |
| Loans and advances to customers | 67,567,063 | 8,331,354 | 1,359,783 | 803,916 | – | 234,572 | 78,296,688 |
| Financial assets held for trading | 44,022 | 77,904 | 3,707 | 453,539 | 1,352,402 | 43,534 | 1,975,108 |
| Derivative financial instruments | – | – | – | – | – | 141,006 | 141,006 |
| Available-for-sale investments | 5,210,646 | 12,278,389 | 8,597,317 | 19,691,059 | 7,806 | 4,381,792 | 50,167,009 |
| Held-to-maturity investments | – | 307,182 | 1,999,487 | 77,944 | – | 2,251 | 2,386,864 |
| Properties for sale | – | – | – | – | – | 373,529 | 373,529 |
| Investments in joint ventures | – | – | – | – | – | 338,914 | 338,914 |
| Properties and equipment | – | – | – | – | – | 2,389,569 | 2,389,569 |
| Investment properties | – | – | – | – | – | 1,020,504 | 1,020,504 |
| Deferred income tax assets | – | – | – | – | – | 40,523 | 40,523 |
| Other assets | 2,281 | – | – | – | – | 1,010,335 | 1,012,616 |
| Total assets | 91,194,770 | 29,226,327 | 21,278,399 | 21,026,458 | 1,360,208 | 20,444,426 | 184,530,588 |
| Liabilities | | | | | | | |
| Deposits and balances from banks | 3,108,798 | 2,744,926 | 863,503 | – | – | 63,705 | 6,780,932 |
| Deposits from customers | 81,852,541 | 27,136,139 | 20,113,353 | 290,876 | 5,022 | 17,555,111 | 146,953,042 |
| Derivative financial instruments | – | – | – | – | – | 146,196 | 146,196 |
| Subordinated debt | – | – | – | 1,940,308 | – | 6,720 | 1,947,028 |
| Other liabilities | 198,407 | – | – | – | – | 1,998,446 | 2,196,853 |
| Provisions | – | – | – | – | – | 156,571 | 156,571 |
| Current income tax liabilities | – | – | – | – | – | 422,206 | 422,206 |
| Deferred income tax liabilities | – | – | – | – | – | 382,438 | 382,438 |
| Total liabilities | 85,159,746 | 29,881,065 | 20,976,856 | 2,231,184 | 5,022 | 20,731,393 | 158,985,266 |
| Total interest repricing gap | 6,035,024 | (654,738) | 301,543 | 18,795,274 | 1,355,186 | (286,967) | 25,545,322 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.2 Market risk (Continued)

### 3.2.4 Interest rate risk (Continued)

**As at 31st December 2016**

| | 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 | 15,550,341 | – | – | – | – | 9,070,154 | 24,620,495 |
| Placements with and loans and advances to banks | – | 9,234,806 | 17,211,693 | – | – | 116,468 | 26,562,967 |
| Loans and advances to customers | 55,541,540 | 6,503,829 | 1,482,366 | 755,382 | – | 236,881 | 64,519,998 |
| Financial assets held for trading | – | – | 20,316 | 29,333 | 49,291 | 427,461 | 526,401 |
| Derivative financial instruments | – | – | – | – | – | 239,247 | 239,247 |
| Available-for-sale investments | 4,598,982 | 12,020,108 | 4,002,333 | 20,671,053 | 239,501 | 3,930,720 | 45,462,697 |
| Held-to-maturity investments | – | 1,019,188 | 791,820 | 702,124 | – | 2,231 | 2,515,363 |
| Properties for sale | – | – | – | – | – | 358,788 | 358,788 |
| Investments in joint ventures | – | – | – | – | – | 303,571 | 303,571 |
| Properties and equipment | – | – | – | – | – | 2,336,588 | 2,336,588 |
| Investment properties | – | – | – | – | – | 1,027,780 | 1,027,780 |
| Deferred income tax assets | – | – | – | – | – | 55,860 | 55,860 |
| Other assets | 2,287 | – | 177,657 | – | – | 659,571 | 839,515 |
| Total assets | 75,693,150 | 28,777,931 | 23,686,185 | 22,157,892 | 288,792 | 18,765,320 | 169,369,270 |
| Liabilities | | | | | | | |
| Deposits and balances from banks | 3,370,256 | 937,150 | 514,768 | – | – | 1,078,978 | 5,901,152 |
| Deposits from customers | 73,691,922 | 30,064,280 | 17,971,802 | 137,413 | 5,022 | 15,013,895 | 136,884,334 |
| Derivative financial instruments | – | – | – | – | – | 221,120 | 221,120 |
| Other liabilities | 134,411 | – | – | – | – | 1,237,895 | 1,372,306 |
| Provisions | – | – | – | – | – | 94,612 | 94,612 |
| Current income tax liabilities | – | – | – | – | – | 39,177 | 39,177 |
| Deferred income tax liabilities | – | – | – | – | – | 476,878 | 476,878 |
| Total liabilities | 77,196,589 | 31,001,430 | 18,486,570 | 137,413 | 5,022 | 18,162,555 | 144,989,579 |
| Total interest repricing gap | (1,503,439) | (2,223,499) | 5,199,615 | 22,020,479 | 283,770 | 602,765 | 24,379,691 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 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 is managed by the Treasury Division and monitored by management and the Asset and Liability Committee in accordance with the guidelines and procedures laid down in the liquidity risk management policy approved by the Board of Directors, which has regard to a variety of factors, including liquidity maintenance 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 to ensure that both the funding liquidity and market liquidity are properly handled. 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 under both normal business conditions and emergency situations.

### 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 liquidity maintenance 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 (Note 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.

The Group conducts stress testing regularly to analyse liquidity risk. The Group's stress tests are conducted with hypothetical as well as historical assumptions. Both funding and market liquidity risks are addressed. Three stress scenarios including the institution-specific crisis, the general market crisis and the combined crisis are adopted with minimum survival period defined according to Supervisory Policy Manual LM-2 'Sound Systems and Controls for Liquidity Risk Management' of the HKMA.

With reference to the stress-testing results, the Group identifies potential vulnerability within the Group, and formulates a Contingency Funding Plan, a component of the Group's Business Continuity Plan, to describe the Group's strategy for dealing with any liquidity problem and the procedures for making up cash flow deficits in emergency situations.

Annual drill test is conducted and the Contingency Funding Plan is subject to regular review in order to cope with the changes of business environment. Any significant changes to the Contingency Funding Plan are approved by the Board of Directors.

The Group also performs reverse stress-testing in accordance with the HKMA's Supervisory Policy Manual IC-5 'Stress-testing'. It is a process of working backwards from the event causing business failures and involves a mix of qualitative and quantitative analyses. The Group uses results of stress-testing and reverse stress-testing to strengthen resilience to liquidity stress and serve as early-warning triggers for the formulation of management actions and contingency funding plan to mitigate potential stress and vulnerability which the Group might face.

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.3 Liquidity risk (Continued)

### 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 reporting date to the contractual maturity date.

| As at 31st December 2017 | 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 | 11,169,437 | 17,585,575 | – | – | – | – | – | 28,755,012 |
| Placements with and loans and advances to banks | – | – | 8,272,111 | 9,361,135 | – | – | – | 17,633,246 |
| Loans and advances to customers | 4,932,205 | 5,194,173 | 7,465,262 | 16,183,816 | 25,163,090 | 18,716,837 | 641,305 | 78,296,688 |
| Financial assets held for trading | – | 44,139 | – | 81,828 | 454,742 | 1,356,089 | 38,310 | 1,975,108 |
| Derivative financial instruments | – | 45,176 | 61,858 | 28,925 | 5,047 | – | – | 141,006 |
| Available-for-sale investments | – | 1,599,443 | 2,716,526 | 10,312,013 | 31,232,557 | 187,281 | 4,119,189 | 50,167,009 |
| Held-to-maturity investments | – | – | 307,773 | 2,001,012 | 78,079 | – | – | 2,386,864 |
| Properties for sale | – | – | – | – | – | – | 373,529 | 373,529 |
| Investments in joint ventures | – | – | – | – | – | – | 338,914 | 338,914 |
| Properties and equipment | – | – | – | – | – | – | 2,389,569 | 2,389,569 |
| Investment properties | – | – | – | – | – | – | 1,020,504 | 1,020,504 |
| Deferred income tax assets | – | – | – | – | – | – | 40,523 | 40,523 |
| Other assets | 85,650 | 806,539 | 4,708 | 38,089 | 73,511 | – | 4,119 | 1,012,616 |
| Total assets | 16,187,292 | 25,275,045 | 18,828,238 | 38,006,818 | 57,007,026 | 20,260,207 | 8,965,962 | 184,530,588 |
| Liabilities | | | | | | | | |
| Deposits and balances from banks | 1,397,117 | 1,820,650 | 2,695,358 | 867,807 | – | – | – | 6,780,932 |
| Deposits from customers | 66,710,550 | 32,613,190 | 27,043,454 | 20,318,132 | 267,716 | – | – | 146,953,042 |
| Derivative financial instruments | – | 32,939 | 80,978 | 27,232 | 5,047 | – | – | 146,196 |
| Subordinated debt | – | – | – | 6,720 | – | 1,940,308 | – | 1,947,028 |
| Other liabilities | 660,481 | 1,178,459 | 65,329 | 292,584 | – | – | – | 2,196,853 |
| Provisions | 36,144 | – | 120,427 | – | – | – | – | 156,571 |
| Current income tax liabilities | – | 284,829 | – | 137,377 | – | – | – | 422,206 |
| Deferred income tax liabilities | – | – | – | – | – | – | 382,438 | 382,438 |
| Total liabilities | 68,804,292 | 35,930,067 | 30,005,546 | 21,649,852 | 272,763 | 1,940,308 | 382,438 | 158,985,266 |
| Net liquidity gap | (52,617,000) | (10,655,022) | (11,177,308) | 16,356,966 | 56,734,263 | 18,319,899 | 8,583,524 | 25,545,322 |
| Of which certificates of deposit included in: | | | | | | | | |
| Available-for-sale investments | – | 692,253 | 1,519,973 | 5,105,517 | 10,075,261 | – | – | 17,393,004 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.3 Liquidity risk (Continued)

### 3.3.2 Maturity analysis (Continued)

As at 31st December 2016

| | 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 | 9,935,968 | 14,684,527 | – | – | – | – | – | 24,620,495 |
| Placements with and loans and advances to banks | – | – | 9,275,481 | 17,287,486 | – | – | – | 26,562,967 |
| Loans and advances to customers | 9,852,976 | 3,690,506 | 4,803,884 | 8,604,866 | 17,556,488 | 19,136,575 | 874,703 | 64,519,998 |
| Financial assets held for trading | – | 226 | 226 | 30,259 | 90,389 | 280,648 | 124,653 | 526,401 |
| Derivative financial instruments | – | 59,347 | 63,777 | 116,123 | – | – | – | 239,247 |
| Available-for-sale investments | – | 716,086 | 1,098,519 | 8,774,922 | 29,837,652 | 723,439 | 4,312,079 | 45,462,697 |
| Held-to-maturity investments | – | – | 1,019,474 | 792,695 | 703,194 | – | – | 2,515,363 |
| Properties for sale | – | – | – | – | – | – | 358,788 | 358,788 |
| Investments in joint ventures | – | – | – | – | – | – | 303,571 | 303,571 |
| Properties and equipment | – | – | – | – | – | – | 2,336,588 | 2,336,588 |
| Investment properties | – | – | – | – | – | – | 1,027,780 | 1,027,780 |
| Deferred income tax assets | – | – | – | – | – | – | 55,860 | 55,860 |
| Other assets | 30,255 | 672,260 | 4,137 | 36,699 | 92,045 | – | 4,119 | 839,515 |
| Total assets | 19,819,199 | 19,822,952 | 16,265,498 | 35,643,050 | 48,279,768 | 20,140,662 | 9,398,141 | 169,369,270 |
| Liabilities | | | | | | | | |
| Deposits and balances from banks | 1,038,215 | 3,409,039 | 515,480 | 938,418 | – | – | – | 5,901,152 |
| Deposits from customers | 59,272,247 | 29,279,409 | 30,120,247 | 18,069,761 | 142,670 | – | – | 136,884,334 |
| Derivative financial instruments | – | 60,551 | 51,578 | 108,991 | – | – | – | 221,120 |
| Other liabilities | 32,715 | 1,131,756 | 37,602 | 170,233 | – | – | – | 1,372,306 |
| Provisions | – | 81,432 | 6,978 | – | 6,091 | 111 | – | 94,612 |
| Current income tax liabilities | – | – | – | 39,177 | – | – | – | 39,177 |
| Deferred income tax liabilities | – | – | – | – | – | – | 476,878 | 476,878 |
| Total liabilities | 60,343,177 | 33,962,187 | 30,731,885 | 19,326,580 | 148,761 | 111 | 476,878 | 144,989,579 |
| Net liquidity gap | (40,523,978) | (14,139,235) | (14,466,387) | 16,316,470 | 48,131,007 | 20,140,551 | 8,921,263 | 24,379,691 |
| Of which certificates of deposit included in: | | | | | | | | |
| Available-for-sale investments | – | 437,058 | 590,900 | 6,645,297 | 10,987,443 | 485,191 | – | 19,145,889 |

### 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 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.3 Liquidity risk (Continued)

### 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 reporting date. 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.

| As at 31st December 2017 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| Liabilities | | | | | | |
| Deposits and balances from banks | 3,211,188 | 2,702,856 | 901,858 | – | – | 6,815,902 |
| Deposits from customers | 99,324,659 | 27,086,611 | 20,619,778 | 288,420 | – | 147,319,468 |
| Subordinated debt | – | – | 73,292 | 293,168 | 2,306,768 | 2,673,228 |
| Other liabilities | 1,838,940 | 65,329 | 292,584 | – | – | 2,196,853 |
| Total | 104,374,787 | 29,854,796 | 21,887,512 | 581,588 | 2,306,768 | 159,005,451 |
| Assets held for managing liquidity risk | 40,822,153 | 19,349,337 | 40,102,909 | 62,137,089 | 30,492,255 | 192,903,743 |

| As at 31st December 2016 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| Liabilities | | | | | | |
| Deposits and balances from banks | 4,450,058 | 521,253 | 974,313 | – | – | 5,945,624 |
| Deposits from customers | 88,614,325 | 30,225,308 | 18,344,838 | 152,087 | – | 137,336,558 |
| Subordinated debt | – | – | – | – | – | – |
| Other liabilities | 1,164,471 | 37,602 | 170,233 | – | – | 1,372,306 |
| Total | 94,228,854 | 30,784,163 | 19,489,384 | 152,087 | – | 144,654,488 |
| Assets held for managing liquidity risk | 39,230,995 | 16,915,675 | 37,295,050 | 53,444,928 | 31,030,185 | 177,916,833 |

Assets available to meet all of the liabilities and to cover outstanding loan commitments include cash and balances with banks, placements with and loans and advances to banks, loans and advances to customers, available-for-sale investments, held-to-maturity investments 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.

The Group's policy defines the size and composition of liquidity cushion. The Group's liquidity cushion includes but not limited to high quality government securities such as Exchange Fund papers and the United States Treasury securities.

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.3 Liquidity risk (Continued)

### 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 reporting date 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.

| As at 31st December 2017 | 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 | 2,964,559 | 3,516,758 | 3,262,375 | 8,741,225 | – | 18,484,917 |
| – Inflow | 2,977,387 | 3,496,611 | 3,261,889 | 8,741,225 | – | 18,477,112 |

| As at 31st December 2016 | 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 | 30,915,376 | 6,455,935 | 6,470,451 | – | – | 43,841,762 |
| – Inflow | 30,917,200 | 6,463,202 | 6,476,943 | – | – | 43,857,345 |

# 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 37(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 37(b), are summarised in the table below.

**(d) Capital commitments**

Capital commitments for the acquisition of properties and equipment (Note 37(a)) are summarised in the table below.

**As at 31st December 2017**

| | No later than 1 year | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|
| Loan and other commitments | 36,388,686 | 4,342,644 | 930,640 | 41,661,970 |
| Forward forward deposits placed | – | – | – | – |
| Guarantees, acceptances and other financial facilities | | | | |
| – Acceptances | 391,616 | – | – | 391,616 |
| – Guarantees and standby letters of credit | 2,380,855 | 311,609 | 8,435 | 2,700,899 |
| – Documentary and commercial letters of credit | 2,009,726 | – | – | 2,009,726 |
| Operating lease commitments | 88,453 | 109,569 | 11,586 | 209,608 |
| Capital commitments | 140,667 | 11,886 | – | 152,553 |
| Total | 41,400,003 | 4,775,708 | 950,661 | 47,126,372 |

**As at 31st December 2016**

| | No later than 1 year | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|
| Loan and other commitments | 33,515,281 | 5,718,053 | 312,638 | 39,545,972 |
| Forward forward deposits placed | 376,558 | – | – | 376,558 |
| Guarantees, acceptances and other financial facilities | | | | |
| – Acceptances | 330,560 | – | – | 330,560 |
| – Guarantees and standby letters of credit | 2,158,759 | 238,474 | 8,091 | 2,405,324 |
| – Documentary and commercial letters of credit | 1,821,266 | – | – | 1,821,266 |
| Operating lease commitments | 94,688 | 102,135 | 19,208 | 216,031 |
| Capital commitments | 154,931 | 23,920 | – | 178,851 |
| Total | 38,452,043 | 6,082,582 | 339,937 | 44,874,562 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.4 Fair value of financial assets and liabilities

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

(i) Balances with banks and placements with and loans and advances to banks

Balances with banks and 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 the reporting date approximates their fair value.

(ii) Loans and advances to customers

Loans and advances are stated net of impairment allowances. An insignificant portion of loans and advances to customers bears interest at fixed rate. The carrying amount at the reporting date approximates their fair value.

(iii) Held-to-maturity 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. For the carrying value and fair value of held-to-maturity securities, please refer to Note 22. The fair value of held-to-maturity securities is classified under Level 1 (2017: HK$2,383,170,000, 2016: HK$2,360,571,000) and Level 2 (2017: nil, 2016: HK$155,198,000) in the fair value hierarchy. Please refer to Note 3.4(b) for the definition of fair value hierarchy.

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

Substantially all the deposits and balances from banks and deposits from customers will mature within 1 year from the reporting date. Hence, the carrying amount at the reporting date approximates their fair value.

(v) Subordinated debt

The fair value of subordinated debt of HK$1,941,883,000 (2016: nil) is classified under Level 2 in the fair value hierarchy.

**(b) Fair value hierarchy**

**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.

The Group is to recognise transfers into and transfers out of fair value hierarchy levels as of that date of the event or change in circumstances that caused the transfer.

HKFRS 13 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, funds and debt securities on exchanges 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 instruments such as over-the-counter derivative contracts, unlisted equity securities and unlisted debt securities. Observable parameters that are used as input include market data such as HIBOR and LIBOR yield curves and exchange rate implied volatilities.

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

Recurring fair value measurement

| As at 31st December 2017 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets held for trading | | | | |
| Debt securities | 1,152,597 | 784,201 | – | 1,936,798 |
| Equity securities | 35,161 | – | – | 35,161 |
| Funds | 3,005 | – | – | 3,005 |
| Others | 144 | – | – | 144 |
| Derivative financial instruments | | | | |
| Exchange rate contracts | – | 141,006 | – | 141,006 |
| Available-for-sale investments | | | | |
| Debt securities | 15,093,373 | 30,954,447 | 2,874 | 46,050,694 |
| Equity securities | 3,981,743 | 100,657 | 33,915 | 4,116,315 |
| Total Assets | 20,266,023 | 31,980,311 | 36,789 | 52,283,123 |
| Derivative financial instruments | | | | |
| Exchange rate contracts | – | 146,196 | – | 146,196 |
| Total Liabilities | – | 146,196 | – | 146,196 |

| As at 31st December 2016 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets held for trading | | | | |
| Debt securities | 184,579 | 217,169 | – | 401,748 |
| Equity securities | 120,449 | – | – | 120,449 |
| Funds | 4,099 | – | – | 4,099 |
| Others | 105 | – | – | 105 |
| Derivative financial instruments | | | | |
| Exchange rate contracts | – | 239,247 | – | 239,247 |
| Available-for-sale investments | | | | |
| Debt securities | 9,506,218 | 31,644,400 | 2,874 | 41,153,492 |
| Equity securities | 4,201,554 | 73,961 | 33,690 | 4,309,205 |
| Total Assets | 14,017,004 | 32,174,777 | 36,564 | 46,228,345 |
| Derivative financial instruments | | | | |
| Exchange rate contracts | – | 221,120 | – | 221,120 |
| Total Liabilities | – | 221,120 | – | 221,120 |

# 3 FINANCIAL RISK MANAGEMENT (CONTINUED)

## 3.4 Fair value of financial assets and liabilities (Continued)

**(b) Fair value hierarchy (Continued)**

Level 2 fair values of unlisted debt securities are determined based on quotes from brokers. The most significant input is discount rate of the instruments.

Level 2 fair values of unlisted equity securities are determined based on quoted prices for identical assets from over-the-counter market.

Level 2 fair values of exchange rate contracts and options are determined using forward exchange rates and implied volatilities at the reporting date, with the resulting value discounted back to present value.

Level 3 fair values of unlisted equity securities and debentures are stated at cost which is considered to be a reasonable approximation of the fair value.

The following table presents the changes in level 3 instruments for the years ended 31st December 2016 and 2017 respectively.

| | Available-for-sale investments | | |
|---|---|---|---|
| | Equity securities | Debt securities | Total |
| As at 1st January 2016 | 2,939,273 | 2,874 | 2,942,147 |
| Total losses | | | |
| – Loss | (1,004) | – | (1,004) |
| – Other comprehensive income | – | – | – |
| Purchases | – | – | – |
| Settlements | – | – | – |
| Transfer to Level 1 | (2,822,377) | – | (2,822,377) |
| Exchange adjustments | (82,202) | – | (82,202) |
| As at 31st December 2016 | 33,690 | 2,874 | 36,564 |
| As at 1st January 2017 | **33,690** | **2,874** | **36,564** |
| Total gains | | | |
| – Profit | **–** | **–** | **–** |
| – Other comprehensive income | **–** | **–** | **–** |
| Purchases | **–** | **–** | **–** |
| Settlements | **–** | **–** | **–** |
| Exchange adjustments | **225** | **–** | **225** |
| As at 31st December 2017 | **33,915** | **2,874** | **36,789** |

# 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 ('BCR') 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 BCR. The required information is filed with the 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 statutory minimum ratio. 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 regulatory capital of the Group comprises the following:

- Common Equity Tier 1 ('CET1') capital and Tier 1 capital: share capital, general reserve, available-for-sale investments revaluation reserve and retained earnings; and

- Tier 2 capital: subordinated debt, collective impairment allowances and regulatory reserve.

| | 2017 | 2016 |
|---|---|---|
| CET1 capital ratio | **16.7%** | 18.0% |
| Tier 1 capital ratio | **16.7%** | 18.0% |
| Total capital ratio | **18.9%** | 18.7% |

## 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 Division 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

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.

