



Build A Better Living

Annual Report 2018



Vision

To become a first-class medium
to large bank in Hong Kong



Core Values

Integrity
Impartiality
Prudence
Creation

Mission

Provide better service to our customers
Create higher value to our shareholders
Build up broader career path for our associates
Assume full responsibilities as a corporate citizen

28/F, CCB Tower, 3 Connaught Road Central
Central, Hong Kong

Tel: 3918 6939 www.asia.ccb.com

CONTENTS

About Us	02
About CCB	03
Our History	04
To Customers and Shareholders	06
Board of Directors and Executive Management	08
Subsidiary, Joint Venture and Associated Companies	15
Corporate Social Responsibility	16
Awards and Honors	22
Report of the Board of Directors	24
Independent Auditor's Report	27
Consolidated Statement of Profit or Loss	34
Consolidated Statement of Comprehensive Income	35
Consolidated Statement of Financial Position	36
Consolidated Statement of Changes in Equity	38
Consolidated Statement of Cash Flows	40
Notes to the Consolidated Financial Statements	41
Unaudited Supplementary Financial Information	176
Service Network	205



This annual report is printed on environmentally friendly paper.

ABOUT US

China Construction Bank (Asia)

China Construction Bank (Asia) Corporation Limited (“CCB (Asia)”) is the comprehensive and integrated commercial banking platform of China Construction Bank Corporation (“CCB”) in Hong Kong. Currently, CCB (Asia) has over 50 service outlets in Hong Kong and offers a wide array of banking products and services to customers, including consumer banking services, commercial banking services, corporate banking services, private banking services, treasury business and cross-border financial services, etc.

For consumer banking, in addition to providing conventional transactional, foreign exchange and cash services, CCB (Asia) also offers deposits, loans (including personal loans, credit cards loan, residential mortgages and auto-financing), securities agency and investments (mutual fund and bond trading), consolidated banking, insurance (including life insurance, general insurance and insurance broker), MPF referral services, RMB services, credit card, electronic banking services (online and mobile banking), cross border services and safe deposit boxes services.

For commercial banking, CCB (Asia) provides a diverse range of financial products and services to local mid-caps and medium-to-large corporations, both non blue-chip listed as well as private companies, including bilateral commercial loans, syndicated loans, project finance, property development loans, trade finance, commercial mortgage financing, machinery loans, FX products, as well as corporate wealth management, cash management and deposit services. CCB (Asia) also capitalizes on the extensive branch network of CCB to create synergy in businesses such as RMB cross-border collaboration services including SBLC loans, LC discount, RMB deposit, remittance and foreign exchange.

For corporate banking, CCB (Asia) provides a full range of banking services including bilateral loans, syndicated loans, club deals, merger and acquisition financings, trade finance, bond financings, treasury products, cash management, deposit services and related retail products to blue-chip companies and large local corporations. Besides, CCB (Asia) also offers comprehensive financing solutions to large state-owned enterprises and Chinese conglomerates, including the provision of credit enhancement service in supporting domestic companies in Mainland China to issue its offshore corporate bond. Fully supported by CCB, CCB (Asia) launches synergistic businesses such as entrusted payment, export account receivable risk participation, discount against draft avalisation and more. Other business developments of corporate banking include the aircraft finance business and the emerging business in the Shenzhen Qianhai Financial District and the Shanghai Pilot Free Trade Zone.

For treasury business, CCB (Asia) manages the bank’s bond portfolio, issues bank debt instruments, carries out money market lending and borrowing, bond repurchase, foreign exchange, interest rate and derivative products proprietary trading and market making. Designated by The Hong Kong Monetary Authority, CCB (Asia) is Primary Liquidity Provider (PLP) for offshore RMB market in Hong Kong. In addition, CCB (Asia) provides bank clients with treasury products sales and trading services including foreign exchange, interest rates, derivatives and securities, as well as bond capital markets services such as debt instruments issuance and underwriting. Comprehensive and integrated trading and financing solutions are offered to clients. CCB (Asia) has established extensive treasury business relationships with banks, corporate and institutional clients. Flexible and diversified investment, trading, financing and hedging products are also provided to local and overseas clients.

ABOUT CCB

China Construction Bank Corporation

China Construction Bank Corporation, headquartered in Beijing, is a leading joint stock large-scale commercial bank in China. Its predecessor, the People's Construction Bank of China, was established in October 1954. It was listed on Hong Kong Stock Exchange in October 2005 (stock code: 939) and the Shanghai Stock Exchange in September 2007 (stock code: 601939). At the end of 2018, the Bank's market capitalisation reached US\$207,179 million, ranking fifth among all listed banks in the world. The Group ranks second among global banks in terms of Tier 1 capital.

The Bank provides customers with comprehensive financial services, such as personal banking, corporate banking, investment and wealth management. With 14,977 banking outlets and 345,971 staff members, the Bank serves hundreds of millions of personal and corporate customers. The bank has commercial banking branches and subsidiaries in 29 countries and regions with nearly 200 commercial banking entities at various levels, and subsidiaries in different industries and sectors, including fund management, financial leasing, trust, insurance, futures, pension and investment banking.

Adhering to the "customer-centric, market-oriented" business philosophy, the Bank is committed to developing itself into a bank with top value creation capability. The Bank strives to achieve the balance between short-term and long-term benefits, and between business goals and social responsibilities, so as to maximise the value for customers, shareholders, society and its associates.

Vision

Build a world class banking group with top value creation capability.

Mission

Provide better services to our customers, create greater value to our shareholders, build up a broader career platform for our associates, and assume full responsibilities as a corporate citizen.