**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 statement of profit or loss, 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.

# 5 SEGMENT REPORTING

**(a) By operating segment**

Operating segments, and the amounts of each segment item reported in the consolidated financial statements, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

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.

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 and corporate banking – incorporating banking services to individual and corporate customers such as current accounts, savings accounts, time deposits, safe deposit box, credit and debit cards, loans and other credit facilities.

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

Treasury – conducting treasury operations for trading and investment purposes such as foreign exchange, money market and capital market activities and providing treasury products such as yield enhancement and hedging products to retail and corporate customers.

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

## 5 SEGMENT REPORTING (CONTINUED)

**(a) By operating segment (Continued)**

| 2017 | Retail and corporate banking | Trade finance | Treasury | Others | Total |
|---|---|---|---|---|---|
| Net interest income | 2,213,110 | 89,453 | 715,986 | 81,514 | 3,100,063 |
| Net fee and commission income | 196,217 | 89,364 | – | 480,420 | 766,001 |
| Other operating income | 54,492 | 15,573 | 464,952 | 202,686 | 737,703 |
| Operating income | 2,463,819 | 194,390 | 1,180,938 | 764,620 | 4,603,767 |
| Operating expenses | (795,471) | (84,629) | (99,776) | (539,959) | (1,519,835) |
| Charge of impairment losses on loans and advances | (59,173) | (181) | – | – | (59,354) |
| Share of net profits of joint ventures | – | – | – | 54,180 | 54,180 |
| Profit before income tax | 1,609,175 | 109,580 | 1,081,162 | 278,841 | 3,078,758 |
| Income tax expense | 430,068 | 15,493 | 182,323 | 20,357 | 648,241 |
| Depreciation expenses | 5,163 | 538 | 2,102 | 109,873 | 117,676 |
| Operating assets | 78,288,048 | 3,658,373 | 97,342,383 | 5,241,784 | 184,530,588 |
| Operating liabilities | 148,268,466 | 142,730 | 7,898,354 | 2,675,716 | 158,985,266 |

| 2016 (Restated) | Retail and corporate banking | Trade finance | Treasury | Others | Total |
|---|---|---|---|---|---|
| Net interest income | 1,595,094 | 77,045 | 865,593 | 99,098 | 2,636,830 |
| Net fee and commission income | 168,835 | 90,290 | 10,095 | 388,021 | 657,241 |
| Other operating income | 48,682 | 16,179 | 315,629 | 183,943 | 564,433 |
| Operating income | 1,812,611 | 183,514 | 1,191,317 | 671,062 | 3,858,504 |
| Operating expenses | (721,970) | (82,019) | (82,720) | (540,979) | (1,427,688) |
| (Charge)/reversal of impairment losses on loans and advances | (21,871) | 1,440 | – | – | (20,431) |
| Share of net profits of joint ventures | – | – | – | 33,564 | 33,564 |
| Profit before income tax | 1,068,770 | 102,935 | 1,108,597 | 163,647 | 2,443,949 |
| Income tax expense | 317,905 | 14,469 | 176,074 | 22,523 | 530,971 |
| Depreciation expenses | 5,061 | 191 | 361 | 95,138 | 100,751 |
| Operating assets | 63,418,449 | 3,417,187 | 100,008,898 | 2,524,736 | 169,369,270 |
| Operating liabilities | 137,485,756 | 57,713 | 6,407,556 | 1,038,554 | 144,989,579 |

# 5 SEGMENT REPORTING (CONTINUED)

**(b) By geographical regions**

The following tables provide information by geographical area, which was determined with reference to the location of the principal operations of the branches and subsidiaries of the Group.

**2017**

| | Total assets | Total liabilities | Contingent liabilities and commitments | Total operating income | Profit before income tax | Capital expenditure |
|---|---|---|---|---|---|---|
| Hong Kong and Mainland China | 161,403,946 | 145,784,771 | 40,481,826 | 3,849,184 | 2,473,881 | 164,398 |
| United States | 20,626,549 | 10,947,437 | 6,224,867 | 697,928 | 566,393 | 929 |
| United Kingdom | 2,500,093 | 2,253,058 | 57,518 | 56,655 | 38,484 | 77 |
| Total | 184,530,588 | 158,985,266 | 46,764,211 | 4,603,767 | 3,078,758 | 165,404 |

**2016**

| | Total assets | Total liabilities | Contingent liabilities and commitments | Total operating income | Profit before income tax | Capital expenditure |
|---|---|---|---|---|---|---|
| Hong Kong and Mainland China | 150,242,694 | 132,283,289 | 37,507,881 | 3,253,294 | 1,968,761 | 196,377 |
| United States | 16,769,116 | 10,670,212 | 6,935,251 | 551,962 | 439,371 | 459 |
| United Kingdom | 2,357,460 | 2,036,078 | 36,548 | 53,248 | 35,817 | 45 |
| Total | 169,369,270 | 144,989,579 | 44,479,680 | 3,858,504 | 2,443,949 | 196,881 |

# 6 NET INTEREST INCOME

**Interest Income**

| | 2017 | 2016 |
|---|---|---|
| Cash and balances with banks | 626,345 | 481,928 |
| Held-to-maturity and available-for-sale investments | 1,137,281 | 1,015,279 |
| Loans and advances to customers | 2,570,503 | 2,190,274 |
| Others | 10,146 | 7,488 |
| Interest income on financial assets that are not at fair value through profit or loss | 4,344,275 | 3,694,969 |

**Included within interest income**

| | | |
|---|---|---|
| Interest income accrued on impaired financial assets | 34,439 | 571 |

**Interest expense**

| | | |
|---|---|---|
| Deposits and balances from banks | 125,136 | 65,516 |
| Deposits from customers | 1,109,023 | 990,174 |
| Subordinated debt | 6,817 | – |
| Others | 3,236 | 2,449 |
| Interest expense on financial liabilities that are not at fair value through profit or loss | 1,244,212 | 1,058,139 |

## 7 NET FEE AND COMMISSION INCOME

| Fee and commission income | 2017 | 2016 |
|---|---|---|
| Bills | 92,275 | 88,542 |
| Nominees, custodian and securities brokerage | 232,480 | 167,181 |
| Investment products | 145,801 | 104,019 |
| Remittance | 61,257 | 55,534 |
| Facility fees | 133,082 | 115,882 |
| Credit cards | 43,110 | 43,682 |
| Retail banking | 47,345 | 44,116 |
| Insurance | 48,284 | 66,934 |
| Loans and advances | 4,480 | 6,016 |
| Trust and other commissions | 4,037 | 3,665 |
| | 812,151 | 695,571 |

| Fee and commission expense | | |
|---|---|---|
| Bills | 6,837 | 5,097 |
| Nominees, custodian and securities brokerage | 16,637 | 14,376 |
| Retail banking | 22,551 | 18,668 |
| Credit cards | 82 | 91 |
| Remittance | 43 | 98 |
| | 46,150 | 38,330 |
| 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 | 272,947 | 254,122 |
| – fee and commission expense | 6,919 | 5,188 |
| Net fee and commission income on trust and other fiduciary activities | | |
| – fee and commission income | 25,710 | 25,220 |

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 NET TRADING INCOME

| | 2017 | 2016 |
|---|---|---|
| Foreign exchange | 335,023 | 245,515 |
| Interest rate instruments | 24,071 | 1,272 |
| Equities | 58,159 | (4,680) |
| Other trading income | 2,210 | 878 |
| | 419,463 | 242,985 |

'Foreign exchange' 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.

## 9 OTHER OPERATING INCOME

| | 2017 | 2016 |
|---|---|---|
| Gross rental income from investment properties | 74,556 | 40,026 |
| Others | 72,549 | 70,454 |
| | 147,105 | 110,480 |

Direct operating expenses arising from investment properties of HK$4,000 are included in building expenses (Note 11) (2016: HK$12,098,000), of which nil (2016: HK$696,000) are related to investment properties that do not generate rental income.

## 10 NET EARNED INSURANCE PREMIUM

| | 2017 | 2016 |
|---|---|---|
| Insurance premium revenue | 54,492 | 57,768 |
| Insurance premium ceded to reinsurers | (14,238) | (14,432) |
| | 40,254 | 43,336 |

The related net insurance claims incurred and movement in policyholders' liabilities of HK$22,326,000 (2016: HK$24,182,000) were shown after being netted off with the insurance claims and loss adjustment expenses recovered from reinsurers of HK$3,751,000 (2016: HK$1,936,000).

## 11 OPERATING EXPENSES

| | 2017 | 2016 |
|---|---|---|
| Auditor's remuneration | | |
| Statutory audit services | 9,354 | 7,283 |
| Non-statutory audit and other services (Note a) | 10,748 | 8,637 |
| Advertising costs | 18,602 | 24,677 |
| Depreciation expenses | 117,676 | 100,751 |
| Employee benefit expenses | | |
| Wages and salaries and other costs (Note b) | 864,055 | 781,928 |
| Pension costs – defined contribution schemes | 57,878 | 56,860 |
| Pension costs – defined benefit schemes | – | 12 |
| Premises and equipment expenses, excluding depreciation | | |
| Rental of premises | 116,846 | 147,780 |
| Building expenses | 35,433 | 50,468 |
| Other operating expenses | | |
| Computer rental and licence | 24,711 | 18,230 |
| Credit card business promotion | 28,301 | 30,942 |
| Credit card service fee | 12,102 | 10,496 |
| Insurance | 2,911 | 3,774 |
| Legal and consultancy | 17,422 | 14,903 |
| Postage | 14,767 | 14,566 |
| Printing and stationery | 8,937 | 9,384 |
| Repair and maintenance | 21,778 | 19,118 |
| Telephone and communications | 30,818 | 29,259 |
| Travelling and transportation | 7,407 | 6,523 |
| Water, heat and light | 17,198 | 16,505 |
| Others | 102,891 | 75,592 |
| | 1,519,835 | 1,427,688 |

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.

## 12 DIRECTORS' EMOLUMENTS

The emoluments of the Directors of the Bank disclosed pursuant to section 383 of the Hong Kong Companies Ordinance (Cap.622) and the Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G) were set out below:

| | 2017 | 2016 |
|---|---|---|
| Fees | 6,092 | 6,067 |
| Basic salaries, allowances and bonus | 24,874 | 21,757 |
| Contributions to retirement benefits schemes | 1,282 | 1,262 |
| | 32,248 | 29,086 |

## 13 CHARGE OF IMPAIRMENT LOSSES ON LOANS AND ADVANCES TO CUSTOMERS

| | 2017 | 2016 |
|---|---|---|
| Trade bills | (153) | 135 |
| Loans and advances to customers | 59,507 | 20,296 |
| | 59,354 | 20,431 |
| Net charge of impairment losses | | |
| – Individually assessed (Note 18(b)) | 7,917 | 15,750 |
| – Collectively assessed (Note 18(b)) | 51,437 | 4,681 |
| | 59,354 | 20,431 |
| Of which | | |
| – new allowances | 94,423 | 64,589 |
| – releases | (28,898) | (38,981) |
| – recoveries | (6,171) | (5,177) |
| Net charge to statement of profit or loss | 59,354 | 20,431 |

## 14 INCOME TAX EXPENSE

Hong Kong profits tax has been provided at the rate of 16.5% (2016: 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 statement of profit or loss represents:

| | 2017 | 2016 |
|---|---|---|
| Current income tax: | | |
| – Hong Kong profits tax | 385,975 | 311,683 |
| – Overseas taxation | 251,905 | 224,752 |
| – Over provisions in respect of prior years | (4,666) | (7,377) |
| Total current income tax | 633,214 | 529,058 |
| Deferred income tax: | | |
| – Hong Kong deferred tax | (4,280) | 10,570 |
| – Overseas deferred tax | 19,307 | (8,657) |
| Total deferred income tax | 15,027 | 1,913 |
| Income tax expense | 648,241 | 530,971 |

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:

| | 2017 | 2016 |
|---|---|---|
| Profit before tax | 3,078,758 | 2,443,949 |
| Tax calculated at domestic tax rates applicable to profits in the respective countries | 653,331 | 529,263 |
| Tax effects of: | | |
| Effect of change in US corporation tax rate | 13,073 | – |
| Income not subject to tax | (32,348) | (13,249) |
| Expenses not deductible for tax purposes | 18,851 | 22,565 |
| Net effect of investments in partnerships | – | (231) |
| Over provisions in respect of prior years | (4,666) | (7,377) |
| Income tax expense | 648,241 | 530,971 |

## 15 DIVIDEND

The dividends paid in 2017 and 2016 were HK$940,000,000 (HK$47 per share) for both years. A dividend in respect of the year ended 31st December 2017 of HK$47 per share, amounting to a total dividend of HK$940,000,000, is to be proposed at the Annual General Meeting on 18th April 2018. These financial statements do not reflect this dividend payable.

| | 2017 | 2016 |
|---|---|---|
| Proposed final dividend of HK$47 (2016: HK$47) per ordinary share | 940,000 | 940,000 |

## 16 CASH AND BALANCES WITH BANKS

| | 2017 | 2016 |
|---|---|---|
| Cash in hand | 355,681 | 359,477 |
| Balances with central banks and Hong Kong Monetary Authority | 8,877,217 | 7,322,108 |
| Balances with banks | 19,522,114 | 16,938,910 |
| | 28,755,012 | 24,620,495 |

Included in the above amounts, HK$313,863,000 (2016: HK$356,883,000) were deposited in central banks or designated banks as at 31st December 2017 to comply with the statutory requirements of respective jurisdiction in which the Group is operating the business.

## 17 PLACEMENTS WITH AND LOANS AND ADVANCES TO BANKS

| | 2017 | 2016 |
|---|---|---|
| Placements with banks maturing between 1 and 12 months | 17,633,246 | 26,485,410 |
| Loans and advances to banks maturing between 1 and 12 months | – | 77,557 |
| | 17,633,246 | 26,562,967 |

Included in the above amounts, HK$383,300,000 (2016: HK$364,233,000) were deposited with designated banks in the People's Republic of China as at 31st December 2017, to comply with the local statutory requirement. No impairment allowances for the placements with and loans and advances to banks were needed.

## 18 LOANS AND ADVANCES TO CUSTOMERS

**(a) Analysis of loans and advances to customers**

| | 2017 | 2016 |
|---|---|---|
| Loans and advances to individuals | | |
| – Overdrafts | 513,473 | 657,224 |
| – Credit cards | 242,496 | 242,990 |
| – Term loans and others | 6,367,287 | 5,664,033 |
| – Mortgages | 8,986,591 | 8,598,110 |
| Loans and advances to corporate entities | | |
| – Large corporate customers and others | 57,043,547 | 43,608,898 |
| – SME | 5,493,662 | 6,032,519 |
| Gross loans and advances to customers | 78,647,056 | 64,803,774 |
| Less: impairment allowances | | |
| – Individually assessed | (37,297) | (26,029) |
| – Collectively assessed | (313,071) | (257,747) |
| | 78,296,688 | 64,519,998 |
| Gross trade bills and other eligible bills, included within loans and advances to customers | 579,706 | 673,580 |
| Less: impairment allowances on trade bills | | |
| – Collectively assessed | (759) | (912) |
| | 578,947 | 672,668 |

The Group accepted listed securities at fair value of HK$3,575,134,000 (2016: HK$3,364,389,000) as collateral for shares financing facilities. These securities are permitted to be sold or re-pledged in the event of default by the borrowers.

## 18 LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

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

| | Impairment allowances for loans and advances to individuals – Individual assessment | | | | |
|---|---|---|---|---|---|
| | Overdrafts | Credit cards | Term loans and others | Mortgages | Total |
| As at 1st January 2017 | 296 | 695 | 265 | 178 | 1,434 |
| Charge/(write-back) of impairment losses (Note 13) | (12) | 1,716 | (1) | (391) | 1,312 |
| Loans written off as uncollectible | (153) | (2,969) | (390) | – | (3,512) |
| Recoveries of advances written off in previous years | 14 | 882 | 465 | 332 | 1,693 |
| As at 31st December 2017 | 145 | 324 | 339 | 119 | 927 |
| As at 1st January 2016 | 1 | 661 | 307 | 100 | 1,069 |
| Charge/(write-back) of impairment losses (Note 13) | 295 | 3,467 | 487 | (201) | 4,048 |
| Loans written off as uncollectible | – | (4,395) | (680) | – | (5,075) |
| Recoveries of advances written off in previous years | – | 962 | 151 | 279 | 1,392 |
| As at 31st December 2016 | 296 | 695 | 265 | 178 | 1,434 |

| | Impairment allowances for loans and advances to corporate entities – Individual assessment | | |
|---|---|---|---|
| | Large corporate customers and others | SME | Total |
| As at 1st January 2017 | 16,028 | 8,567 | 24,595 |
| Charge/(write-back) of impairment losses (Note 13) | 6,986 | (381) | 6,605 |
| Loans written off as uncollectible | (24) | (89) | (113) |
| Recoveries of advances written off in previous years | 1,828 | 2,650 | 4,478 |
| Exchange adjustments | 234 | 571 | 805 |
| As at 31st December 2017 | 25,052 | 11,318 | 36,370 |
| As at 1st January 2016 | 12,171 | 6,184 | 18,355 |
| Charge of impairment losses (Note 13) | 6,657 | 5,045 | 11,702 |
| Loans written off as uncollectible | (5,214) | (3,667) | (8,881) |
| Recoveries of advances written off in previous years | 2,489 | 1,296 | 3,785 |
| Exchange adjustments | (75) | (291) | (366) |
| As at 31st December 2016 | 16,028 | 8,567 | 24,595 |

## 18 LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

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

| | Impairment allowances for loans and advances to individuals – Collective assessment | | | | |
|---|---|---|---|---|---|
| | Overdrafts | Credit cards | Term loans and others | Mortgages | Total |
| As at 1st January 2017 | 2,576 | 3,725 | 22,860 | 34,357 | 63,518 |
| Charge/(write-back) of impairment losses (Note 13) | (521) | (104) | 2,430 | 889 | 2,694 |
| Exchange adjustments | – | – | 127 | 581 | 708 |
| As at 31st December 2017 | 2,055 | 3,621 | 25,417 | 35,827 | 66,920 |
| As at 1st January 2016 | 2,565 | 3,828 | 25,443 | 34,516 | 66,352 |
| Charge/(write-back) of impairment losses (Note 13) | 11 | (103) | (2,486) | 743 | (1,835) |
| Exchange adjustments | – | – | (97) | (902) | (999) |
| As at 31st December 2016 | 2,576 | 3,725 | 22,860 | 34,357 | 63,518 |

| | Impairment allowances for loans and advances to corporate entities – Collective assessment | | |
|---|---|---|---|
| | Large corporate customers and others | SME | Total |
| As at 1st January 2017 | 170,801 | 23,428 | 194,229 |
| Charge/(write-back) of impairment losses (Note 13) | 50,533 | (1,790) | 48,743 |
| Exchange adjustments | 3,020 | 159 | 3,179 |
| As at 31st December 2017 | 224,354 | 21,797 | 246,151 |
| As at 1st January 2016 | 165,924 | 23,520 | 189,444 |
| Charge of impairment losses (Note 13) | 6,138 | 378 | 6,516 |
| Exchange adjustments | (1,261) | (470) | (1,731) |
| As at 31st December 2016 | 170,801 | 23,428 | 194,229 |

## 19 FINANCIAL ASSETS HELD FOR TRADING

| | 2017 | 2016 |
|---|---|---|
| Debt securities | | |
| Listed outside Hong Kong | 1,152,597 | 95,684 |
| Unlisted | 784,201 | 306,064 |
| **Total debt securities** | 1,936,798 | 401,748 |
| Equity securities | | |
| Listed in Hong Kong | 35,161 | 120,449 |
| **Total equity securities** | 35,161 | 120,449 |
| Funds | | |
| Listed in Hong Kong | 3,005 | 4,099 |
| **Total funds** | 3,005 | 4,099 |
| Other financial assets held for trading | 144 | 105 |
| **Total financial assets held for trading** | 1,975,108 | 526,401 |
| Included within debt securities are: | | |
| Government notes and bonds | 676,221 | 99,301 |
| Other debt securities | 1,260,577 | 302,447 |
| | 1,936,798 | 401,748 |
| Financial assets held for trading are analysed by type of issuer as follows: | | |
| Sovereigns | 676,221 | 99,301 |
| Banks | 5,964 | 22,264 |
| Corporates | 1,292,923 | 404,836 |
| | 1,975,108 | 526,401 |

## 20 DERIVATIVE FINANCIAL INSTRUMENTS

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.

**As at 31st December 2017**

| | Contract amount | Fair values | |
|---|---|---|---|
| | | Assets | Liabilities |
| Derivatives held for trading | | | |
| Exchange rate contracts | | | |
| Forwards and swaps | **9,493,127** | **135,461** | **(140,651)** |
| Options purchased | **4,473,328** | **5,545** | **–** |
| Options written | **4,510,657** | **–** | **(5,545)** |
| Total recognised derivative assets/(liabilities) | | **141,006** | **(146,196)** |

**As at 31st December 2016**

| | Contract amount | Fair values | |
|---|---|---|---|
| | | Assets | Liabilities |
| Derivatives held for trading | | | |
| Exchange rate contracts | | | |
| Forwards and swaps | 43,857,345 | 239,247 | (221,120) |
| Total recognised derivative assets/(liabilities) | | 239,247 | (221,120) |

| | Credit risk weighted amount | |
|---|---|---|
| | **2017** | 2016 |
| Exchange rate contracts | **388,686** | 243,247 |

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

The credit risk weighted amounts as at 31st December 2017 and 2016 are the amounts that have been calculated in accordance with the BCR.

The above credit risk weighted amounts and fair values have not taken into account the effect of bilateral netting arrangements 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 positions. Trading limits and price verification controls are key aspects of this activity.

## 21 AVAILABLE-FOR-SALE INVESTMENTS

| | 2017 | 2016 |
|---|---|---|
| Debt securities | | |
| Listed in Hong Kong | 6,461,409 | 3,979,239 |
| Listed outside Hong Kong | 8,631,964 | 5,526,978 |
| Unlisted | 30,957,321 | 31,647,275 |
| **Total debt securities** | 46,050,694 | 41,153,492 |
| Equity securities | | |
| Listed outside Hong Kong | 3,981,743 | 4,201,554 |
| Unlisted | 134,572 | 107,651 |
| **Total equity securities** | 4,116,315 | 4,309,205 |
| | 50,167,009 | 45,462,697 |
| Included within debt securities are: | | |
| Certificates of deposit held | 17,393,004 | 19,145,889 |
| Government notes and bonds | 11,657 | – |
| Other debt securities | 28,646,033 | 22,007,603 |
| | 46,050,694 | 41,153,492 |
| Available-for-sale investments are analysed by type of issuer as follows: | | |
| Sovereign | 11,657 | – |
| Banks | 38,243,573 | 38,004,686 |
| Corporates | 11,911,779 | 7,458,011 |
| | 50,167,009 | 45,462,697 |

Note:

Included in the balance of equity securities listed outside Hong Kong was the Bank's investment in Bank of Shanghai, China with fair value of HK$3,981,743,000 (2016: HK$4,201,554,000).

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

| | 2017 | 2016 |
|---|---|---|
| As at 1st January | 45,462,697 | 38,557,109 |
| Additions | 24,416,066 | 14,949,437 |
| Gains from changes in fair value | (590,472) | 1,269,147 |
| Disposals and redemptions | (20,163,306) | (8,819,882) |
| Amortisation | (25,201) | (22,591) |
| Exchange adjustments | 1,019,172 | (518,281) |
| Others | 48,053 | 47,758 |
| As at 31st December | 50,167,009 | 45,462,697 |

## 22 HELD-TO-MATURITY INVESTMENTS

| | 2017 | 2016 |
|---|---|---|
| Debt securities | | |
| Listed in Hong Kong | 687,418 | 799,108 |
| Listed outside Hong Kong | 359,968 | 326,927 |
| Unlisted | 1,339,478 | 1,389,328 |
| | 2,386,864 | 2,515,363 |
| Included within debt securities are: | | |
| Government bills, notes and bonds | 2,371,400 | 2,344,055 |
| Other debt securities | 15,464 | 171,308 |
| | 2,386,864 | 2,515,363 |
| Held-to-maturity investments are analysed by type of issuer as follows: | | |
| Sovereigns | 2,371,400 | 2,344,055 |
| Banks | 15,464 | 171,308 |
| | 2,386,864 | 2,515,363 |

As at 31st December 2017, certain of the Bank's branches in the United States have pledged held-to-maturity investments amounting to HK$344,504,000 (2016: HK$311,046,000) 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 2017, listed and unlisted Exchange Fund Bills and Notes at amortised cost of HK$2,026,896,000 (2016: HK$2,033,009,000) were pledged to the Hong Kong Monetary Authority to facilitate settlement operations. There were no related liabilities at the year end.

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

| | 2017 | 2016 |
|---|---|---|
| As at 1st January | 2,515,363 | 2,508,464 |
| Additions | 3,933,566 | 2,194,810 |
| Redemptions | (4,064,031) | (2,181,734) |
| Amortisation | (1,219) | (4,506) |
| Exchange adjustments | 3,165 | 259 |
| Others | 20 | (1,930) |
| As at 31st December | 2,386,864 | 2,515,363 |

## 23 PROPERTIES FOR SALE

| | 2017 | 2016 |
|---|---|---|
| Property development | | |
| Leasehold land held for development for sale | 358,788 | 358,788 |
| Building development cost | 14,741 | – |
| | 373,529 | 358,788 |

The Group has undertaken a project to redevelop the properties located in West Point. As at 31st December 2017, the land and building costs (less depreciation) incurred for this project were HK$497,902,000 (2016: HK$478,384,000), of which HK$373,529,000 (2016: HK$358,788,000) were classified as properties held for sale while the remaining HK$124,373,000 as bank premises under development in accordance with the redevelopment plan.

## 24 SUBSIDIARIES

The following is a list of the subsidiaries as at 31st December 2017:

| Name | Place of incorporation | Principal activities and place of operation | Particulars of issued share capital | Percentage of ordinary share capital held | 2017 | | 2016 | |
|---|---|---|---|---|---|---|---|---|
| | | | | | Total assets | Total equity | Total assets | Total equity |
| Shanghai Commercial Bank (Nominees) Limited | Hong Kong | Nominee services Hong Kong | 100 ordinary shares | [1]100% | 10 | 10 | 10 | 10 |
| Shanghai Commercial Bank Trustee Limited | Hong Kong | Trustee services Hong Kong | 1,000 ordinary shares | [2]60% | 15,086 | 14,811 | 14,991 | 14,786 |
| Shacom Futures Limited | Hong Kong | Commodities trading Hong Kong | 100,000 ordinary shares | [1]100% | 29,528 | 7,360 | 40,389 | 7,938 |
| Shacom Investment Limited | Hong Kong | Investment in Exchange Fund Bills and Notes Hong Kong | 10,000 ordinary shares | [1]100% | 2,437,404 | 1,670 | 2,467,346 | 1,443 |
| Shacom Property Holdings (BVI) Limited | British Virgin Islands | Property holding United Kingdom | 2 ordinary shares of US$1 each | [1]100% | 37,007 | 769 | 32,560 | (203) |
| Shacom Property (NY), Inc. | United States of America | Property holding United States of America | 10 ordinary shares of US$1 each | [1]100% | 5,677 | 5,677 | 5,685 | 5,685 |
| Shacom Property (CA), Inc. | United States of America | Property holding United States of America | 10 ordinary shares of US$1 each | [1]100% | 2,747 | 2,747 | 2,738 | 2,738 |
| Shacom Assets Investments Limited | Hong Kong | Investment in notes and bonds Hong Kong | 10,000 ordinary shares | [1]100% | 1,026,082 | 60 | 1,011,987 | 66 |
| Infinite Financial Solutions Limited | Hong Kong | I.T. application services provider Hong Kong | 500,000 ordinary shares | [1]100% | 29,860 | 19,033 | 25,537 | 17,734 |
| Shacom Insurance Brokers Limited | Hong Kong | Insurance broker Hong Kong | 1,000,000 ordinary shares | [1]100% | 5,289 | 1,319 | 2,856 | 1,228 |
| Shacom Securities Limited | Hong Kong | Securities brokerage services Hong Kong | 1,000,000 ordinary shares | [1]100% | 225,599 | 161,134 | 227,324 | 159,157 |
| Hai Kwang Property Management Company Limited | Hong Kong | Property management Hong Kong | 2 ordinary shares | [1]100% | 791 | 454 | 697 | 461 |
| Paofoong Insurance Company (Hong Kong) Limited | Hong Kong | Insurance Hong Kong | 500,000 ordinary shares | [2]60% | 280,793 | 177,675 | 264,331 | 163,414 |
| Right Honour Investments Limited | British Virgin Islands | Property holding Hong Kong | 1 ordinary share of US$1 each | [1]100% | 5 | (113) | – | (98) |

## 24 SUBSIDIARIES (CONTINUED)

| Name | Place of incorporation | Principal activities and place of operation | Particulars of issued share capital | Percentage of ordinary share capital held | 2017 Total assets | 2017 Total equity | 2016 Total assets | 2016 Total equity |
|---|---|---|---|---|---|---|---|---|
| Glory Step Investments Limited | British Virgin Islands | Property holding Hong Kong | 1 ordinary share of US$1 each | 100% | 192,569 | (2,445) | 192,680 | (2,333) |
| Silver Wisdom Investments Limited | British Virgin Islands | Property holding Hong Kong | 1 ordinary share of US$1 each | 100% | 294,936 | (2,666) | 287,190 | (2,532) |
| KCC 23F Limited | British Virgin Islands | Property holding Hong Kong | 1 ordinary share of HK$1 each | [1]100% | 313,102 | 113,292 | 292,684 | 92,974 |
| KCC 25F Limited | British Virgin Islands | Property holding Hong Kong | 1 ordinary share of HK$1 each | [1]100% | 315,099 | 115,203 | 294,666 | 94,869 |
| KCC 26F Limited | British Virgin Islands | Property holding Hong Kong | 1 ordinary share of HK$1 each | [1]100% | 317,099 | 117,328 | 296,657 | 96,985 |

[1] Ordinary share capital is held directly by the Bank.

[2] 60% of ordinary share capital is held directly by the Bank and 40% of ordinary share capital is held by non-controlling interests in equity.

The carrying amounts of loans to subsidiaries are HK$4,578,200,000 (2016: HK$4,590,875,000) which approximate their fair values, of which HK$3,959,851,000 (2016: HK$3,974,623,000) are secured, interest free and have no fixed term of repayment, while HK$618,349,000 (2016: HK$616,252,000) are secured, interest-bearing with fixed term of repayment.

## 25 INVESTMENTS IN JOINT VENTURES

| | 2017 | 2016 |
|---|---|---|
| As at 1st January | 303,571 | 304,440 |
| Share of profits, net of tax | 54,180 | 33,564 |
| Dividends paid | (20,590) | (18,150) |
| Liquidation of a joint venture | (2,618) | – |
| Other equity movement | 4,371 | (16,283) |
| As at 31st December | 338,914 | 303,571 |

The Group's interests in its joint ventures for the years ended 2017 and 2016, which are unlisted, are as follows:

| Name of entity | Place of incorporation | % of ownership interest 2017 | % of ownership interest 2016 |
|---|---|---|---|
| Joint Electronic Teller Services Limited | Hong Kong | 20% of 'A' shares | 20% of 'A' shares |
| Bank Consortium Holding Limited | Hong Kong | 14.29% of 'A' shares | 14.29% of 'A' shares |
| BC Reinsurance Limited | Hong Kong | 21% | 21% |
| Hong Kong Life Insurance Limited (Note c) | Hong Kong | 16.67% | 16.67% |
| i-Tech Solutions Limited (Note b) | Hong Kong | – | 50% |

## 25 INVESTMENTS IN JOINT VENTURES (CONTINUED)

Summarised financial information for joint ventures which are accounted for using the equity method is set out below:

**2017**

| Name | Assets | Liabilities | Revenue | Profit | Other comprehensive income | Total comprehensive income | Dividends received from joint ventures |
|---|---|---|---|---|---|---|---|
| Joint Electronic Teller Services Limited | 423,994 | 24,064 | 163,496 | 25,356 | – | 25,356 | 700 |
| Bank Consortium Holding Limited | 814,283 | 87,912 | 499,784 | 167,334 | 510 | 167,844 | 16,740 |
| BC Reinsurance Limited | 930,413 | 416,941 | 102,007 | 99,053 | 57 | 99,110 | 3,150 |
| Hong Kong Life Insurance Limited | 16,282,938 | 15,614,302 | 3,369,123 | 62,025 | 25,747 | 87,772 | – |
| i-Tech Solutions Limited | – | – | – | – | – | – | – |
| | 18,451,628 | 16,143,219 | 4,134,410 | 353,768 | 26,314 | 380,082 | 20,590 |

**2016**

| Name | Assets | Liabilities | Revenue | Profit/(loss) | Other comprehensive income | Total comprehensive income | Dividends received from joint ventures |
|---|---|---|---|---|---|---|---|
| Joint Electronic Teller Services Limited | 512,169 | 123,342 | 147,246 | 29,162 | – | 29,162 | 700 |
| Bank Consortium Holding Limited | 726,629 | 60,852 | 541,047 | 142,251 | 59 | 142,310 | 14,300 |
| BC Reinsurance Limited | 831,429 | 429,361 | 164,042 | 43,354 | 73,784 | 117,138 | 3,150 |
| Hong Kong Life Insurance Limited | 15,647,229 | 15,066,365 | 3,536,847 | 29,798 | (190,718) | (160,920) | – |
| i-Tech Solutions Limited | 5,375 | 139 | 2,238 | (625) | – | (625) | – |
| | 17,722,831 | 15,680,059 | 4,391,420 | 243,940 | (116,875) | 127,065 | 18,150 |

Note a: The balances with the joint ventures arise from normal business transactions and are included in Note 40.

Note b: i-Tech Solutions Limited commenced members' voluntary liquidation on 30th September 2016, and was dissolved on 11th July 2017.

Note c: On 20th March 2017, the Bank along with the other 4 shareholders of Hong Kong Life Insurance Limited ('Hong Kong Life') entered into an agreement with First Origin International Limited to sell their entire interest in Hong Kong Life at a consideration of HK$7.1 billion. The completion of the transaction is subject to approvals by the relevant regulators.

In accordance with the share sale agreement regarding Hong Kong Life, the sellers and the purchaser have agreed to extend the satisfaction of certain conditions by 20th March 2018 to 30th September 2018. Save as disclosed here, all other terms and conditions of the agreement remain unchanged.

## 26 PROPERTIES AND EQUIPMENT

| | | | | Property under development | | |
|---|---|---|---|---|---|---|
| | Leasehold land | Bank premises | Furniture, fittings and equipment | Leasehold land | Development cost | Total |
| As at 1st January 2016 | | | | | | |
| Cost | 1,210,817 | 812,489 | 645,077 | 654,449 | 240,505 | 3,563,337 |
| Accumulated depreciation | (103,949) | (249,917) | (565,547) | (6,264) | – | (925,677) |
| Net book amount | 1,106,868 | 562,572 | 79,530 | 648,185 | 240,505 | 2,637,660 |
| Year ended December 2016 | | | | | | |
| Opening net book amount | 1,106,868 | 562,572 | 79,530 | 648,185 | 240,505 | 2,637,660 |
| Additions | – | 17,968 | 100,813 | – | 27,572 | 146,353 |
| Transfers | | | | | | |
| Cost | 654,449 | 268,077 | – | (654,449) | (268,077) | – |
| Accumulated depreciation | (6,459) | – | – | 6,459 | – | – |
| Transfers from investment properties (Note 27) | | | | | | |
| Cost | 7,778 | 5,304 | – | – | – | 13,082 |
| Accumulated depreciation | (341) | (1,389) | – | – | – | (1,730) |
| Transfers to properties for sale (Note 23) | | | | | | |
| Cost | (360,733) | – | – | – | – | (360,733) |
| Accumulated depreciation | 1,945 | – | – | – | – | 1,945 |
| Disposals/write-off | | | | | | |
| Cost | – | (3,522) | (34,601) | – | – | (38,123) |
| Accumulated depreciation | – | 3,522 | 32,731 | – | – | 36,253 |
| Depreciation charge | (17,757) | (41,698) | (34,095) | (195) | – | (93,745) |
| Exchange adjustments | – | (4,150) | (224) | – | – | (4,374) |
| Closing net book amount | 1,385,750 | 806,684 | 144,154 | – | – | 2,336,588 |
| As at 31st December 2016 | | | | | | |
| Cost | 1,512,311 | 1,094,481 | 707,532 | – | – | 3,314,324 |
| Accumulated depreciation | (126,561) | (287,797) | (563,378) | – | – | (977,736) |
| Net book amount | 1,385,750 | 806,684 | 144,154 | – | – | 2,336,588 |
| Year ended December 2017 | | | | | | |
| Opening net book amount | **1,385,750** | **806,684** | **144,154** | **–** | **–** | **2,336,588** |
| Additions | **–** | **935** | **158,526** | **–** | **4,914** | **164,375** |
| Transfers | | | | | | |
| Cost | **(120,244)** | **–** | **–** | **120,244** | **–** | **–** |
| Accumulated depreciation | **648** | **–** | **–** | **(648)** | **–** | **–** |
| Transfers to investment properties (Note 27) | | | | | | |
| Cost | **(415)** | **(182)** | **–** | **–** | **–** | **(597)** |
| Accumulated depreciation | **5** | **6** | **–** | **–** | **–** | **11** |
| Disposals/write-off | | | | | | |
| Cost | **–** | **–** | **(41,376)** | **–** | **–** | **(41,376)** |
| Accumulated depreciation | **–** | **–** | **36,635** | **–** | **–** | **36,635** |
| Depreciation charge | **(17,432)** | **(36,550)** | **(54,667)** | **(137)** | **–** | **(108,786)** |
| Exchange adjustments | **–** | **2,505** | **214** | **–** | **–** | **2,719** |
| Closing net book amount | **1,248,312** | **773,398** | **243,486** | **119,459** | **4,914** | **2,389,569** |
| As at 31st December 2017 | | | | | | |
| Cost | **1,391,652** | **1,098,904** | **827,425** | **120,244** | **4,914** | **3,443,139** |
| Accumulated depreciation | **(143,340)** | **(325,506)** | **(583,939)** | **(785)** | **–** | **(1,053,570)** |
| Net book amount | **1,248,312** | **773,398** | **243,486** | **119,459** | **4,914** | **2,389,569** |

## 26 PROPERTIES AND EQUIPMENT (CONTINUED)

The Group has undertaken a project to redevelop the properties located in West Point. As at 31st December 2017, the land and building costs (less depreciation) incurred for this project were HK$497,902,000 (2016: HK$478,384,000), of which HK$373,529,000 (2016: HK$358,788,000) were classified as properties held for sale while the remaining HK$124,373,000 as bank premises under development in accordance with the redevelopment plan.

During 2016, the Group had completed the redevelopment of Shanghai Commercial Bank Tower ('SCBT'). The redevelopment costs incurred for SCBT were HK$1,950,785,000 including land and building costs, of which HK$922,526,000 had been reclassified as bank premises and HK$1,028,259,000 as investment properties from property under development in accordance with their usage.

As at 31st December 2017, interests in freehold land outside Hong Kong amounted to HK$34,652,000 (2016: HK$33,029,000) are included as bank premises above.

## 27 INVESTMENT PROPERTIES

| | | | Property under development | | |
|---|---|---|---|---|---|
| | Leasehold land | Buildings | Leasehold land | Buildings | Total |
| As at 1st January 2016 | | | | | |
| Cost | 3,211 | 3,418 | 729,457 | 268,070 | 1,004,156 |
| Accumulated depreciation | (269) | (1,295) | (6,982) | – | (8,546) |
| Net book amount | 2,942 | 2,123 | 722,475 | 268,070 | 995,610 |
| Year ended December 2016 | | | | | |
| Opening net book amount | 2,942 | 2,123 | 722,475 | 268,070 | 995,610 |
| Additions | – | 19,796 | – | 30,732 | 50,528 |
| Transfers | | | | | |
| Cost | 729,457 | 298,802 | (729,457) | (298,802) | – |
| Accumulated depreciation | (7,200) | – | 7,200 | – | – |
| Transfers to properties and equipment (Note 26) | | | | | |
| Cost | (7,778) | (5,304) | – | – | (13,082) |
| Accumulated depreciation | 341 | 1,389 | – | – | 1,730 |
| Depreciation charge | (676) | (6,112) | (218) | – | (7,006) |
| Closing net book amount | 717,086 | 310,694 | – | – | 1,027,780 |
| As at 31st December 2016 | | | | | |
| Cost | 724,890 | 316,712 | – | – | 1,041,602 |
| Accumulated depreciation | (7,804) | (6,018) | – | – | (13,822) |
| Net book amount | 717,086 | 310,694 | – | – | 1,027,780 |
| Year ended December 2017 | | | | | |
| Opening net book amount | **717,086** | **310,694** | **–** | **–** | **1,027,780** |
| Additions | **–** | **1,028** | **–** | **–** | **1,028** |
| Transfers from properties and equipment (Note 26) | | | | | |
| Cost | **415** | **182** | **–** | **–** | **597** |
| Accumulated depreciation | **(5)** | **(6)** | **–** | **–** | **(11)** |
| Depreciation charge | **(865)** | **(8,025)** | **–** | **–** | **(8,890)** |
| Closing net book amount | **716,631** | **303,873** | **–** | **–** | **1,020,504** |
| As at 31st December 2017 | | | | | |
| Cost | **725,305** | **317,922** | **–** | **–** | **1,043,227** |
| Accumulated depreciation | **(8,674)** | **(14,049)** | **–** | **–** | **(22,723)** |
| Net book amount | **716,631** | **303,873** | **–** | **–** | **1,020,504** |

## 27 INVESTMENT PROPERTIES (CONTINUED)

During 2016, the Group had completed the redevelopment of Shanghai Commercial Bank Tower ('SCBT'). The redevelopment costs incurred for SCBT were HK$1,950,785,000 including land and building costs, of which HK$922,526,000 had been reclassified as bank premises and HK$1,028,259,000 as investment properties from property under development in accordance with their usage.

**(a) Fair value measurement of investment properties**

As at 31st December 2017, the Group's investment properties were valued at HK$3,342,000,000 (2016: HK$3,326,000,000) by an independent firm of chartered surveyors, Cushman & Wakefield Limited, who has among their staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of properties being valued. The valuations were performed on an open market value basis.

The basis of the valuation of property was market value which is consistent with the definition of fair value under HKFRS 13 'Fair value measurement' and takes into account the highest and best use of the property from the perspective of market participants.

The major key input used in valuing the investment properties was the unit sale rate taking into account of time, location, and individual factors such as size and levels of buildings, which ranged from HK$32,000 (2016: HK$29,700) to HK$135,000 (2016: HK$151,000) per square foot. A decrease in unit sale rate would result in decrease in fair value measurement of the investment properties by the same percentage and vice versa.

Investment properties are classified as Level 3 under the fair value hierarchy as defined in HKFRS 13 'Fair value measurement' as at 31st December 2017 and 2016.

**(b) Information about Level 3 fair value measurement**

| | | | Range | |
|---|---|---|---|---|
| | Valuation technique(s) | Unobservable input(s) | 2017 | 2016 |
| Investment properties | Income capitalisation approach | Market yields | 2.5% to 2.75% | 2.5% to 2.625% |
| | | Market rental | HK$68 to HK$303 per square foot | HK$62 to HK$313 per square foot |

For investment properties of which the fair value is determined using the income capitalisation approach, the assessment is conducted on the basis of capitalisation of net incomes with due allowance for outgoings and reversionary income potential. The fair value measurement is positively correlated to the market rental and inversely correlated to the market yields.

## 28 OTHER ASSETS

| | 2017 | 2016 |
|---|---|---|
| Repossessed assets | – | 16,880 |
| Accounts receivable and prepayments | 877,506 | 606,089 |
| Others | 135,110 | 216,546 |
| | 1,012,616 | 839,515 |

## 29 DEPOSITS FROM CUSTOMERS

| | 2017 | | | |
|---|---|---|---|---|
| | Large corporate customers and others | SME | Individuals | Total |
| Demand deposits and current accounts | 9,299,146 | 2,872,084 | 5,833,033 | 18,004,263 |
| Savings deposits | 15,247,120 | 2,778,913 | 29,535,581 | 47,561,614 |
| Time, call and notice deposits | 31,955,041 | 2,186,059 | 46,854,558 | 80,995,658 |
| Deposits from Hong Kong Government Exchange Fund | 391,507 | – | – | 391,507 |
| | 56,892,814 | 7,837,056 | 82,223,172 | 146,953,042 |

| | 2016 | | | |
|---|---|---|---|---|
| | Large corporate customers and others | SME | Individuals | Total |
| Demand deposits and current accounts | 8,146,235 | 2,186,875 | 4,791,617 | 15,124,727 |
| Savings deposits | 14,081,655 | 2,158,167 | 26,702,845 | 42,942,667 |
| Time, call and notice deposits | 32,436,252 | 1,896,879 | 44,095,618 | 78,428,749 |
| Deposits from Hong Kong Government Exchange Fund | 388,191 | – | – | 388,191 |
| | 55,052,333 | 6,241,921 | 75,590,080 | 136,884,334 |

Deposits amounting to HK$81,270,573,000 (2016: HK$78,739,222,000) are at fixed interest rates, HK$65,565,877,000 (2016: HK$58,067,394,000) are at managed interest rates and all other deposits, amounting to HK$116,592,000 (2016: HK$77,718,000) are at variable rates.

## 30 SUBORDINATED DEBT

| | 2017 | 2016 |
|---|---|---|
| US$250 million fixed rate subordinated notes issued due 2027 at amortised cost | 1,947,028 | – |

This represents US$250,000,000 Basel III compliant 10-year subordinated fixed rate notes qualifying as Tier 2 capital of the Bank in accordance with the Hong Kong Banking (Capital) Rules (the "Notes"), which are listed on the Hong Kong Stock Exchange. The Notes will mature on 29th November 2027 with an optional redemption date falling on 29th November 2022. Interest at 3.75% p.a. is payable semi-annually from the issue date to the optional redemption date. Thereafter, if the Notes are not redeemed, the interest rate will be reset and the Notes will bear interest at the prevailing 5-year U.S. Treasury Rate plus 170.5 basis points. The Bank may, subject to receiving the prior approval of the Hong Kong Monetary Authority, redeem the Notes at the option of the Bank in whole but not in part, at par either on the optional redemption date or for tax or regulatory reasons at any time prior to maturity of the Notes.

## 31 OTHER LIABILITIES

| | 2017 | 2016 |
|---|---|---|
| Margin deposits | 233,569 | 170,952 |
| Accounts payable and accruals | 935,624 | 419,967 |
| Liabilities for insurance contracts (Note) | 98,089 | 96,326 |
| Others | 929,571 | 685,061 |
| | 2,196,853 | 1,372,306 |

Note: Amounts recoverable from reinsurance of liabilities under insurance contracts issued amounting to HK$5,197,000 (2016: HK$3,569,000) are included in 'Other assets' in Note 28.

## 32 PROVISIONS

| | 2017 | 2016 |
|---|---|---|
| As at 1st January | 94,612 | 96,049 |
| Additional provisions charged to statement of profit or loss | 206,702 | 139,223 |
| Utilised during the year | (144,743) | (140,660) |
| As at 31st December | 156,571 | 94,612 |
| Current | 147,563 | 88,410 |
| Non-current | 9,008 | 6,202 |

Majority of the 2017 and 2016 balances represent provision for staff bonus and staff related costs.

## 33 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 assets

| | Impairment allowances | Accelerated tax depreciation | Fair value losses on available-for-sale investments | Others | Total |
|---|---|---|---|---|---|
| As at 1st January 2016 | 40,181 | (7,745) | 31 | 15,104 | 47,571 |
| Credited/(charged) to statement of profit or loss | 5,674 | (150) | – | 3,133 | 8,657 |
| Exchange adjustments | (1,478) | 1,184 | – | (82) | (376) |
| Reclassified from deferred income tax liabilities | – | – | 8 | – | 8 |
| As at 31st December 2016 | 44,377 | (6,711) | 39 | 18,155 | 55,860 |
| (Charged)/credited to the statement of profit or loss | (10,958) | (9,142) | – | 3,841 | (16,259) |
| Exchange adjustments | 1,462 | (653) | – | 123 | 932 |
| Charged to equity | – | – | (25) | – | (25) |
| Reclassified from/(to) deferred income tax liabilities | – | (2) | 17 | – | 15 |
| As at 31st December 2017 | 34,881 | (16,508) | 31 | 22,119 | 40,523 |

### Deferred income tax liabilities

| | Impairment allowances | Accelerated tax depreciation | Fair value gains on available-for-sale investments | Others | Total |
|---|---|---|---|---|---|
| As at 1st January 2016 | 30,634 | (10,494) | (311,239) | (1,155) | (292,254) |
| Charged to statement of profit or loss | (673) | (9,859) | – | (38) | (10,570) |
| Charged to equity | – | – | (174,046) | – | (174,046) |
| Reclassified to deferred income tax assets | – | – | (8) | – | (8) |
| As at 31st December 2016 | 29,961 | (20,353) | (485,293) | (1,193) | (476,878) |
| Credited/(charged) to the statement of profit or loss | 4,964 | (4,925) | – | 1,193 | 1,232 |
| Credited to equity | – | – | 93,223 | – | 93,223 |
| Reclassified (to)/from deferred income tax assets | – | 2 | (17) | – | (15) |
| As at 31st December 2017 | 34,925 | (25,276) | (392,087) | – | (382,438) |

## 34 SHARE CAPITAL

| | 2017 | 2016 |
|---|---|---|
| Issued and fully paid: | | |
| 20,000,000 shares | 2,000,000 | 2,000,000 |

## 35 RESERVES ATTRIBUTABLE TO EQUITY HOLDERS

| | Regulatory reserve | Available-for-sale investments revaluation reserve | General and other reserves | Total |
|---|---|---|---|---|
| As at 1st January 2016 | 696,550 | 1,574,971 | 7,296,974 | 9,568,495 |
| Change in fair value of available-for-sale investments | – | 1,269,506 | – | 1,269,506 |
| Realised on disposal of available-for-sale investments | – | (181,639) | – | (181,639) |
| Effect of deferred taxation | – | (174,105) | – | (174,105) |
| Currency translation differences | (1,856) | (32,685) | (83,177) | (117,718) |
| Share of reserves of joint ventures | – | 14,125 | (30,408) | (16,283) |
| Transfer from retained earnings | 9,408 | – | – | 9,408 |
| As at 31st December 2016 | 704,102 | 2,470,173 | 7,183,389 | 10,357,664 |
| As at 1st January 2017 | 704,102 | 2,470,173 | 7,183,389 | 10,357,664 |
| Change in fair value of available-for-sale investments | – | (590,532) | – | (590,532) |
| Realised on disposal of available-for-sale investments | – | (45,489) | – | (45,489) |
| Effect of deferred taxation | – | 93,208 | – | 93,208 |
| Currency translation differences | 3,218 | 71,124 | 95,126 | 169,468 |
| Share of reserves of joint ventures | – | 4,359 | 12 | 4,371 |
| Transfer from retained earnings | 33,403 | – | – | 33,403 |
| As at 31st December 2017 | 740,723 | 2,002,843 | 7,278,527 | 10,022,093 |

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 operations are made in consultation with the Hong Kong Monetary Authority.

As at 31st December 2017, the regulatory reserves for Hong Kong and overseas branches operations were HK$612,455,000 (2016: HK$612,455,000) and HK$128,268,000 (2016: HK$91,647,000) respectively.

**(b) Available-for-sale investments revaluation reserve**

Available-for-sale investments 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 2.12, Note 2.14 and Note 2.16)

**(c) General and other reserves**

General and other reserves comprise previous years' transfers from retained earnings and translation reserve arising from translation of foreign operations during consolidation and share of changes in equity of joint ventures.

## 36 CASH AND CASH EQUIVALENTS AND OTHER CASH FLOW INFORMATION

**(a) Reconciliation of liabilities arising from financing activities**

| | 2017 Subordinated debt | 2016 Subordinated debt |
|---|---|---|
| Balance as at 1st January | – | – |
| Cash inflow from issue of subordinated debt net of cost | 1,937,597 | – |
| Non-cash changes: | | |
| – Foreign exchange movement | 2,614 | – |
| – Amortisation of discount and issuance cost | 6,817 | – |
| Balance as at 31st December | 1,947,028 | – |

**(b) 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 3 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.

| | 2017 | 2016 |
|---|---|---|
| Cash and balances with banks | 25,227,993 | 21,481,136 |
| Placements with and loans and advances to banks | 2,587,867 | 2,768,127 |
| Certificates of deposit | – | 233,747 |
| | 27,815,860 | 24,483,010 |

## 37 CONTINGENT LIABILITIES AND COMMITMENTS

**(a) Capital commitments**

Capital expenditure at the reporting date but not yet incurred is as follows:

| | 2017 | 2016 |
|---|---|---|
| Properties and equipment | | |
| Contracted but not provided for | 152,553 | 178,851 |

## 37 CONTINGENT LIABILITIES AND COMMITMENTS (CONTINUED)

**(b) Operating lease commitments**

(i) As lessee

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

| | 2017 | 2016 |
|---|---|---|
| No later than 1 year | 88,453 | 94,688 |
| Later than 1 year and no later than 5 years | 109,569 | 102,135 |
| Later than 5 years | 11,586 | 19,208 |
| | 209,608 | 216,031 |

(ii) As lessor

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

| | 2017 | 2016 |
|---|---|---|
| No later than 1 year | 83,360 | 83,640 |
| Later than 1 year and no later than 5 years | 109,918 | 195,926 |
| | 193,278 | 279,566 |

The Group leases its investment properties (Note 27) under operating lease arrangements, with leases typically for a period from 3 to 5 years. The terms of the leases generally require the tenants to pay security deposits and provide for rent adjustments according to the prevailing market conditions at the expiration of the lease.

**(c) Credit commitments**

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

| | 2017 | 2016 |
|---|---|---|
| Direct credit substitutes | 2,699,479 | 2,402,064 |
| Trade-related contingencies | 2,402,762 | 2,155,086 |
| Forward forward deposits placed | – | 376,558 |
| Other commitments with an original maturity of: | | |
| – under 1 year | 1,149,009 | 343,116 |
| – 1 year and over | 7,087,758 | 7,205,384 |
| – unconditionally cancellable | 33,425,203 | 31,997,472 |
| | 46,764,211 | 44,479,680 |

The credit risk weighted amount of credit commitments is HK$6,314,885,000 (2016: HK$6,266,622,000).

**(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.

## 38 OFFSETTING FINANCIAL INSTRUMENTS

The following tables present details of financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements.

**As at 31st December 2017**

| | Gross amounts of recognised financial assets | Gross amounts of recognised financial liabilities set off in the statement of financial position | Net amounts of financial assets presented in the statement of financial position | Related amounts not set off in the statement of financial position | | Net amounts |
|---|---|---|---|---|---|---|
| | | | | Financial instruments | Cash collateral received | |
| Assets | | | | | | |
| Derivative financial instruments | 105,548 | – | 105,548 | (50,510) | (6,219) | 48,819 |
| Other assets | 403,370 | (340,768) | 62,602 | – | – | 62,602 |
| Total | 508,918 | (340,768) | 168,150 | (50,510) | (6,219) | 111,421 |

| | Gross amounts of recognised financial liabilities | Gross amounts of recognised financial assets set off in the statement of financial position | Net amounts of financial liabilities presented in the statement of financial position | Related amounts not set off in the statement of financial position | | Net amounts |
|---|---|---|---|---|---|---|
| | | | | Financial instruments | Cash collateral pledged | |
| Liabilities | | | | | | |
| Derivative financial instruments | 108,642 | – | 108,642 | (50,510) | (24,470) | 33,662 |
| Other liabilities | 341,210 | (340,768) | 442 | – | – | 442 |
| Total | 449,852 | (340,768) | 109,084 | (50,510) | (24,470) | 34,104 |

## 38 OFFSETTING FINANCIAL INSTRUMENTS (CONTINUED)

As at 31st December 2016

| | Gross amounts of recognised financial assets | Gross amounts of recognised financial liabilities set off in the statement of financial position | Net amounts of financial assets presented in the statement of financial position | Related amounts not set off in the statement of financial position | | Net amounts |
|---|---|---|---|---|---|---|
| | | | | Financial instruments | Cash collateral received | |
| Assets | | | | | | |
| Derivative financial instruments | 168,525 | – | 168,525 | (99,751) | – | 68,774 |
| Other assets | 236,610 | (161,539) | 75,071 | – | – | 75,071 |
| Total | 405,135 | (161,539) | 243,596 | (99,751) | – | 143,845 |

| | Gross amounts of recognised financial liabilities | Gross amounts of recognised financial assets set off in the statement of financial position | Net amounts of financial liabilities presented in the statement of financial position | Related amounts not set off in the statement of financial position | | Net amounts |
|---|---|---|---|---|---|---|
| | | | | Financial instruments | Cash collateral pledged | |
| Liabilities | | | | | | |
| Derivative financial instruments | 163,704 | – | 163,704 | (99,751) | (16,210) | 47,743 |
| Other liabilities | 203,259 | (161,539) | 41,720 | – | – | 41,720 |
| Total | 366,963 | (161,539) | 205,424 | (99,751) | (16,210) | 89,463 |

Derivative financial instruments disclosed above are recorded on a gross basis in the consolidated statement of financial position. Since master netting agreements have been entered into for these derivative financial instruments, the net settlement amounts if an event of default or other precedent events occurred are disclosed under 'Net amounts' to comply with the accounting requirements.

The tables below reconcile the amounts of derivative financial instruments, net amounts of other assets and other liabilities presented in the consolidated statement of financial position.

| | 2017 | 2016 |
|---|---|---|
| Assets | | |
| Net amounts of derivative financial instruments after offsetting as stated above | **105,548** | 168,525 |
| Derivative financial instruments not in scope of offsetting disclosures | **35,458** | 70,722 |
| Total derivative financial instruments | **141,006** | 239,247 |
| Net amounts of other assets after offsetting as stated above | **62,602** | 75,071 |
| Other assets not in scope of offsetting disclosures | **950,014** | 764,444 |
| Total other assets | **1,012,616** | 839,515 |
| Liabilities | | |
| Net amounts of derivative financial instruments after offsetting as stated above | **108,642** | 163,704 |
| Derivative financial instruments not in scope of offsetting disclosures | **37,554** | 57,416 |
| Total derivative financial instruments | **146,196** | 221,120 |
| Net amounts of other liabilities after offsetting as stated above | **442** | 41,720 |
| Other liabilities not in scope of offsetting disclosures | **2,196,411** | 1,330,586 |
| Total other liabilities | **2,196,853** | 1,372,306 |

## 39 INFORMATION ABOUT LOANS, QUASI-LOANS AND OTHER DEALINGS IN FAVOUR OF DIRECTORS, CONTROLLED BODIES CORPORATE AND CONNECTED ENTITIES

Balances below are disclosed pursuant to Section 383 of the Hong Kong Companies Ordinance (Cap. 622) and Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G).

| | Balance outstanding as at 31st December | | Maximum balance during the year | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Aggregate amount outstanding in respect of principal and interest | 109,002 | 111,283 | 114,358 | 117,411 |

## 40 RELATED PARTY TRANSACTIONS

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

| 2017 | Ultimate holding company and fellow subsidiaries | Joint ventures | Key management personnel (Note) | Other related parties | Total |
|---|---|---|---|---|---|
| Aggregate amounts outstanding at the year end | | | | | |
| – Loans and advances | – | – | 143,480 | – | 143,480 |
| – Cash and balances with banks | 9 | – | – | 13,948 | 13,957 |
| – Deposits and balances from banks and customers | 469,145 | 384,412 | 1,473,970 | 2,697,532 | 5,025,059 |
| – Available-for-sale investments | 100,657 | – | – | 514,522 | 615,179 |
| – Collectively assessed impairment allowances | – | – | 592 | – | 592 |
| – Contingent liabilities and other commitments | 7,831 | 62,000 | 614,860 | – | 684,691 |
| Interest income received from related parties | 1,624 | – | 4,143 | 48 | 5,815 |
| Interest expenses paid to related parties | 2,493 | 1,446 | 2,604 | 27,662 | 34,205 |

## 40 RELATED PARTY TRANSACTIONS (CONTINUED)

**2016**

| | Ultimate holding company and fellow subsidiaries | Joint ventures | Key management personnel (Note) | Other related parties | Total |
|---|---|---|---|---|---|
| Aggregate amounts outstanding at the year end | | | | | |
| – Loans and advances | – | 16,368 | 146,956 | – | 163,324 |
| – Cash and balances with banks | 445,335 | – | – | 22,947 | 468,282 |
| – Deposits and balances from banks and customers | 677,375 | 247,325 | 1,378,200 | 1,299,970 | 3,602,870 |
| – Available-for-sale investments | 73,961 | – | – | 470,409 | 544,370 |
| – Collectively assessed impairment allowances | – | 65 | 611 | – | 676 |
| – Contingent liabilities and other commitments | 7,769 | 195,632 | 821,032 | – | 1,024,433 |
| Interest income received from related parties | 278 | 24 | 4,469 | 48 | 4,819 |
| Interest expenses paid to related parties | 2,511 | 2,415 | 27,741 | 15,315 | 47,982 |

Note: Include key management personnel and Directors of the Bank and the ultimate holding company, their close family members and entities that are controlled or jointly controlled, directly or indirectly, by key management personnel or Directors.

**Key management personnel compensation**

The compensation for Directors and key management personnel of the Bank is as follows:

| | 2017 | 2016 |
|---|---|---|
| Salaries and other short-term employee benefits | 90,030 | 85,414 |

# 41 STATEMENT OF FINANCIAL POSITION AND RESERVE MOVEMENT OF THE BANK

**(a) Statement of Financial Position of the Bank**

| | As at 31st December | |
|---|---|---|
| | 2017 | 2016 |
| **ASSETS** | | |
| Cash and balances with banks | 28,751,257 | 24,616,688 |
| Placements with and loans and advances to banks | 17,633,246 | 26,562,967 |
| Loans and advances to customers | 78,296,688 | 64,519,998 |
| Financial assets held for trading | 1,936,942 | 494,370 |
| Derivative financial instruments | 141,006 | 239,247 |
| Available-for-sale investments | 50,111,396 | 45,370,130 |
| Held-to-maturity investments | 344,504 | 466,474 |
| Investments in joint ventures | 113,000 | 116,000 |
| Investments in and loans to subsidiaries | 3,087,352 | 3,118,817 |
| Properties and equipment | 1,568,395 | 1,500,966 |
| Investment properties | 1,051,362 | 1,055,514 |
| Deferred income tax assets | 37,476 | 55,852 |
| Other assets | 939,764 | 779,346 |
| **TOTAL ASSETS** | 184,012,388 | 168,896,369 |
| **LIABILITIES** | | |
| Deposits and balances from banks | 6,780,932 | 5,901,152 |
| Deposits from customers | 146,953,042 | 136,884,334 |
| Derivative financial instruments | 146,196 | 221,120 |
| Subordinated debt | 1,947,028 | – |
| Other liabilities | 2,051,660 | 1,227,697 |
| Provisions | 154,554 | 92,806 |
| Current income tax liabilities | 421,076 | 38,800 |
| Deferred income tax liabilities | 382,397 | 476,850 |
| **TOTAL LIABILITIES** | 158,836,885 | 144,842,759 |
| **EQUITY** | | |
| **CAPITAL AND RESERVES ATTRIBUTABLE TO EQUITY HOLDERS** | | |
| Share capital | 2,000,000 | 2,000,000 |
| Retained earnings | 13,173,191 | 11,711,236 |
| Reserves | 10,002,312 | 10,342,374 |
| | 25,175,503 | 24,053,610 |
| **TOTAL EQUITY AND LIABILITIES** | 184,012,388 | 168,896,369 |

Approved and authorised for issue by the Board of Directors on 19th March 2018.

**Stephen Ching Yen LEE**
Chairman

**Hung-ching YUNG**
Director

**Gordon Che Keung KWONG**
Director

**David Sek-chi KWOK**
Managing Director & Chief Executive

## 41 STATEMENT OF FINANCIAL POSITION AND RESERVE MOVEMENT OF THE BANK (CONTINUED)

**(b) Reserve movement of the Bank**

| | Regulatory reserve | Available-for-sale investments revaluation reserve | General reserve | Total |
|---|---|---|---|---|
| As at 1st January 2016 | 696,550 | 1,574,178 | 7,265,654 | 9,536,382 |
| Change in fair value of available-for-sale investments | – | 1,270,044 | – | 1,270,044 |
| Realised on disposal of available-for-sale investments | – | (181,639) | – | (181,639) |
| Effect of deferred taxation | – | (174,194) | – | (174,194) |
| Currency translation differences | (1,856) | (32,685) | (83,086) | (117,627) |
| Transfer from retained earnings | 9,408 | – | – | 9,408 |
| As at 31st December 2016 | 704,102 | 2,455,704 | 7,182,568 | 10,342,374 |
| As at 1st January 2017 | **704,102** | **2,455,704** | **7,182,568** | **10,342,374** |
| Change in fair value of available-for-sale investments | **–** | **(590,623)** | **–** | **(590,623)** |
| Realised on disposal of available-for-sale investments | **–** | **(45,489)** | **–** | **(45,489)** |
| Effect of deferred taxation | **–** | **93,223** | **–** | **93,223** |
| Currency translation differences | **3,218** | **71,124** | **95,082** | **169,424** |
| Transfer from retained earnings | **33,403** | **–** | **–** | **33,403** |
| As at 31st December 2017 | **740,723** | **1,983,939** | **7,277,650** | **10,002,312** |

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 Capital charges for credit, market and operational risks

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

### (a) Capital charge for credit risk

| | 2017 | 2016 |
|---|---|---|
| Sovereign exposures | 5,064 | 3,650 |
| Bank exposures | 2,559,459 | 2,611,725 |
| Securities Firm exposures | 45,712 | 20,675 |
| Corporate exposures | 4,857,090 | 3,652,529 |
| Cash items | 10,102 | 8,106 |
| Regulatory Retail exposures | 274,054 | 299,109 |
| Residential Mortgage Loans | 450,307 | 463,816 |
| Other exposures which are not past due exposures | 1,147,952 | 1,090,742 |
| Past due exposures | 37,571 | 16,610 |
| Total capital charge for on-balance sheet exposures | 9,387,311 | 8,166,962 |
| Direct credit substitutes | 212,493 | 189,060 |
| Trade-related contingencies | 38,157 | 33,931 |
| Forward forward deposits placed | – | 6,025 |
| Other commitments | 254,541 | 272,314 |
| Exchange rate contracts | 31,095 | 19,460 |
| Total capital charge for off-balance sheet exposures | 536,286 | 520,790 |
| Credit valuation adjustment | 11,155 | 7,205 |
| Total capital charge for credit risk | 9,934,752 | 8,694,957 |

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

| | 2017 | 2016 |
|---|---|---|
| Interest rate exposures (non-securitisation) | 170,018 | 41,310 |
| Equity exposures | – | 13,936 |
| Foreign exchange exposures | 194,160 | 173,280 |
| Capital charge for market risk | 364,178 | 228,526 |

The Group uses the Standardised Approach for calculating market risk.

### (c) Capital charge for operational risk

| | 2017 | 2016 |
|---|---|---|
| Capital charge for operational risk | 589,612 | 533,910 |

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

## 2 Risk management

### (a) Credit risk

#### (i) Credit risk exposures

**As at 31st December 2017**

| | Total exposures | Exposures after recognised credit risk mitigation | | Risk-weighted | | Total risk–weighted amounts |
|---|---|---|---|---|---|---|
| | | Rated | Unrated | Rated | Unrated | |
| A. On-balance Sheet | | | | | | |
| 1 Sovereign | 11,275,814 | 11,275,814 | – | 63,305 | – | 63,305 |
| 2 Multilateral Development Bank | 15,464 | 15,464 | – | – | – | – |
| 3 Bank | 72,108,834 | 72,034,402 | 1,716,333 | 31,376,417 | 616,824 | 31,993,241 |
| 4 Securities Firm | 1,142,792 | – | 1,142,792 | – | 571,396 | 571,396 |
| 5 Corporate | 66,215,755 | 9,335,180 | 54,795,930 | 5,917,699 | 54,795,930 | 60,713,629 |
| 6 Cash Items | 376,419 | – | 1,477,683 | – | 126,272 | 126,272 |
| 7 Regulatory Retail | 4,791,353 | – | 4,567,568 | – | 3,425,676 | 3,425,676 |
| 8 Residential Mortgage Loans | 10,487,701 | – | 10,487,701 | – | 5,628,839 | 5,628,839 |
| 9 Other exposures which are not Past Due Exposures | 14,092,560 | 2,414,979 | 11,242,846 | 2,414,979 | 11,934,418 | 14,349,397 |
| 10 Past Due Exposures | 466,470 | – | 466,470 | – | 469,638 | 469,638 |
| B. Off-balance Sheet | | | | | | |
| 1 Off-balance sheet exposures other than OTC derivative transactions | 6,953,712 | 860,217 | 6,093,495 | 311,737 | 6,003,148 | 6,314,885 |
| 2 OTC derivative transactions | 668,929 | 435,091 | 233,838 | 154,848 | 233,838 | 388,686 |

**As at 31st December 2016**

| | Total exposures | Exposures after recognised credit risk mitigation | | Risk-weighted | | Total risk–weighted amounts |
|---|---|---|---|---|---|---|
| | | Rated | Unrated | Rated | Unrated | |
| A. On-balance Sheet | | | | | | |
| 1 Sovereign | 9,671,218 | 9,671,218 | – | 45,630 | – | 45,630 |
| 2 Multilateral Development Bank | 15,881 | 15,881 | – | – | – | – |
| 3 Bank | 77,723,410 | 75,916,364 | 2,320,720 | 32,177,639 | 468,929 | 32,646,568 |
| 4 Securities Firm | 516,869 | – | 516,869 | – | 258,435 | 258,435 |
| 5 Corporate | 49,452,908 | 5,568,250 | 42,327,558 | 3,329,054 | 42,327,558 | 45,656,612 |
| 6 Cash Items | 373,475 | – | 1,442,820 | – | 101,327 | 101,327 |
| 7 Regulatory Retail | 4,997,153 | – | 4,985,159 | – | 3,738,869 | 3,738,869 |
| 8 Residential Mortgage Loans | 10,495,308 | – | 10,488,467 | – | 5,797,701 | 5,797,701 |
| 9 Other exposures which are not Past Due Exposures | 13,084,493 | 2,303,078 | 10,774,331 | 2,303,078 | 11,331,191 | 13,634,269 |
| 10 Past Due Exposures | 205,082 | – | 205,082 | – | 207,622 | 207,622 |
| B. Off-balance Sheet | | | | | | |
| 1 Off-balance sheet exposures other than OTC derivative transactions | 6,880,954 | 804,889 | 6,076,065 | 268,086 | 5,998,536 | 6,266,622 |
| 2 OTC derivative transactions | 671,091 | 637,160 | 33,931 | 209,520 | 33,727 | 243,247 |

As at 31st December 2017, the credit risk to bank, corporate, regulatory retail, other exposures and past due exposures are covered by recognised collateral of HK$8,018,000 (2016: nil), HK$454,659,000 (2016: HK$1,069,345,000), HK$210,936,000 (2016: nil), HK$427,651,000 (2016: nil) and HK$460,135,000 (2016: HK$197,814,000) respectively.

As at 31st December 2017, the credit risk to corporate, regulatory retail, other exposures which are not past due exposures and off-balance sheet exposures other than OTC derivative transactions are covered by recognised guarantees of HK$1,629,986,000 (2016: HK$1,237,874,000), HK$12,849,000 (2016: HK$11,994,000), HK$7,084,000 (2016: HK$7,084,000) and HK$689,483,000 (2016: HK$428,330,000) respectively.

## 2 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:

| | 2017 | 2016 |
|---|---|---|
| Notional amounts: | | |
| – Banks | 13,053,564 | 41,057,864 |
| – Corporates | 4,966,778 | 2,164,650 |
| – Others | 161,537 | 236,869 |
| | 18,181,879 | 43,459,383 |
| Gross total positive fair value | 137,461 | 236,497 |
| Credit equivalent amounts: | | |
| – Banks | 433,838 | 619,223 |
| – Corporates | 233,296 | 40,598 |
| – Others | 1,795 | 11,270 |
| | 668,929 | 671,091 |
| Risk-weighted amounts: | | |
| – Banks | 154,221 | 200,552 |
| – Corporates | 232,670 | 31,436 |
| – Others | 1,795 | 11,259 |
| | 388,686 | 243,247 |

As at 31st December 2017, the default risk exposure, capital charge and risk-weighted amount under the standardised credit valuation adjustment method are HK$668,929,000, HK$11,155,000 and HK$139,438,000 respectively (2016: HK$671,091,000, HK$7,205,000 and HK$90,063,000 respectively).

### (b) Asset securitisation

There are no such exposures for the years ended 31st December 2017 and 2016.

## 2 Risk management (Continued)

### (c) Equity exposures in banking book

Equity holdings in other entities are accounted for in accordance with the underlying intentions of holdings at the inception of acquisition. The classifications for equity holdings taken for relationship and strategic purposes will be separated from those taken for other purposes (including capital appreciation). Investments in equity shares which are intended to be held on a continuing basis, but which do not comprise investments in joint ventures or subsidiaries, are classified as 'Available-for-sale Investments' and are reported in the statement of financial position.

Gains related to equity exposures are as follows:

| | 2017 | 2016 |
|---|---|---|
| Realised gains from sales during the year | – | 108,506 |
| Unrealised revaluation gains at year ended: | | |
| – Amount included in reserves but not through statement of profit or loss | 2,488,863 | 3,184,137 |

### (d) Interest rate exposures in banking book

**2017**

| | Currency | | | | |
|---|---|---|---|---|---|
| Equivalent in Hong Kong Dollars | HKD | USD | RMB | Others | Total |
| Interest rate risk shock (200 basis points upward) Increase/(decline) in earnings | 162,078 | 5,121 | (24,448) | (60,892) | 81,859 |

**2016**

| | Currency | | | | |
|---|---|---|---|---|---|
| Equivalent in Hong Kong Dollars | HKD | USD | RMB | Others | Total |
| Interest rate risk shock (200 basis points upward) Increase/(decline) in earnings | (381,973) | 458,441 | (81,860) | (33,165) | (38,557) |

For 2017 and 2016, 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.

The above analysis is based on the methodology as set out by the HKMA in the completion instructions for the 'Return of Interest Rate Risk Exposure' which is compiled on a quarterly basis.

## 3 Non-bank mainland exposures

**The Bank**

| Types of counterparties | 2017 On-balance sheet exposures | 2017 Off-balance sheet exposures | 2017 Total | 2016 On-balance sheet exposures | 2016 Off-balance sheet exposures | 2016 Total |
|---|---|---|---|---|---|---|
| 1. Central government, central government-owned entities and their subsidiaries and joint ventures | **4,219,582** | **12** | **4,219,594** | 2,198,317 | 69,333 | 2,267,650 |
| 2. Local governments, local government-owned entities and their subsidiaries and joint ventures | **30,272** | **453,366** | **483,638** | 24,877 | 420,916 | 445,793 |
| 3. PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and joint ventures | **9,209,284** | **948,601** | **10,157,885** | 3,216,168 | 868,132 | 4,084,300 |
| 4. Other entities of central government not reported in item 1 above | **580,924** | **–** | **580,924** | 554,779 | – | 554,779 |
| 5. Other entities of local governments not reported in item 2 above | **67,508** | **–** | **67,508** | 67,506 | – | 67,506 |
| 6. PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China | **4,423,548** | **843,733** | **5,267,281** | 5,127,081 | 1,213,967 | 6,341,048 |
| 7. Other counterparties where the exposures are considered by the reporting institution to be non-bank Mainland China exposures | **566,744** | **56** | **566,800** | 635,540 | 5 | 635,545 |
| Total | **19,097,862** | **2,245,768** | **21,343,630** | 11,824,268 | 2,572,353 | 14,396,621 |
| Total assets after provision | **176,700,450** | | | 159,110,699 | | |
| On-balance sheet exposures as percentage of total assets | **10.81%** | | | 7.43% | | |

## 4 Currency concentrations

| Equivalent in Hong Kong dollars | Spot assets | Spot liabilities | Forward purchases | Forward sales | Net options position | Net long/ (short) position | Net structural position |
|---|---|---|---|---|---|---|---|
| | 2017 | | | | | | |
| US Dollars | 67,811,000 | (64,626,000) | 5,829,000 | (6,433,000) | – | 2,581,000 | 6,865,000 |
| Pound Sterling | 3,328,000 | (3,377,000) | 793,000 | (770,000) | – | (26,000) | 34,000 |
| Renminbi | 19,262,000 | (18,584,000) | 3,746,000 | (3,713,000) | – | 711,000 | 1,963,000 |
| Canadian Dollars | 1,638,000 | (1,689,000) | 83,000 | (31,000) | – | 1,000 | – |
| Australian Dollars | 3,647,000 | (3,629,000) | 262,000 | (253,000) | – | 27,000 | – |
| Other currencies and gold | 2,586,000 | (2,724,000) | 1,334,000 | (1,160,000) | – | 36,000 | – |
| | 98,272,000 | (94,629,000) | 12,047,000 | (12,360,000) | – | 3,330,000 | 8,862,000 |

| Equivalent in Hong Kong dollars | Spot assets | Spot liabilities | Forward purchases | Forward sales | Net options position | Net long/ (short) position | Net structural position |
|---|---|---|---|---|---|---|---|
| | 2016 | | | | | | |
| US Dollars | 62,144,000 | (58,355,000) | 49,340,000 | (25,307,000) | – | 27,822,000 | 7,067,000 |
| Pound Sterling | 3,050,000 | (2,953,000) | 491,000 | (594,000) | – | (6,000) | 28,000 |
| Renminbi | 13,933,000 | (13,014,000) | 5,748,000 | (5,861,000) | – | 806,000 | 1,539,000 |
| Canadian Dollars | 1,729,000 | (1,725,000) | 20,000 | (24,000) | – | – | – |
| Australian Dollars | 3,847,000 | (3,810,000) | 703,000 | (726,000) | – | 14,000 | – |
| Other currencies and gold | 2,956,000 | (2,856,000) | 2,216,000 | (2,286,000) | – | 30,000 | – |
| | 87,659,000 | (82,713,000) | 58,518,000 | (34,798,000) | – | 28,666,000 | 8,634,000 |

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 net options position is calculated based on the delta-weighted positions of all foreign exchange option contracts.

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

## 5 Disclosure on Remuneration

### GUIDING PRINCIPLES

The Bank aims to sustain long-term capital preservation and financial strength for the benefits of all stakeholders and is committed to promoting a sound corporate culture of prudent risk-taking at all levels of the Bank, with staff at all times conscientiously serving the Bank by adhering to the established values. The Remuneration Policy (the '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 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 (the '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. Johnson Mou Daid CHA. The other members are Dr. Richard LEE and Mr. Hung-ching YUNG. The fees for members of the Committee for the year are as follows:

| | 2017 | 2016 |
|---|---|---|
| Chairman | 200 | 200 |
| Member | 100 | 100 |

The Committee reviews the Policy and the remuneration structure at least annually and the Policy will be submitted to the Board for approval. In 2017, the Committee held two meetings. The review covered the composition and changes in the senior management and key personnel, the risk level and financial stability of the Bank, and the vesting of variable remuneration with reference to the risk appetite and the risk exposure of the Bank.

The Committee may at its discretion seek information and recommendations from relevant departments, committees or independent consultant as appropriate when conducting the review. In 2017, the Committee has not sought advice from external consultant on remuneration matters but has commissioned Internal Audit Department to conduct an independent review on the effectiveness of the Bank's remuneration system to ensure compliance with the principles set out in the Supervisory Policy Manual CG-5 'Guideline on a Sound Remuneration System' issued by the HKMA.

### REMUNERATION OF DIRECTORS, SENIOR MANAGEMENT AND KEY PERSONNEL

The Committee is responsible for making recommendations to the Board on the formulation and review of the remuneration packages for Directors, the Chief Executive, senior management and key personnel, 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 associates shall be involved in deciding his/her own remuneration package.

## 5 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 provident fund contribution. Variable remuneration takes into account the overall performance of the Bank and individual business units, while individual performance is 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 which is all cash-based 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 established remuneration measures continued to apply in 2017. The timing and the portion of the performance-related bonus distribution are vested in the Committee and finally with the Board. The bonus (or part of it) may be withheld if the Bank's performance is not justified, or if the business objectives are not achieved, or when it is necessary to protect the financial soundness of the Bank.

**DEFERRAL ARRANGEMENTS**

In view of the Bank's existing business model and organisation structure, a portion of the discretionary bonus payment of senior management and key personnel is subject to deferment arrangements as determined by the Committee and vesting by equal portions over a period of three years in order to align with the long-term value creation and time horizons of risk. In circumstances where it is later established that any performance measurement is proven to have been manifestly misstated, or it is later established that the employee concerned has committed fraud, malfeasance, or has violated material internal control policies or breached the relevant rules and regulations, a claw back of unvested deferred variable remuneration shall apply.

## 5 Disclosure on Remuneration (Continued)

**SENIOR MANAGEMENT AND KEY PERSONNEL REMUNERATION**

Aggregate quantitative information on remuneration for the Bank's senior management and key personnel during the year, split into fixed and variable remuneration, is set out below:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| Total value of remuneration awards for the current financial year | Non-deferred | Deferred | Non-deferred | Deferred |
| **Fixed remuneration** | | | | |
| Number of Beneficiaries | 20 | | 18 | |
| • Cash-based | 47,291 | Nil | 47,186 | Nil |
| **Variable remuneration** | | | | |
| Number of Beneficiaries | 17 | | 17 | |
| • Cash-based | 23,285 | 5,526 | 20,309 | 4,136 |
| **Deferred remuneration** | | | | |
| • Vested cash | – | 2,630 | – | 1,962 |
| • Unvested cash | – | 8,822 | – | 6,091 |

*Notes:*

(i) Remuneration refers to all remuneration payable to employees during the year when being appointed as senior management or key personnel.

(ii) Senior management refers to the Chief Executive and division heads of major businesses and operations at the rank of Executive Vice President or above. Key personnel refers to employees whose duties or activities in the course of the employment involve the assumption of material risk or the taking on of material exposures on behalf of the Bank. In 2017, there are 13 employees categorised as senior management (2016: 16) and 7 employees categorised as key personnel (2016: 2). No senior management or key personnel has been awarded or paid sign-on award, guaranteed bonus or severance payment during the years of 2017 and 2016.

(iii) The remuneration awards of senior management and key personnel are aggregated due to the small number of key personnel.

(iv) The unvested deferred remuneration relates to the 2015, 2016 and 2017 variable remuneration.

(v) No deferred variable remuneration had been reduced through performance adjustments or due to ex post explicit or implicit adjustments in 2017 and 2016.

The Bank has complied with the disclosure requirements set out in Part 3 of the Supervisory Policy Manual CG-5 'Guideline on a Sound Remuneration System' issued by the HKMA.

The following disclosures are prepared under regulatory scope of consolidation to comply with the Banking (Disclosure) Rules and do not form part of the audited financial statements.

## 1 Capital structure and adequacy

The calculation of the capital adequacy ratios as at 31st December 2017 is based on the Banking (Capital) Rules ('BCR'). The capital adequacy ratios represent the consolidated ratios of the Bank's Hong Kong offices, overseas branches, Shacom Property (CA), Inc., Shacom Property (NY), Inc., Shacom Property Holdings (BVI) Limited, Shacom Investment Limited, Shacom Assets Investments Limited, Right Honour Investments Limited, Glory Step Investments Limited, Silver Wisdom Investments Limited, Shacom Insurance Brokers Limited, KCC 23F Limited, KCC 25F Limited and KCC 26F Limited computed in accordance with Section 3C(1) of the BCR.

For accounting purposes, the basis of consolidation is described in Note 2.2 to the consolidated financial statements.

The table below presents the balance sheets based on the accounting scope of consolidation and the regulatory scope of consolidation respectively as at 31st December 2017.

| | Balance sheet as in published financial statements | Under regulatory scope of consolidation |
|---|---|---|
| **Assets** | | |
| Cash and balances with banks | 28,755,012 | 28,751,257 |
| Placements with and loans and advances to banks | 17,633,246 | 17,633,246 |
| Loans and advances to customers | 78,296,688 | 78,296,688 |
| Financial assets held for trading | 1,975,108 | 1,936,942 |
| Derivative financial instruments | 141,006 | 141,006 |
| Available-for-sale investments | 50,167,009 | 50,111,396 |
| Held-to-maturity investments | 2,386,864 | 2,386,864 |
| Properties for sale | 373,529 | 373,529 |
| Investments in joint ventures | 338,914 | 113,000 |
| Investments in and amounts due from subsidiaries | – | 200,082 |
| Properties and equipment | 2,389,569 | 2,350,096 |
| Investment properties | 1,020,504 | 1,051,362 |
| Deferred income tax assets | 40,523 | 40,509 |
| Other assets | 1,012,616 | 953,248 |
| **Total assets** | 184,530,588 | 184,339,225 |
| **Liabilities** | | |
| Deposits and balances from banks | 6,780,932 | 6,780,932 |
| Deposits from customers | 146,953,042 | 146,953,042 |
| Derivatives financial instruments | 146,196 | 146,196 |
| Amounts due to subsidiaries | – | 361,130 |
| Subordinated debt | 1,947,028 | 1,947,028 |
| Other liabilities | 2,196,853 | 2,056,113 |
| Provisions | 156,571 | 154,554 |
| Current income tax liabilities | 422,206 | 421,114 |
| Deferred income tax liabilities | 382,438 | 382,397 |
| **Total liabilities** | 158,985,266 | 159,202,506 |
| **Equity** | | |
| Share capital | 2,000,000 | 2,000,000 |
| Retained earnings | 13,446,235 | 13,134,361 |
| Reserves | 10,022,093 | 10,002,358 |
| Non-controlling interests | 76,994 | – |
| **Total equity** | 25,545,322 | 25,136,719 |
| **Total equity and liabilities** | 184,530,588 | 184,339,225 |

## 1 Capital structure and adequacy (Continued)

The table below shows the reconciliation of the capital components from balance sheet based on regulatory scope of consolidation to the Capital Disclosures Template as at 31st December 2017.

| | Balance sheet as in published financial statements | Under regulatory scope of consolidation | Cross reference to definition of capital components |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with banks | 28,755,012 | 28,751,257 | |
| Placements with and loans and advances to banks | 17,633,246 | 17,633,246 | |
| Loans and advances to customers | 78,296,688 | 78,296,688 | |
| *of which: collective impairment allowances reflected in regulatory capital* | | *313,073* | (1) |
| Financial assets held for trading | 1,975,108 | 1,936,942 | |
| Derivative financial instruments | 141,006 | 141,006 | |
| Available-for-sale investments | 50,167,009 | 50,111,396 | |
| *of which: insignificant capital investments in financial sector entities exceeding 10% threshold* | | *1,580,109* | (2) |
| Held-to-maturity investments | 2,386,864 | 2,386,864 | |
| Properties for sale | 373,529 | 373,529 | |
| Investments in joint ventures | 338,914 | 113,000 | |
| Investments in and amounts due from subsidiaries | – | 200,082 | |
| Properties and equipment | 2,389,569 | 2,350,096 | |
| Investment properties | 1,020,504 | 1,051,362 | |
| Deferred income tax assets | 40,523 | 40,509 | (3) |
| Other assets | 1,012,616 | 953,248 | |
| **Total assets** | 184,530,588 | 184,339,225 | |
| **Liabilities** | | | |
| Deposits and balances from banks | 6,780,932 | 6,780,932 | |
| Deposits from customers | 146,953,042 | 146,953,042 | |
| Derivatives financial instruments | 146,196 | 146,196 | |
| Amounts due to subsidiaries | – | 361,130 | |
| Subordinated debt | 1,947,028 | 1,947,028 | |
| *of which: eligible for inclusion in regulatory capital* | | *1,940,308* | (4) |
| Other liabilities | 2,196,853 | 2,056,113 | |
| Provisions | 156,571 | 154,554 | |
| Current income tax liabilities | 422,206 | 421,114 | |
| Deferred income tax liabilities | 382,438 | 382,397 | |
| **Total liabilities** | 158,985,266 | 159,202,506 | |
| **Equity** | | | |
| Share capital | 2,000,000 | 2,000,000 | (5) |
| Retained earnings | 13,446,235 | 13,134,361 | (6) |
| Reserves | 10,022,093 | 10,002,358 | |
| *of which: accumulated other comprehensive income (loss), other than regulatory reserve* | | *9,261,635* | (7) |
| *regulatory reserve* | | *740,723* | (8) |
| Non-controlling interests | 76,994 | – | |
| **Total equity** | 25,545,322 | 25,136,719 | |
| **Total equity and liabilities** | 184,530,588 | 184,339,225 | |

## 1 Capital structure and adequacy (Continued)

The Group has already applied full capital deductions under the BCR. The Capital Disclosures Template as at 31st December 2017 is shown below.

| | | Component of regulatory capital reported by bank | Cross-referenced to balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| | **CET1 capital: instruments and reserves** | | |
| 1 | Directly issued qualifying CET1 capital instruments plus any related share premium | 2,000,000 | (5) |
| 2 | Retained earnings | 13,134,361 | (6) |
| 3 | Disclosed reserves | 10,002,358 | (7)+(8) |
| 4 | Directly issued capital subject to phase out from CET1 capital (only applicable to non-joint stock companies) | Not applicable | |
| 5 | Minority interests arising from CET1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in CET1 capital of the consolidation group) | – | |
| 6 | **CET1 capital before regulatory deductions** | **25,136,719** | |
| | **CET1 capital: regulatory deductions** | | |
| 7 | Valuation adjustments | – | |
| 8 | Goodwill (net of associated deferred tax liability) | – | |
| 9 | Other intangible assets (net of associated deferred tax liability) | – | |
| 10 | Deferred tax assets net of deferred tax liabilities | 40,509 | (3) |
| 11 | Cash flow hedge reserve | – | |
| 12 | Excess of total EL amount over total eligible provisions under the IRB approach | – | |
| 13 | Gain-on-sale arising from securitisation transactions | – | |
| 14 | Gains and losses due to changes in own credit risk on fair valued liabilities | – | |
| 15 | Defined benefit pension fund net assets (net of associated deferred tax liabilities) | – | |
| 16 | Investments in own CET1 capital instruments (if not already netted off paid-in capital on reported balance sheet) | – | |
| 17 | Reciprocal cross-holdings in CET1 capital instruments | – | |
| 18 | Insignificant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold) | 1,580,109 | (2) |
| 19 | Significant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold) | – | |
| 20 | Mortgage servicing rights (amount above 10% threshold) | Not applicable | |
| 21 | Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability) | Not applicable | |
| 22 | Amount exceeding the 15% threshold | Not applicable | |
| 23 | of which: significant investments in the common stock of financial sector entities | Not applicable | |
| 24 | of which: mortgage servicing rights | Not applicable | |
| 25 | of which: deferred tax assets arising from temporary differences | Not applicable | |

## 1 Capital structure and adequacy (Continued)

| | | Component of regulatory capital reported by bank | Cross-referenced to balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| 26 | National specific regulatory adjustments applied to CET1 capital | 740,723 | |
| 26a | Cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) | – | |
| 26b | Regulatory reserve for general banking risks | 740,723 | (8) |
| 26c | Securitisation exposures specified in a notice given by the Monetary Authority | – | |
| 26d | Cumulative losses below depreciated cost arising from the institution's holdings of land and buildings | – | |
| 26e | Capital shortfall of regulated non-bank subsidiaries | – | |
| 26f | Capital investment in a connected company which is a commercial entity (amount above 15% of the reporting institution's capital base) | – | |
| 27 | Regulatory deductions applied to CET1 capital due to insufficient AT1 capital and Tier 2 capital to cover deductions | – | |
| 28 | **Total regulatory deductions to CET1 capital** | **2,361,341** | |
| 29 | **CET1 capital** | **22,775,378** | |
| | **AT1 capital: instruments** | | |
| 30 | Qualifying AT1 capital instruments plus any related share premium | – | |
| 31 | of which: classified as equity under applicable accounting standards | – | |
| 32 | of which: classified as liabilities under applicable accounting standards | – | |
| 33 | Capital instruments subject to phase out arrangements from AT1 capital | – | |
| 34 | AT1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in AT1 capital of the consolidation group) | – | |
| 35 | of which: AT1 capital instruments issued by subsidiaries subject to phase out arrangements | – | |
| 36 | **AT1 capital before regulatory deductions** | **–** | |
| | **AT1 capital: regulatory deductions** | | |
| 37 | Investments in own AT1 capital instruments | – | |
| 38 | Reciprocal cross-holdings in AT1 capital instruments | – | |
| 39 | Insignificant capital investments in AT1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold) | – | |
| 40 | Significant capital investments in AT1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | – | |
| 41 | National specific regulatory adjustments applied to AT1 capital | – | |
| 42 | Regulatory deductions applied to AT1 capital due to insufficient Tier 2 capital to cover deductions | – | |
| 43 | **Total regulatory deductions to AT1 capital** | **–** | |
| 44 | **AT1 capital** | **–** | |
| 45 | **Tier 1 capital (Tier 1 = CET1 + AT1)** | **22,775,378** | |

## 1 Capital structure and adequacy (Continued)

| | | Component of regulatory capital reported by bank | Cross-referenced to balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| | **Tier 2 capital: instruments and provisions** | | |
| 46 | Qualifying Tier 2 capital instruments plus any related share premium | 1,940,308 | (4) |
| 47 | Capital instruments subject to phase out arrangements from Tier 2 capital | – | |
| 48 | Tier 2 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in Tier 2 capital of the consolidation group) | – | |
| 49 | of which: capital instruments issued by subsidiaries subject to phase out arrangements | – | |
| 50 | Collective impairment allowances and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital | 1,053,796 | (1) + (8) |
| 51 | **Tier 2 capital before regulatory deductions** | **2,994,104** | |
| | **Tier 2 capital: regulatory deductions** | | |
| 52 | Investments in own Tier 2 capital instruments | – | |
| 53 | Reciprocal cross-holdings in Tier 2 capital instruments | – | |
| 54 | Insignificant capital investments in Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold) | – | |
| 55 | Significant capital investments in Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | – | |
| 56 | National specific regulatory adjustments applied to Tier 2 capital | – | |
| 56a | Add back of cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) eligible for inclusion in Tier 2 capital | – | |
| 57 | **Total regulatory deductions to Tier 2 capital** | **–** | |
| 58 | **Tier 2 capital** | **2,994,104** | |
| 59 | **Total capital (Total capital = Tier 1 + Tier 2)** | **25,769,482** | |
| 60 | **Total risk weighted assets** | **136,106,777** | |
| | **Capital ratios (as a percentage of risk weighted assets)** | | |
| 61 | CET1 capital ratio | 16.7% | |
| 62 | Tier 1 capital ratio | 16.7% | |
| 63 | Total capital ratio | 18.9% | |
| 64 | Institution specific buffer requirement (minimum CET1 capital requirement as specified in s.3B of the BCR plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB or D-SIB requirements) | 6.5% | |
| 65 | of which: capital conservation buffer requirement | 1.250% | |
| 66 | of which: bank specific countercyclical buffer requirement | 0.78% | |
| 67 | of which: G-SIB and D-SIB buffer requirement | 0.0% | |
| 68 | CET1 capital surplus over the minimum CET1 requirement and any CET1 capital used to meet the Tier 1 and Total capital requirement under s.3B of the BCR | 12.2% | |

## 1 Capital structure and adequacy (Continued)

| | | Component of regulatory capital reported by bank | Cross-referenced to balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| **National minima (if different from Basel 3 minimum)** | | | |
| 69 | National CET1 minimum ratio | Not applicable | |
| 70 | National Tier 1 minimum ratio | Not applicable | |
| 71 | National Total capital minimum ratio | Not applicable | |
| **Amounts below the thresholds for deduction (before risk weighting)** | | | |
| 72 | Insignificant capital investments in CET1 capital instruments, AT1 capital instruments and Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | 2,435,550 | |
| 73 | Significant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | 461,048 | |
| 74 | Mortgage servicing rights (net of related tax liability) | Not applicable | |
| 75 | Deferred tax assets arising from temporary differences (net of related tax liability) | Not applicable | |
| **Applicable caps on the inclusion of provisions in Tier 2 capital** | | | |
| 76 | Provisions eligible for inclusion in Tier 2 in respect of exposures subject to the basic approach and the standardised (credit risk) approach (prior to application of cap) | 1,053,796 | |
| 77 | Cap on inclusion of provisions in Tier 2 under the basic approach and the standardised (credit risk) approach | 1,550,562 | |
| 78 | Provisions eligible for inclusion in Tier 2 in respect of exposures subject to the IRB approach (prior to application of cap) | – | |
| 79 | Cap for inclusion of provisions in Tier 2 under the IRB approach | – | |
| **Capital instruments subject to phase-out arrangements (only applicable between 1st Jan 2018 and 1st Jan 2022)** | | | |
| 80 | Current cap on CET1 capital instruments subject to phase out arrangements | Not applicable | |
| 81 | Amount excluded from CET1 capital due to cap (excess over cap after redemptions and maturities) | Not applicable | |
| 82 | Current cap on AT1 capital instruments subject to phase out arrangements | – | |
| 83 | Amount excluded from AT1 capital due to cap (excess over cap after redemptions and maturities) | – | |
| 84 | Current cap on Tier 2 capital instruments subject to phase out arrangements | – | |
| 85 | Amount excluded from Tier 2 capital due to cap (excess over cap after redemptions and maturities) | – | |

## 1 Capital structure and adequacy (Continued)

**Note to the template:**

Element where a more conservative definition has been applied in the BCR relative to that set out in Basel III capital standards:

| Row No. | Description | Hong Kong basis | Basel III basis |
|---|---|---|---|
| 10 | **Deferred tax assets net of deferred tax liabilities ('DTA')** | **40,509** | **–** |
| | Explanation<br>As set out in paragraphs 69 and 87 of the Basel III text issued by the Basel Committee (December 2010), DTAs that rely on future profitability of the bank to be realised are to be deducted, whereas DTAs which relate to temporary differences may be given limited recognition in CET1 capital (and hence be excluded from deduction from CET1 capital up to the specified threshold). In Hong Kong, an authorised institution is required to deduct all DTAs in full, irrespective of their origin, from CET1 capital. Therefore, the amount to be deducted as reported in row 10 may be greater than that required under Basel III.<br><br>The amount reported under the column 'Basel III basis' in this box represents the amount reported in row 10 (i.e. the amount reported under the 'Hong Kong basis') adjusted by reducing the amount of DTAs to be deducted which relate to temporary differences to the extent not in excess of the 10% threshold set for DTAs arising from temporary differences and the aggregate 15% threshold set for mortgage servicing rights, DTAs arising from temporary differences and significant investments in CET1 capital instruments issued by financial sector entities (excluding those that are loans, facilities and other credit exposures to connected companies) under Basel III. | | |
| Remarks:<br>The amount of the 10%/15% thresholds mentioned above is calculated based on the amount of CET1 capital determined under the BCR. | | | |

Abbreviations:
CET1: Common Equity Tier 1
AT1: Additional Tier 1

The Main Features Template as at 31st December 2017 is shown below:

| | | Ordinary shares | Subordinated notes |
|---|---|---|---|
| 1 | Issuer | Shanghai Commercial Bank Limited | Shanghai Commercial Bank Limited |
| 2 | Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement) | NA | XS1720518478 |
| 3 | Governing law(s) of the instrument | Laws of Hong Kong | English law, except that the subordination provisions shall be governed by the laws of Hong Kong. |
| | Regulatory treatment | | |
| 4 | Transitional Basel III rules# | NA | NA |
| 5 | Post-transitional Basel III rules+ | Common Equity Tier 1 | Tier 2 |
| 6 | Eligible at solo*/group/group & solo | Solo and Group | Solo and Group |
| 7 | Instrument type (types to be specified by each jurisdiction) | Ordinary shares | Other Tier 2 instruments |

## 1 Capital structure and adequacy (Continued)

| | | Ordinary shares | Subordinated notes |
|---|---|---|---|
| 8 | Amount recognised in regulatory capital (Currency in million, as of most recent reporting date) | HK$2,000 million | HK$1,940 million |
| 9 | Par value of instrument | NA | US$250 million |
| 10 | Accounting classification | Shareholders' equity | Liability-amortised cost |
| 11 | Original date of issuance | 1951, 1968, 1969, 1970, 1972, 1973, 1975, 1979, 1981, 1985, 1988, 1990, 1991, 1996, 2000 | 29th November 2017 |
| 12 | Perpetual or dated | Perpetual | Dated |
| 13 | Original maturity date | No maturity | 29th November 2027 |
| 14 | Issuer call subject to prior supervisory approval | No | Yes |
| 15 | Optional call date, contingent call dates and redemption amount | NA | One-off call date: 29th November 2022.<br><br>Additional optional redemption in whole at 100% of principal amount with accrued interest for taxation reasons, tax deductions reasons and regulatory reasons. Redemption amount subject to adjustment following occurrence of a Non-Viability Event. Redemption subject to prior written consent of the Hong Kong Monetary Authority. |
| 16 | Subsequent call dates, if applicable | NA | NA |
| | Coupons/dividends | | |
| 17 | Fixed or floating dividend/coupon | Floating | Fixed |
| 18 | Coupon rate and any related index | NA | 3.75% p.a.<br><br>Fixed until 29th November 2022 and thereafter reset to a new fixed rate equal to the sum of the then prevailing U.S. Treasury Rate and the Spread at Pricing. |
| 19 | Existence of a dividend stopper | No | No |
| 20 | Fully discretionary, partially discretionary or mandatory | Fully discretionary | Mandatory |
| 21 | Existence of step up or other incentive to redeem | No | No |
| 22 | Noncumulative or cumulative | Noncumulative | Cumulative |

## 1 Capital structure and adequacy (Continued)

| | | Ordinary shares | Subordinated notes |
|---|---|---|---|
| 23 | Convertible or non-convertible | Non-convertible | Non-convertible |
| 24 | If convertible, conversion trigger(s) | NA | NA |
| 25 | If convertible, fully or partially | NA | NA |
| 26 | If convertible, conversion rate | NA | NA |
| 27 | If convertible, mandatory or optional conversion | NA | NA |
| 28 | If convertible, specify instrument type convertible into | NA | NA |
| 29 | If convertible, specify issuer of instrument it converts into | NA | NA |
| 30 | Write-down feature | No | Yes |
| 31 | If write-down, write-down trigger(s) | NA | The earlier of the Hong Kong Monetary Authority notifying the issuer in writing:<br><br>(i) that the HKMA is of the opinion that a write-off or conversion is necessary, without which the Issuer would become non-viable or<br><br>(iI) that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the Issuer would become non-viable. |
| 32 | If write-down, full or partial | NA | May be in part or in full |
| 33 | If write-down, permanent or temporary | NA | Permanent |
| 34 | If temporary write-down, description of write-up mechanism | NA | NA |

## 1 Capital structure and adequacy (Continued)

| | | Ordinary shares | Subordinated notes |
|---|---|---|---|
| 35 | Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument) | NA | The rights of the holders will, in the event of the winding up of the Bank, rank<br><br>(i) subordinate and junior in right of payment to, and of all claims of, (a) all unsubordinated creditors of the Issuer (including its depositors), and (b) all other Subordinated Creditors of the Issuer whose claims are stated to rank senior to the Notes or rank senior to the Notes by operation of law or contract;<br><br>(ii) pari passu in right of payment to and of all claims of the holders of Parity Obligations; and<br><br>(iii) senior in right of payment to, and of all claims of, (a) the holders of Junior Obligations, and (b) holders of Tier 1 Capital Instruments of the Issuer. |
| 36 | Non-compliant transitioned features | No | No |
| 37 | If yes, specify non-compliant features | NA | NA |

Footnote:

\# Regulatory treatment of capital instruments subject to transitional arrangements provided for in Schedule 4H of the BCR

\+ Regulatory treatment of capital instruments not subject to transitional arrangement provided for in Schedule 4H of the BCR

* Include solo-consolidated

NA Not applicable

## 2 Overview of risk management and risk weighted amounts ('RWA')

### (a) Overview of risk management

The Group's risk management framework is designed to cover all business processes and ensure various risks are properly managed and controlled in the course of conducting business. The key financial risks related to the Group's business include credit risk, counterparty credit risk, market risk, liquidity risk and operational risk. Further information on the management of these risks is set out within this Regulatory disclosures and Notes to the Consolidated Financial Statements as follows:

| | |
|---|---|
| – Credit risk | – Note 6 of Regulatory disclosures and Note 3.1 of Notes to the Consolidated Financial Statements |
| – Counterparty credit risk | – Note 7 of Regulatory disclosures |
| – Market risk | – Note 8 of Regulatory disclosures and Note 3.2 of Notes to the Consolidated Financial Statements |
| – Liquidity risk | – Note 3.3 of Notes to the Consolidated Financial Statements |
| – Operational risk | – Note 3.6 of Notes to the Consolidated Financial Statements |

**Risk culture**

The Group has long recognized the importance of a strong risk culture which is the core value of the Group and is endorsed by the Board of Directors ('the Board') and being followed by the senior management. The risk culture of the Group is created through fixing and complying with the risk management strategies and core risk management principles as well as establishing a sound risk management systems and effective risk management process to address material risks under normal and stressed conditions in a forward-looking approach. Risk awareness is promoted to all staff to enhance the Group's overall risk management through appropriate training. The Group's risk culture is further reinforced by the Group's remuneration system that is established to ensure that incentives would not create excessive or undue risk exposure and unethical behaviour which could threaten the reputation as well as safety and soundness of the Group.

**Risk governance**

The Board has ultimate responsibility for the effective management of risk and approves and oversees the Group's overall risk management framework. The Board delegates its power to supervise the Group's major functional areas, including treasury, retail banking, corporate banking, wealth management, credit control and financial control, and the risks associated with them to the Risk Committee, the Audit Committee, and the Executive Committee. The Risk Committee in particular has the authority and responsibility to oversee and guide the overall management of the collective set of different risks undertaken by the Group.

The Chief Executive, Chief Risk Officer and the senior management have the responsibility to ensure various risk limits are appropriately established according to the risk management strategies set by the Board, and to oversee the effectiveness of managing and controlling risk in the day-to-day management of the Group.

Various business and functional units of the Group have their respective risk management responsibilities. Business units act as the first line of defense in risk management while other functional units, in particular Risk Management Division, which are independent from the business units and act as the second line of defense, assist in managing different kinds of risks.

Independent Audit Department as the third line of defense is responsible for providing independent assurance through conducting internal audits, and reporting to the Audit Committee on the quality of risk controls and management, the adequacy and the compliance of internal policies and procedures.

## 2 Overview of risk management and risk weighted amounts ('RWA') (Continued)

### (a) Overview of risk management (Continued)

**Risk appetite**

The Group's Risk Appetite Statement is reviewed and approved by the Board from time to time but at least annually with reference to evolving industry and market development, which describes the level of risk that the Group is prepared to accept in pursuit of the Group's strategic objectives. The Group adopts a moderate risk appetite in managing and controlling risks in a prudent manner with a view to achieving steady growth and reasonable returns.

Various ratios and risk limits are set according to the legal and regulatory requirements to limit and control the risk exposure of the Group under a risk tolerance level acceptable to the Group and commensurate with the risk adverse culture as well as prudent management practice.

**Stress testing**

Stress testing is a risk management tool and involves the use of various techniques to assess the Group's potential vulnerability to adverse changes in market conditions. It is conducted with hypothetical as well as historical assumptions. With the establishment of various alerting levels under different scenarios, it helps alert the management to adverse unexpected outcomes related to a variety of risks and provides an indication to the amount of financial resources (including capital and liquidity) that might be necessary for absorbing losses caused by, or to withstand, severe stressed conditions.

**Risk information reporting, risk measurement and reporting systems**

The Group has developed various systems for risk measurement and reporting for different risk exposures. Further information on the measurement and reporting of credit risk and market risk exposures are provided in Note 6(a) and Note 8(a) of Regulatory disclosures respectively. For liquidity risk, the monitoring and reporting takes the form of cash flow measurement and projections for the next day, week and month respectively, as these are key periods for liquidity management. Stress testing is conducted with hypothetical as well as historical assumptions regularly to analyse liquidity risk. Both funding and market liquidity risks are addressed.

A quarterly report on risk exposures and risk management activities of the Group is presented to the Risk Committee regularly; which covers the assessment on major risk exposures including credit risk, market risk, interest rate risk, liquidity risk, legal & compliance & regulatory risk, operational risk, reputation risk, strategic risk and technology risk. Besides, the results of stress tests, maintenance of regulatory risk limit, risk monitoring on overseas branches are also presented.

The Group continues to invest significant resources in IT systems and processes in order to maintain and improve the risk management capabilities. A number of key initiatives and projects to enhance consistent data aggregation, reporting and management, and work towards meeting new regulatory standards are in progress.

**Risk mitigation**

The Group applies different strategies and process to hedge and mitigate different risks. Exposure to credit risk is mitigated 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. Collateral or other security is not usually obtained for credit risk exposures on derivatives instruments, except where the Group requires margin deposits from counterparties. For liquidity risk management, the Group uses results of stress-testing and reverse stress-testing to strengthen resilience to liquidity stress and serve as early-warning triggers for the formulation of management actions and contingency funding plan to mitigate potential stress and vulnerability which the Group might face.

## 2 Overview of risk management and risk weighted amounts ('RWA') (Continued)

**(b) Overview of RWA**

The table below shows the breakdowns of RWA for various risks as at 31st December 2017 and 30th September 2017 and the accordingly minimum capital requirments as at 31st December 2017 which are made by multiplying the Group's RWA by 8%.

| | | RWA | | Minimum capital requirements |
|---|---|---|---|---|
| | | **31st December 2017** | 30th September 2017 | **31st December 2017** |
| 1 | Credit risk for non-securitization exposures | **122,503,658** | 119,231,336 | **9,800,293** |
| 2 | Of which STC approach | **122,503,658** | 119,231,336 | **9,800,293** |
| 2a | Of which BSC approach | **–** | – | **–** |
| 3 | Of which IRB approach | **–** | – | **–** |
| 4 | Counterparty credit risk | **528,124** | 128,169 | **42,250** |
| 5 | Of which SA-CCR | **–** | – | **–** |
| 5a | Of which CEM | **388,686** | 95,044 | **31,095** |
| 6 | Of which IMM(CCR) approach | **–** | – | **–** |
| 7 | Equity positions in banking book under market-based approach | **–** | – | **–** |
| 8 | CIS exposures – LTA | **–** | – | **–** |
| 9 | CIS exposures – MBA | **–** | – | **–** |
| 10 | CIS exposures – FBA | **–** | – | **–** |
| 11 | Settlement risk | **–** | – | **–** |
| 12 | Securitization exposures in banking book | **–** | – | **–** |
| 13 | Of which IRB(S) approach – ratings-based method | **–** | – | **–** |
| 14 | Of which IRB(S) approach – supervisory formula method | **–** | – | **–** |
| 15 | Of which STC(S) approach | **–** | – | **–** |
| 16 | Market risk | **4,552,225** | 3,312,975 | **364,178** |
| 17 | Of which STM approach | **4,552,225** | 3,312,975 | **364,178** |
| 18 | Of which IMM approach | **–** | – | **–** |
| 19 | Operational risk | **7,370,150** | 7,202,175 | **589,612** |
| 20 | Of which BIA approach | **7,370,150** | 7,202,175 | **589,612** |
| 21 | Of which STO approach | **–** | – | **–** |
| 21a | Of which ASA approach | **–** | – | **–** |
| 22 | Of which AMA approach | **N/A** | N/A | **N/A** |
| 23 | Amounts below the thresholds for deduction (subject to 250% RW) | **1,152,620** | 1,002,380 | **92,210** |
| 24 | Capital floor adjustment | **–** | – | **–** |
| 24a | Deduction to RWA | **–** | – | **–** |
| 24b | Of which portion of regulatory reserve for general banking risks and collective provisions which is not included in Tier 2 Capital | **–** | – | **–** |
| 24c | Of which portion of cumulative fair value gains arising from the revaluation of land and buildings which is not included in Tier 2 Capital | **–** | – | **–** |
| 25 | **Total** | **136,106,777** | **130,877,035** | **10,888,543** |

N/A: Not applicable in the case of Hong Kong

## 3 Linkages between financial statements and regulatory exposures

**(a) Linkages between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories**

| | | | Carrying values of items: | | | | |
|---|---|---|---|---|---|---|---|
| | Carrying values as reported in published financial statements | Carrying values under scope of regulatory consolidation | subject to credit risk framework | subject to counterparty credit risk framework | subject to the securitisation framework | subject to market risk framework | not subject to capital requirements or subject to deduction from capital |
| **Assets** | | | | | | | |
| Cash and balances with banks | 28,755,012 | 28,751,257 | 28,751,257 | – | – | – | – |
| Placements with and loans and advances to banks | 17,633,246 | 17,633,246 | 17,633,246 | – | – | – | – |
| Loans and advances to customers | 78,296,688 | 78,296,688 | 78,296,688 | – | – | – | – |
| Financial assets held for trading | 1,975,108 | 1,936,942 | 5,224 | – | – | 1,931,718 | – |
| Derivative financial instruments | 141,006 | 141,006 | – | 137,461 | – | 137,461 | 3,545 |
| Available-for-sale investments | 50,167,009 | 50,111,396 | 48,531,287 | – | – | – | 1,580,109 |
| Held-to-maturity investments | 2,386,864 | 2,386,864 | 2,386,864 | – | – | – | – |
| Properties for sale | 373,529 | 373,529 | 373,529 | – | – | – | – |
| Investments in joint ventures | 338,914 | 113,000 | 113,000 | – | – | – | – |
| Investments in and amounts due from subsidiaries | – | 200,082 | 200,082 | – | – | – | – |
| Properties and equipment | 2,389,569 | 2,350,096 | 2,350,096 | – | – | – | – |
| Investment properties | 1,020,504 | 1,051,362 | 1,051,362 | – | – | – | – |
| Deferred income tax assets | 40,523 | 40,509 | – | – | – | – | 40,509 |
| Other assets | 1,012,616 | 953,248 | 953,248 | – | – | – | – |
| **Total assets** | **184,530,588** | **184,339,225** | **180,645,883** | **137,461** | **–** | **2,069,179** | **1,624,163** |
| **Liabilities** | | | | | | | |
| Deposits and balances from banks | 6,780,932 | 6,780,932 | – | – | – | – | 6,780,932 |
| Deposits from customers | 146,953,042 | 146,953,042 | – | – | – | – | 146,953,042 |
| Derivatives financial instruments | 146,196 | 146,196 | – | – | – | – | 146,196 |
| Amounts due to subsidiaries | – | 361,130 | – | – | – | – | 361,130 |
| Subordinated debt | 1,947,028 | 1,947,028 | – | – | – | – | 1,947,028 |
| Other liabilities | 2,196,853 | 2,056,113 | – | – | – | – | 2,056,113 |
| Provisions | 156,571 | 154,554 | – | – | – | – | 154,554 |
| Current income tax liabilities | 422,206 | 421,114 | – | – | – | – | 421,114 |
| Deferred income tax liabilities | 382,438 | 382,397 | – | – | – | – | 382,397 |
| **Total liabilities** | **158,985,266** | **159,202,506** | **–** | **–** | **–** | **–** | **159,202,506** |

## 3 Linkages between financial statements and regulatory exposures (Continued)

**(b) Main sources of differences between regulatory exposure amounts and carrying values in financial statements**

| | | Items subject to: | | | |
|---|---|---|---|---|---|
| | Total | credit risk framework | securitisation framework | counterparty credit risk framework | market risk framework |
| Asset carrying value amount under scope of regulatory consolidation (as per Regulatory Disclosures Note 3(a)) | 182,715,062 | 180,645,883 | – | 137,461 | 2,069,179 |
| Liabilities carrying value amount under regulatory scope of consolidation (as per Regulatory Disclosures Note 3(a)) | – | – | – | – | – |
| Total net amount under regulatory scope of consolidation | 182,715,062 | 180,645,883 | – | 137,461 | 2,069,179 |
| Off-balance sheet amounts | 46,764,211 | 6,953,712 | – | – | – |
| Differences due to consideration of provisions | 315,126 | 315,126 | – | – | – |
| Differences due to potential exposures for counterparty risk | 531,468 | – | – | 531,468 | – |
| Differences due to reversal of credit balance of other assets | 12,153 | 12,153 | – | – | – |
| Exposure amounts considered for regulatory purposes | 230,338,020 | 187,926,874 | – | 668,929 | 2,069,179 |

**(c) Explanations of differences between accounting and regulatory exposure amount**

**Basis of consolidation**

The basis of consolidation for regulatory purposes is different from that for accounting purposes. Subsidiaries included in the consolidation for regulatory purposes are specified by the Hong Kong Monetary Authority ('HKMA'). Subsidiaries not included in consolidation for regulatory purposes are mainly securities and insurance companies that are authorised and supervised by the Securities and Futures Commission and Insurance Authority respectively.

Most of the principal subsidiaries of the Group are included under scope of regulatory consolidation that there are no material differences between the carrying values of assets as reported in published financial statements and under scope of regulatory consolidation.

Exposure amounts considered for regulatory purposes requires adjustments to be made to the carrying value of assets as reported in published financial statements. The main adjustments taken by the Group include the consideration of provisions, off-balance sheet exposures and potential exposure of default risk.

The Group uses the standarised approach to calculate the risk-weighted assets for its credit risk and market risk exposures. Collective impairment allowances that are deducted from the carrying amount of exposures in financial statements need to be reintegrated in the regulatory exposure value under the standarised approach. Off-balance sheet contracts, such as guarantees and commitments, also carry credit risks. These exposures are converted to credit equivalent amounts and added to the regulatory exposure amounts. The default risk exposures of OTC derivative contracts as reported in published financial statements include their fair value only. Potential exposures for counterparty credit risk of OTC derivative contracts are therefore needed to be added to the regulatory exposure amount.

## 3 Linkages between financial statements and regulatory exposures (Continued)

**(c) Explanations of differences between accounting and regulatory exposure amount (Continued)**

**Valuation control framework**

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 Risk Committee is delegated by the Board to approve the fair valuation policy and to review the governance structure and control framework to ensure that fair values are either determined or validated by control units independent of risk taking units. Control units have overall responsibility for independent verification of valuation results from risk taking units and ensuring the valuation process for financial instruments is conducted effectively and appropriately. Revaluation reports of trading and non-trading positions are compiled regularly and submitted to senior management for review. Any significant valuation issues are reported to senior management, Asset and Liability Committee and Risk Committee.

**Valuation methodologies and process**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless whether the price is directly observable or estimated using another valuation technique.

For financial instrument with bid-offer close-out price, its fair value can be the price within the bid-offer price that is the most representative of fair value. For example, using bid prices for net long positions and ask prices for net short positions. All bid-offer market prices of the financial products, including foreign exchange, equities, debt securities, interest rate swap and bullion will be obtained from designated financial data service providers.

For financial instrument without bid-offer close-out price, the Group uses valuation techniques to establish the fair value of instruments including the use of recent arm's length market transactions between knowledgeable and willing parties, reference to the current fair value of another financial instrument that is substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

## 3 Linkages between financial statements and regulatory exposures (Continued)

**(c) Explanations of differences between accounting and regulatory exposure amount (Continued)**

**Valuation adjustments**

Valuation adjustments are an integral part of the valuation process. Appropriate valuation adjustments are made when the Group considers that there are additional factors that are not incorporated within the valuation methodologies or models such as illiquidity adjustment, concentration adjustment and valuation uncertainty adjustment.

Illiquidity adjustment will be taken if the securities are deemed illiquid that cannot be sold quickly due to a shortage of interested buyers or a lack of an established trading market. Where the Group holds a security that has a significant concentration ratio (ratio of amount of security held by the Group to the total issuance size), concentration adjustment may be required. To adopt illiquidity or concentration adjustment, securities with the same issuer and have nearby maturities as the security in subject would be selected and the yields of these securities would be extracted and interpolated as the yield of security in subject and the price of the illiquid security would then be calculated and compared with the price calculated by the usual valuation methodologies and processes.

The prices of certain debt securities may be less readily determinable from market data. If there is no quotation from designated financial data service providers, other sources will be sought such as the prices of most recent executed transactions. Standard deviation of the prices of the debt securities quoted by different rate sources will be calculated as the uncertainly of the prices quoted of the securities. If the standard deviation exceeds 2%, valuation uncertainty adjustment may be required. The fair value of the debt securities will be adjusted by the standard deviation of the prices of the corresponding securities.

As at 31st December 2017, no valuation adjustment was required as most of the Group's investments were listed equities or debt securities of straight bonds that did not contain any complex features.

## 4 Countercyclical capital buffer ('CCyB') ratio

CCyB ratio is calculated as the weighted average of the applicable jurisdictional CCyB ('JCCyB') ratio effective at the date for which the determination is made, in respect of the jurisdictions (including Hong Kong) where the Bank has private sector credit exposures. The weight to be attributed to a given jurisdiction's applicable CCyB ratio is the ratio of the Bank's aggregate risk-weighted amounts ('RWA') for its private sector credit exposures (in both the banking book and the trading book) in that jurisdiction where the location of the exposures is determined as far as possible on an ultimate risk basis to the sum of the Bank's aggregate RWA across all jurisdictions in which the Bank has private sector credit exposures.

Key drivers for the changes in exposure amounts include asset quality, credit growth and credit portfolio. The applicable JCCyB ratio for Hong Kong is determined by the Hong Kong Monetary Authority ('HKMA') based on the Initial Reference Calculator that is transparently calculated and made public, while the applicable JCCyB ratio in respect of a given jurisdiction outside Hong Kong may differ from the JCCyB ratio as determined by the relevant authority in that jurisdiction if the HKMA has determined and announced the application of a higher or lower rate.

## 4 Countercyclical capital buffer ('CCyB') ratio (Continued)

The following table shows the CCyB ratio, the geographical breakdown of the RWA in relation to private sector credit exposures that are relevant to the calculation of CCyB ratio and the applicable JCCyB ratio corresponding to each jurisdiction for calculating CCyB ratio as at 31st December 2017.

| | Jurisdiction | Applicable JCCyB ratio in effect | Total RWA used in computation of CCyB ratio | CCyB ratio | CCyB amount |
|---|---|---|---|---|---|
| | | % | HK$'000 | % | HK$'000 |
| 1 | Hong Kong | 1.250% | 55,623,297 | | |
| 2 | Mainland China | 0.000% | 6,835,948 | | |
| 3 | Australia | 0.000% | 80,325 | | |
| 4 | Belgium | 0.000% | 504 | | |
| 5 | Bermuda | 0.000% | 1,313,769 | | |
| 6 | Brazil | 0.000% | 37 | | |
| 7 | Cambodia | 0.000% | 256 | | |
| 8 | Canada | 0.000% | 60,022 | | |
| 9 | Cayman Islands | 0.000% | 904,659 | | |
| 10 | Chile | 0.000% | 214 | | |
| 11 | Dominican Republic | 0.000% | 7 | | |
| 12 | Finland | 0.000% | 442 | | |
| 13 | France | 0.000% | 23,318 | | |
| 14 | Germany | 0.000% | 3,561 | | |
| 15 | India | 0.000% | 1,062 | | |
| 16 | Indonesia | 0.000% | 1,195 | | |
| 17 | Italy | 0.000% | 948 | | |
| 18 | Japan | 0.000% | 398,257 | | |
| 19 | Macao | 0.000% | 89,189 | | |
| 20 | Madagascar | 0.000% | 1,354 | | |
| 21 | Malaysia | 0.000% | 2 | | |
| 22 | Mexico | 0.000% | 109 | | |
| 23 | Netherlands | 0.000% | 3 | | |
| 24 | New Zealand | 0.000% | 36,576 | | |
| 25 | Portugal | 0.000% | 137 | | |
| 26 | Singapore | 0.000% | 425,125 | | |
| 27 | South Africa | 0.000% | 2,809 | | |
| 28 | South Korea | 0.000% | 31 | | |
| 29 | Sweden | 2.000% | 118 | | |
| 30 | Switzerland | 0.000% | 1,678 | | |
| 31 | Chinese Taipei | 0.000% | 1,044,252 | | |
| 32 | Thailand | 0.000% | 9,580 | | |
| 33 | United Kingdom | 0.000% | 296,794 | | |
| 34 | United States | 0.000% | 21,214,116 | | |
| 35 | West Indies UK | 0.000% | 954,300 | | |
| | **Total** | | **89,323,994** | **0.78%** | **695,293** |

## 5 Leverage ratio

The leverage ratios represent the consolidated ratios computed on the same regulatory consolidation basis as the capital adequacy ratio. The table below presents the Summary Comparison Table as at 31st December 2017.

| Item | | Leverage ratio framework |
|---|---|---|
| 1 | Total consolidated assets as per published financial statements | 184,530,588 |
| 2 | Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation | (191,363) |
| 3 | Adjustment for fiduciary assets recognised on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure | – |
| 4 | Adjustments for derivative financial instruments | 531,468 |
| 5 | Adjustment for securities financing transactions (i.e. repos and similar secured lending) | – |
| 6 | Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures) | 10,296,232 |
| 7 | Other adjustments | (2,048,268) |
| 8 | Leverage ratio exposure | 193,118,657 |

The Leverage Ratio Common Disclosure Template as at 31st December 2017 is shown below:

| Item | | Leverage ratio framework |
|---|---|---|
| | **On-balance sheet exposures** | |
| 1 | On-balance sheet items (excluding derivatives and SFTs, but including collateral) | 184,511,292 |
| 2 | Less: Asset amounts deducted in determining Basel III Tier 1 capital (reported as negative amounts) | (2,361,341) |
| 3 | Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2) | 182,149,951 |
| | **Derivative exposures** | |
| 4 | Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin) | 141,006 |
| 5 | Add-on amounts for PFE associated with all derivatives transactions | 531,468 |
| 6 | Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework | – |
| 7 | Less: Deductions of receivables assets for cash variation margin provided in derivatives transactions (reported as negative amounts) | – |
| 8 | Less: Exempted CCP leg of client-cleared trade exposures (reported as negative amounts) | – |
| 9 | Adjusted effective notional amount of written credit derivatives | – |
| 10 | Less: Adjusted effective notional offsets and add-on deductions for written credit derivatives (reported as negative amounts) | – |
| 11 | Total derivative exposures (sum of lines 4 to 10) | 672,474 |

## 5 Leverage ratio (Continued)

| Item | | Leverage ratio framework |
|---|---|---|
| | **Securities financing transaction exposures** | |
| 12 | Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions | – |
| 13 | Less: Netted amounts of cash payables and cash receivables of gross SFT assets (reported as negative amounts) | – |
| 14 | CCR exposure for SFT assets | – |
| 15 | Agent transaction exposures | – |
| 16 | Total securities financing transaction exposures (sum of lines 12 to 15) | – |
| | **Other off-balance sheet exposures** | |
| 17 | Off-balance sheet exposure at gross notional amount | 46,764,211 |
| 18 | Less: Adjustments for conversion to credit equivalent amounts (reported as negative amounts) | (36,467,979) |
| 19 | Off-balance sheet items (sum of lines 17 and 18) | 10,296,232 |
| | **Capital and total exposures** | |
| 20 | Tier 1 capital | 22,775,378 |
| 21 | Total exposures (sum of lines 3, 11, 16 and 19) | 193,118,657 |
| | **Leverage ratio** | |
| 22 | **Basel III leverage ratio** | 11.79% |

Abbreviations:
CCP: Central counterparty
CCR: Counterparty credit risk
PFE: Potential future exposure
SFT: Securities financing transactions

## 6 Credit risk

**(a) General information about 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. The Group's exposure to credit risk arises from a range of customer and product types, including exposures to corporate, retail and high net worth customers. The major corporate banking products offered by the Group include commercial loans and trade finance. The retail loans cover mortgage loans, consumer loans and credit cards.

The approach used for defining credit risk management policy and setting credit risk limits is described in Note 3.1 of Notes to the Consolidated Financial Statements.

Various analytical reports on credit risk exposures and credit risk management are provided monthly to senior management; including reports on loans and advances to customers, the credit risk profile of the Group, the portfolio distribution and credit quality, credit portfolio risk monitoring and compliance, impairment allowance and large exposures and risk concentrations.

## 6 Credit risk (Continued)

### (a) General information about credit risk (Continued)

**Credit risk management framework**

The Group's organisation structure establishes a clear set of authority and responsibility for monitoring compliance with policies, procedures and limits.

The Credit Committee is responsible for establishing credit policies, monitoring loan portfolio quality, ensuring compliance with statutory and internal lending limits, evaluating credit applications, making credit decisions and etc. Further information on the Credit Committee is set out in the Corporate Governance Report of this Annual Report.

The Chief Risk Officer takes charges of the Group's overall credit risk management. He is responsible for ensuring that the Group's risk management framework, all related policies and control procedures, and business processes are effective, adequate and properly implemented and consistent with the overall risk appetite of the Group and credit related regulatory requirements. He is also responsible for assessing, evaluating and monitoring the use of risk limits and ensuring that quantifiable risks are within the approved limits.

Various units of the Group have their respective credit risk management responsibilities. Business units including branches and business departments, being the first line of defence, are responsible for performing on-going 'know your customer' checks. The Credit Appraisal Department, Credit Control Department, Market Risk Management Department and the Compliance Department, which are independent from the business units, act as the second line of defence. The Credit Appraisal Department is responsible for independent evaluation of credit applications while Credit Control Department is responsible for performing credit monitoring and review. The Market Risk Management Department is responsible for monitoring the day-to-day management of the credit risk related to treasury operation. The Compliance Department is responsible for monitoring and ensuring that all the relevant regulatory and statutory requirements and limits are complied with by the Group. The Audit Department, being the third line of defence, is responsible for examining and evaluating the adequacy, effectiveness, efficiency and reasonableness of the internal controls, risk management and governance systems and processes of the Group; and assessing compliance with regulatory and statutory requirements.

### (b) Credit quality of exposures as at 31st December 2017

| | | Gross carrying amounts of | | Allowances/ impairments | Net values |
|---|---|---|---|---|---|
| | | Defaulted exposures | Non-defaulted exposures | | |
| 1 | Loans | 492,586 | 78,154,470 | 350,368 | 78,296,688 |
| 2 | Debt securities | – | 48,381,945 | – | 48,381,945 |
| 3 | Off-balance sheet exposures | – | 13,339,008 | – | 13,339,008 |
| 4 | **Total** | **492,586** | **139,875,423** | **350,368** | **140,017,641** |

## 6 Credit risk (Continued)

### (c) Changes in defaulted loans and debt securities

| | | Amount |
|---|---|---|
| 1 | Defaulted loans and debt securities as at end June 2017 | 194,076 |
| 2 | Loans and debt securities that have defaulted since the last reporting period | 429,063 |
| 3 | Returned to non-defaulted status | – |
| 4 | Amounts written off | (2,179) |
| 5 | Other changes | (128,374) |
| 6 | **Defaulted loans and debt securities as at end December 2017** | **492,586** |

### (d) Additional disclosures related to credit quality of exposures

The accounting definition of impaired exposures and the regulatory definition of defaulted exposures are generally aligned. In general, loans and advances overdue for 90 days or more are considered impaired unless other information is available to indicate the contrary. Loans and advances with a specific repayment date are classified as overdue when the principal or interest is past due and remains unpaid. Loans and advances repayable by regular instalments are classified as overdue when an instalment payment is past due and remains unpaid. Loans and advances repayable on demand are classified as overdue when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction.

The approach for determining impairment of financial assets is provided in Note 2.14 of Notes to the Consolidated Financial Statements.

As at 31st December 2017, loans and advances which were past due for more than 90 days were all impaired.

Rescheduled loans and advances to customers are those loans and advances that have been rescheduled or renegotiated for reasons related to the borrower's financial difficulties. A rescheduled loan will normally require an adverse classification under the loan classification system (i.e. substandard or doubtful).

## 6 Credit risk (Continued)

**(d) Additional disclosures related to credit quality of exposures (Continued)**

**(i) Breakdown of credit risk exposures as at 31st December 2017 by industry sector, maturity and geographical region:**

| | Total | Impaired exposure | Individual impairment allowances | Amounts written-off |
|---|---|---|---|---|
| **Credit risk exposure-By industry sector** | | | | |
| – Property investment | 20,839,986 | 22,891 | 131 | – |
| – Property development | 19,952,959 | 405,447 | 1,565 | – |
| – Banks and financial institutions | 38,670,725 | 379 | 33 | – |
| – International, wholesale and retail trade | 15,264,441 | 75,140 | 18,945 | – |
| – Personal | 15,981,208 | 40,544 | 927 | 3,512 |
| – Others* | 29,308,322 | 65,016 | 15,696 | 113 |
| **Total** | **140,017,641** | **609,417** | **37,297** | **3,625** |
| **Credit risk exposure – By geographical region** | | | | |
| – Hong Kong | 63,861,658 | 557,434 | 23,358 | 3,625 |
| – Mainland China | 26,699,104 | 30,274 | 13,859 | – |
| – United States | 25,864,862 | – | – | – |
| – Others | 23,592,017 | 21,709 | 80 | – |
| **Total** | **140,017,641** | **609,417** | **37,297** | **3,625** |
| **Credit risk exposure – By residual maturity** | | | | |
| – Repayable on demand | 4,969,440 | | | |
| – Up to 1 month | 8,750,702 | | | |
| – 1-3 months | 12,807,264 | | | |
| – 3-12 months | 32,056,326 | | | |
| – 1-5 years | 60,941,216 | | | |
| – Over 5 years | 19,848,514 | | | |
| – Indefinite | 644,179 | | | |
| **Total** | **140,017,641** | | | |

* Others include exposures to manufacturing, hotels, catering, telecommunication, transport and other commercial and industrial activities where exposure to each of these sectors is less than 10% of the Group's total RWA for credit risk.

**(ii) Aging analysis of accounting past due exposures as at 31st December 2017:**

| | Gross carrying amount |
|---|---|
| Past due over 3 months but less than 6 months | 413,731 |
| Past due over 6 month but less than 1 year | 48,147 |
| Past due over 1 year | 30,708 |
| **Total** | **492,586** |

**(iii) Breakdown of restructured exposures between impaired and non-impaired exposures as at 31st December 2017:**

| | Gross carrying amount | |
|---|---|---|
| | impaired | Not impaired |
| Rescheduled loans and advances | 23,219 | – |

## 6 Credit risk (Continued)

**(e) Qualitative disclosures related to credit risk mitigation**

**Collateral**

The Group employs a range of policies and practices to mitigate credit risk which is described in Note 3.1.1(a) of Notes to the Consolidated Financial Statements. Further information regarding the nature of collateral held by class of financial asset is provided in Note 3.1.3 of Notes to the Consolidated Financial Statements.

**Revaluation and management of collateral**

To ascertain the estimated fair value of the collateral offered to the Group, collateral other than the bank deposits is revalued according to the Policy on Management of Collateral and Guarantees for monitoring the collateral position against relevant credit exposure.

The revaluation frequency depends on the collateral type but at least annually such as real estate, debt securities, equities, inventory and accounts receivable. More frequent revaluation is needed for listed stocks which are revalued at least twice daily. The collateral value may be adjusted to reflect the likely net realizable value of such collateral.

Advice and service will be sought and employed from external legal professional whenever required to ensure all documentation creating the collateral and providing for the obligation of the parties with respect to each other in respect of the collateral is binding on all parties and legally enforceable in all relevant jurisdictions.

**Recognition of risk mitigation under the standardised approach**

The Group applies the simple approach for credit risk mitigation to all its on – and off-balance sheet banking book exposures that are subject to risk mitigation, where a claim on a counterparty is secured against eligible collateral, the secured portion of the claim must be weighted according to the risk-weight applicable to the collateral (unless that produces a higher risk-weight than would be applicable to the original counterparty, in which case the risk-weight applicable to that counterparty should apply). The unsecured portion of the claim must be weighted according to the risk-weight applicable to the original counterparty. The main types of recognised credit risk mitigant used by the Group include deposits and bank guarantee. In addition, real estate collateral is also recognised for past due exposures.

Where a claim on a counterparty is secured by a guarantee from an eligible guarantor, the portion of the claim that is supported by the guarantee is to be weighted according to the risk-weight applicable to the guarantor (unless the risk-weight applicable to the original counterparty is lower). The unsecured portion of the claim must be weighted according to the risk-weight applicable to the original counterparty.

For capital calculation, the Group has not used any on-balance sheet or off-balance sheet recognised netting for credit risk mitigation.

**Concentrations within credit risk mitigations**

Concentrations within credit risk mitigations taken may occur if a number of guarantors and collaterals with similar economic characteristics are engaged in comparable activities with changes in economic or industry conditions affecting their ability to meet contractual obligations. A range of quantitative tools is used to monitor the Group's credit risk mitigating activities including dedicated stress tests.

A stress-tests and scenario analysis are conducted on the Group's portfolio of collateral to assess the impact under unusual market conditions and relevant reports are submitted to the senior management for review in accordance with the Stress-Testing Policy of the Group.

The credit concentrations within the credit risk mitigation (recognized collateral and guarantees for capital calculation) used by the Group are within acceptable levels.

## 6 Credit risk (Continued)

### (f) Overview of recognized credit risk mitigation as at 31st December 2017

| | | Exposures unsecured: carrying amount | Exposures to be secured | Exposures secured by recognized collateral | Exposures secured by recognized guarantees | Exposures secured by recognized credit derivative contracts |
|---|---|---|---|---|---|---|
| 1 | Loans | 75,085,370 | 3,211,318 | 1,561,399 | 1,649,919 | – |
| 2 | Debt securities | 48,381,945 | – | – | – | – |
| 3 | **Total** | **123,467,315** | **3,211,318** | **1,561,399** | **1,649,919** | **–** |
| 4 | Of which defaulted | 6,335 | 460,135 | 460,135 | – | – |

### (g) Qualitative disclosures on use of ECAI ratings under STC approach

Under the standardised approach ('STC') for the calculation of credit risk within the Basel capital framework, banks are required to use credit assessments provided by external credit assessment institutions ('ECAIs'), recognised by the HKMA for the purposes of regulatory capital calculation, to determine the risk-weights of the banks' credit 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 for the determination of risk weightings for the following classes of exposure:

- Sovereign exposures;
- Public sector entity exposures;
- Bank exposures;
- Securities firm exposures;
- Corporate exposures; and
- Collective investment scheme exposures

The mapping of ECAI ratings of the above six classes of exposure to the risk weights under standardised approach follows the process as prescribed in Part 4 of the Banking (Capital) Rule ('BCR'). Where an exposure of debt securities has an issue-specific external credit assessment, such assessment will be used. In case there is no specific issue rating published by the ECAI, the issuer rating is applied to the senior unsecured claims of that issuer subject to the conditions prescribed by the BCR.

## 6 Credit risk (Continued)

**(h) Credit risk exposures and effects of recognized credit risk mitigation – for STC approach as at 31st December 2017**

| | Exposure classes | Exposures pre-CCF and pre-CRM | | Exposures post-CCF and post-CRM | | RWA and RWA density | |
|---|---|---|---|---|---|---|---|
| | | On-balance sheet amount | Off-balance sheet amount | On-balance sheet amount | Off-balance sheet amount | RWA | RWA density |
| 1 | Sovereign exposures | 11,275,814 | – | 11,275,814 | – | 63,305 | 1% |
| 2 | PSE exposures | – | – | – | – | – | 0% |
| 2a | Of which: domestic PSEs | – | – | – | – | – | 0% |
| 2b | Of which: foreign PSEs | – | – | – | – | – | 0% |
| 3 | Multilateral development bank exposures | 15,464 | – | 15,464 | – | – | 0% |
| 4 | Bank exposures | 72,108,834 | 853,673 | 73,750,735 | 185,958 | 32,035,001 | 43% |
| 5 | Securities firm exposures | 1,142,792 | 265,679 | 1,142,792 | – | 571,396 | 50% |
| 6 | Corporate exposures | 66,215,755 | 34,259,345 | 64,131,110 | 6,005,248 | 66,597,971 | 95% |
| 7 | CIS exposures | – | – | – | – | – | 0% |
| 8 | Cash items | 376,419 | – | 1,477,683 | – | 126,272 | 9% |
| 9 | Exposures in respect of failed delivery on transactions entered into on a basis other than a delivery-versus-payment basis | – | – | – | – | – | 0% |
| 10 | Regulatory retail exposures | 4,791,353 | 3,074,010 | 4,567,568 | 167,730 | 3,551,472 | 75% |
| 11 | Residential mortgage loans | 10,487,701 | 1,075,311 | 10,487,701 | 527,449 | 5,824,499 | 53% |
| 12 | Other exposures which are not past due exposures | 13,631,512 | 7,236,193 | 13,196,777 | 67,327 | 13,264,104 | 100% |
| 13 | Past due exposures | 466,470 | – | 466,470 | – | 469,638 | 101% |
| 14 | Significant exposures to commercial entities | – | – | – | – | – | 0% |
| 15 | **Total** | **180,512,114** | **46,764,211** | **180,512,114** | **6,953,712** | **122,503,658** | **65%** |

## 6 Credit risk (Continued)

### (i) Credit risk exposures by asset classes and by risk weights – for STC approach as at 31st December 2017

| | Exposure class / Risk Weight | 0% | 10% | 20% | 35% | 50% | 75% | 100% | 150% | 250% | Others | Total credit risk exposures amount (post CCF and post CRM) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Sovereign exposures | 10,959,290 | – | 316,524 | – | – | – | – | – | – | – | **11,275,814** |
| 2 | PSE exposures | – | – | – | – | – | – | – | – | – | – | **–** |
| 2a | Of which: domestic PSEs | – | – | – | – | – | – | – | – | – | – | **–** |
| 2b | Of which: foreign PSEs | – | – | – | – | – | – | – | – | – | – | **–** |
| 3 | Multilateral development bank exposures | 15,464 | – | – | – | – | – | – | – | – | – | **15,464** |
| 4 | Bank exposures | – | – | 25,044,591 | – | 43,732,042 | – | 5,160,060 | – | – | – | **73,936,693** |
| 5 | Securities firm exposures | – | – | – | – | 1,142,792 | – | – | – | – | – | **1,142,792** |
| 6 | Corporate exposures | – | – | 39,431 | – | 7,013,685 | – | 63,083,242 | – | – | – | **70,136,358** |
| 7 | CIS exposures | – | – | – | – | – | – | – | – | – | – | **–** |
| 8 | Cash items | 921,149 | – | 537,828 | – | – | – | 18,706 | – | – | – | **1,477,683** |
| 9 | Exposures in respect of failed delivery on transactions entered into on a basis other than a delivery-versus-payment basis | – | – | – | – | – | – | – | – | – | – | **–** |
| 10 | Regulatory retail exposures | – | – | – | – | – | 4,735,298 | – | – | – | – | **4,735,298** |
| 11 | Residential mortgage loans | – | – | – | 7,879,545 | – | 275,790 | 2,859,815 | – | – | – | **11,015,150** |
| 12 | Other exposures which are not past due exposures | – | – | – | – | – | – | 13,264,104 | – | – | – | **13,264,104** |
| 13 | Past due exposures | – | – | – | – | – | – | 460,135 | 6,335 | – | – | **466,470** |
| 14 | Significant exposures to commercial entities | – | – | – | – | – | – | – | – | – | – | **–** |
| 15 | **Total** | **11,895,903** | **–** | **25,938,374** | **7,879,545** | **51,888,519** | **5,011,088** | **84,846,062** | **6,335** | **–** | **–** | **187,465,826** |

## 7 Counterparty credit risk

**(a) Qualitative disclosures related to counterparty credit risk (including those arising from clearing through CCPs)**

Counterparty credit risk arises from over-the-counter ('OTC') derivative contracts and securities financing transactions both in trading and banking book, and is subject to the same risk management framework. Credit equivalent amount and capital charge for the relevant counterparty credit exposures are determined following the regulatory capital requirements. The Group adopts the current exposure method to measure the credit equivalent amount, which comprises current exposures and potential future exposures. The relevant counterparty default risk capital charge is calculated under the standardised approach. The Group also adopts the standardised credit valuation adjustment ('CVA') method to calculate the relevant counterparty CVA capital charge.

The Group exercises strict control over counterparty credit risk exposure. All credit limits are established in advance of transaction. Credit and settlement risk is captured, monitored and reported in accordance with the Group risk methodologies. The credit risk exposures associated with these contracts are predominantly their positive marked-to-market values. These credit risk exposures together with potential exposures from market movements are managed as part of the overall lending limits allowed to counterparties. Collateral or other security is not usually obtained for such credit risk exposures, except where the Group requires margin deposits from counterparties. In the case of a 2-notch downgrade of the Group's credit rating, the impact on the Group's derivative collateral requirements is minimal.

Wrong-way risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty. It arises when default risk and credit exposure increase together. The OTC derivative contracts entered by the Group are mainly foreign exchange contracts, most of which are not exposed to wrong-way risk. In instances where the Group has identified any significant general wrong-way risk, immediate and appropriate actions will be taken and the respective exposure will be under close monitoring in order to effectively manage the credit exposure and minimize losses. Specific wrong-way risk transactions are generally not allowed.

Up to the date of report, the Group has not entered into any transactions with central counterparty ('CCP'). As at 31st December 2017, there were no exposures to CCP.

**(b) Analysis of counterparty default risk exposures (other than those to CCPs) by approaches as at 31st December 2017**

| | | Replacement cost (RC) | PFE | Effective EPE | Alpha (α) used for computing default risk exposure | Default risk exposure after CRM | RWA |
|---|---|---|---|---|---|---|---|
| 1 | SA-CCR (for derivative contracts) | – | – | | 1.4 | – | – |
| 1a | CEM | 137,461 | 531,468 | | – | 668,929 | 388,686 |
| 2 | IMM (CCR) approach | | | – | – | – | – |
| 3 | Simple Approach (for SFTs) | | | | | – | – |
| 4 | Comprehensive Approach (for SFTs) | | | | | – | – |
| 5 | VaR (for SFTs) | | | | | – | – |
| 6 | **Total** | | | | | | 388,686 |

## 7 Counterparty credit risk (Continued)

### (c) CVA capital charge as at 31st December 2017

| | | EAD post CRM | RWA |
|---|---|---|---|
| | Netting sets for which CVA capital charge is calculated by the advanced CVA method | | |
| 1 | (i) VaR (after application of multiplication factor if applicable) | | – |
| 2 | (ii) Stressed VaR (after application of multiplication factor if applicable) | | – |
| 3 | Netting sets for which CVA capital charge is calculated by the standardized CVA method | 668,929 | 139,438 |
| 4 | **Total** | **668,929** | **139,438** |

### (d) Counterparty default risk exposures (other than those to CCPs) by asset classes and by risk weights – for STC approach as at 31st December 2017

| | Exposure class \ Risk Weight | 0% | 10% | 20% | 35% | 50% | 75% | 100% | 150% | 250% | Others | Total default risk exposure after CRM |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Sovereign exposures | – | – | – | – | – | – | – | – | – | – | – |
| 2 | PSE exposures | – | – | – | – | – | – | – | – | – | – | – |
| 2a | Of which: domestic PSEs | – | – | – | – | – | – | – | – | – | – | – |
| 2b | Of which: foreign PSEs | – | – | – | – | – | – | – | – | – | – | – |
| 3 | Multilateral development bank exposures | – | – | – | – | – | – | – | – | – | – | – |
| 4 | Bank exposures | – | – | 211,475 | – | 220,874 | – | 1,489 | – | – | – | 433,838 |
| 5 | Securities firm exposures | – | – | – | – | – | – | – | – | – | – | – |
| 6 | Corporate exposures | – | – | – | – | 1,253 | – | 232,043 | – | – | – | 233,296 |
| 7 | CIS exposures | – | – | – | – | – | – | – | – | – | – | – |
| 8 | Regulatory retail exposures | – | – | – | – | – | – | – | – | – | – | – |
| 9 | Residential mortgage loans | – | – | – | – | – | – | – | – | – | – | – |
| 10 | Other exposures which are not past due exposures | – | – | – | – | – | – | 1,795 | – | – | – | 1,795 |
| 11 | Significant exposures to commercial entities | – | – | – | – | – | – | – | – | – | – | – |
| 12 | **Total** | **–** | **–** | **211,475** | **–** | **222,127** | **–** | **235,327** | **–** | **–** | **–** | **668,929** |

## 7 Counterparty credit risk (Continued)

**(e) Composition of collateral for counterparty default risk exposures (including those for contracts or transactions cleared through CCPs) as at 31st December 2017**

| | | Derivative contracts | | | | SFTs | |
|---|---|---|---|---|---|---|---|
| | | Fair value of recognized collateral received | | Fair value of posted collateral | | Fair value of recognized collateral | Fair value of posted collateral |
| | | Segregated | Unsegregated | Segregated | Unsegregated | | |
| 1 | Cash – other currencies | – | – | – | 24,470 | – | – |
| 2 | **Total** | **–** | **–** | **–** | **24,470** | **–** | **–** |

**(f) Credit-related derivatives contracts**

The Group did not have any credit-related derivatives contracts as at 31st December 2017.

**(g) Exposures to CCPs**

The Group did not have any exposures to CCPs as at 31st December 2017.

## 8 Market risk

**(a) Qualitative disclosures related to 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 foreign exchange contracts, that comprise transactions initiated for the Group's own account and customer needs.

The Group's positions are managed by the Treasury Division 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 and Risk Committee. The Risk Management Division is responsible for monitoring the transactions to ensure the activities are within the relevant limits and guidelines.

Further information on the management of foreign exchange risk and interest rate risk is provided in Note 3.2.3 and Note 3.2.4 of Notes to the Consolidated Financial Statements.

## 8 Market risk (Continued)

**(a) Qualitative disclosures related to market risk (Continued)**

**Market risk measurement**

The measuring procedures and limit system used for market risk management have been approved by the Executive Committee (and also Risk Committee for the measuring procedures). Limits on notional, stop loss and sensitivity are set for trading positions which are marked-to-market daily. 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, the Asset and Liability Committee, the Executive Committee, the Risk Committee and the Board.

The Group measures the exposure of its assets and liabilities to fluctuations in interest rates primarily by way of gap analysis which provides the Group with a static view of the maturity and re-pricing characteristics of balance sheet positions. An interest rate gap report is prepared by classifying all assets and liabilities into various time period categories according to contracted maturities or anticipated re-pricing dates whichever is earlier. The difference in the amount of assets and liabilities maturing or being re-priced in any time period category would then give the Group an indication of the extent to which the Group is exposed to the risk of potential changes in the net interest income.

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 foreign exchange rate and interest rate contracts which are typically made OTC and are managed within limits approved by the Executive Committee and Risk Committee. The policy on the use of derivatives is reviewed by Risk Committee and recommended changes and amendments are approved by the Executive Committee or the Risk Committee. The Group has not designated any derivatives in any hedge relationship for the application of hedge accounting.

**(b) Market risk under STM approach as at 31st December 2017**

| | | RWA |
|---|---|---|
| | Outright product exposures | |
| 1 | Interest rate exposures (general and specific risk) | 2,125,225 |
| 2 | Equity exposures (general and specific risk) | – |
| 3 | Foreign exchange (including gold) exposures | 2,427,000 |
| 4 | Commodity exposures | – |
| | Option exposures | |
| 5 | Simplified approach | – |
| 6 | Delta-plus approach | – |
| 7 | Other approach | – |
| 8 | Securitization exposures | – |
| 9 | **Total** | **4,552,225** |

## 9 Liquidity maintenance ratio

| | 2017 | 2016 |
|---|---|---|
| Liquidity maintenance ratio ('LMR') | **45.6%** | 49.3% |

The LMR is calculated as the simple average of each calendar month's average consolidated LMR of the Bank's Hong Kong offices, overseas branches, Shacom Investment Limited and Shacom Assets Investments Limited for the 12 months of the financial year, computed in accordance with the Banking (Liquidity) Rules.

# BRANCHES AND SUBSIDIARIES

## Management and Administration

Shanghai Commercial Bank Tower, 12 Queen's Road Central, Hong Kong
Telephone: (852) 2841 5415
Fax: (852) 2810 4623
SWIFT: SCBK HK HH
Web Site: www.shacombank.com.hk

## Hong Kong Island Branches

| | |
|---|---|
| Central Head Office | Lobby Floor, Shanghai Commercial Bank Tower, 12 Queen's Road Central |
| Aberdeen Branch | 118 Aberdeen Main Road, Aberdeen |
| Causeway Bay Branch | 18 Pennington Street, Causeway Bay |
| Connaught Road Branch | G/F & 1/F Southland Building, 48 Connaught Road Central, Central |
| 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 | Shop 2, G/F, 57-61 Belcher's 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 | Units 101-103, 1/F., Wing On Plaza, 62 Mody Road, Tsimshatsui East |
| Mongkok Branch | 666 Nathan Road, Mongkok |

## Kowloon Branches (Continued)

| | |
|---|---|
| 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 N117, 1/F., Temple Mall North, 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 | Shops 1-3, G/F., Ming Wai Building, 4-26 Tuen Mun Heung Sze Wui Road, 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,<br>161 Lu Jia Zui Road (E), Pu Dong, Shanghai 200120, P.R.C. |
| Shanghai FTZ Sub-Branch | Room 03-05, 15/F, 55 Ji Long Rd,<br>Pu Dong, Shanghai 200131, P.R.C. |
| Shenzhen Branch | Room 01-03, 20/F, Tower One, Kerry Plaza,<br>No.1 Zhong Xin Si Road, Futian District,<br>Shenzhen 518048, P.R.C. |

## Wholly-owned Subsidiaries

Glory Step Investments Limited
Hai Kwang Property Management Company Limited
Infinite Financial Solutions Limited
KCC 23F Limited
KCC 25F Limited
KCC 26F 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

## Subsidiaries

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