Core Values

Integrity, Impartiality, Prudence, and Creation

OUR HISTORY

1912

CCB (Asia) originated from The Bank of Canton which was established in Hong Kong in 1912 by Chinese businessmen, including Li Yuk-tong and Look Pong-shan. It was the first Chinese-owned bank in Hong Kong and Look Pong-shan was the first chairman. The headquarter was located at 6 Des Voeux Road Central, Hong Kong, which is now the flagship branch of CCB (Asia).



The Bank of Canton's head office was located at 6 Des Voeux Road Central

1945

World War II ended and Hong Kong was liberated. Former staff rebuilt The Bank of Canton and its banking business was quickly back on track. It soon became the largest Chinese-owned remittance and foreign exchange bank in Hong Kong in the post-war era.



Celebration of the 35th Anniversary of The Bank of Canton (1947)

1936

Due to Great Depression, operations of the bank were suspended in 1935. Through re-capitalization by Soong Tse-ven, the bank reopened on November 23 and was chaired by Soong Tse-ven.

The bank expanded its business to Macau by setting up a subsidiary Bank of Canton (Macau), which was the first Chinese-owned financial institution registered in Macau.



The Bank of Canton reopened in 1936. Soong Tse-ven (forth from right) served as the Chairman of the board

1966

Shanghai Fire & Marine Insurance Co. Ltd. became a subsidiary of The Bank of Canton and was renamed Hongkong & Shanghai Insurance Company Limited later. In 2001, Hongkong & Shanghai Insurance Company Limited merged with QBE Insurance (Hong Kong) Ltd, a wholly owned subsidiary of QBE Group and was renamed QBE Hongkong & Shanghai Insurance Limited, which is an associated company of CCB (Asia) today.

1988

The Bank of Canton officially announced its cooperation with Security Pacific National Bank in 1971. In 1988, The Bank of Canton was officially renamed Security Pacific Asian Bank.



The inauguration of Security Pacific Asian Bank

1941

Hong Kong was occupied by Japan in World War II. The bank's business was suspended again.

OUR HISTORY

1993

Security Pacific Corporation merged with Bank of America Corporation. Security Pacific Asian Bank became a wholly-owned subsidiary of Bank of America Corporation and was renamed Bank of America (Asia) in 1993. In 2001, the Chinese name of Bank of America (Asia) was changed to align with English.

2006

China Construction Bank acquired a 100% interest in Bank of America (Asia) from Bank of America and was renamed China Construction Bank (Asia).



The inauguration of CCB (Asia) (2007)

2009

CCB (Asia) acquired AIG Finance (Hong Kong) and was renamed China Construction Bank (Asia) Finance, laying the solid foundation for expanding the credit card and personal loan businesses in Hong Kong.



Signing ceremony of the acquisition of AIG Finance (Hong Kong)

2013

Business integration of China Construction Bank (Asia) and China Construction Bank Hong Kong Branch.



CCB Hong Kong Business Integration Ceremony

The three buildings of CCB in Hong Kong were officially inaugurated. CCB Tower is the head office of CCB (Asia), located at Central; CCB Centre is the mid-to-back office of CCB's entities in Hong Kong, situated in Kowloon Bay; CCB Hong Kong Training Centre is CCB's first offshore training site, located at Sai Wan.



(From left to right) CCB Centre, CCB Tower, CCB Hong Kong Training Centre

2017

CCB (Asia) Celebrates the 105th Anniversary



105th Anniversary Cocktail Reception on February 21

TO CUSTOMERS AND SHAREHOLDERS

We are delighted to announce that the consolidated net profit after tax for China Construction Bank (Asia) Corporation Limited ["CCB (Asia)"] to reach HKD3,574 million for the year ended December 31, 2018, an increase of HKD306 million or 9.4%, as compared with 2017.

Total operating income of CCB (Asia) for the year of 2018 amounted to HKD8,222 million, an increase of 11.0% as compared with that of 2017. If including the interest income of trading advances to customers and trade bills of HKD140 million and the hedging FX and interest rate swaps expense of HKD5 million, net interest income amounted to HKD6,255 million, increased by 25.0% as compared with 2017. Non-interest income after excluding the aforesaid interest and hedging income was HKD1,967 million, representing a decrease of 18.2% as compared with 2017, mainly attributable to the reduction in net trading income of HKD512 million.

Total operating expenses rose by 4.2% to HKD3,206 million and the cost-to-income ratio dropped by 2.5 percentage points to 39.0%.

In 2018, the amount of impairment allowance charges was HKD635 million, representing an increase of HKD268 million against 2017. It was mainly due to the increase in collective impairment charge of HKD503 million after considering the countercyclical market movement. On the other hand, there was a reversal in individual impairment charges of HKD127 million compared with a charge of HKD155 million in 2017.

Taxation expenses increased by 16.9% to HKD782 million, which was mainly due to an expansion of operating profit for the year.

Total consolidated assets as at December 31, 2018 stood at HKD481.0 billion, recording a decrease of 7.7% from HKD521.0 billion at the end of 2017. Advances to customers and trade bills contracted by 11.6% to HKD254.5 billion, mainly resulted from the contraction of loans guaranteed by mainland branches, coupled with certain commercial loans held-for-sale reclassified into financial assets at fair value through profit or loss in accordance with the newly implemented Hong Kong Financial Reporting Standard No. 9. Asset quality continuously maintained at a satisfactory level, with the impaired advances to customers and trade bills representing 0.31% of the total advances to customers and trade bills.

In view of the uplift of market uncertainty, CCB (Asia) exercised a more prudential credit standard. Financial assets measured at amortized costs (formerly known as held-to-maturity investments) decreased by 30.9% to HKD12.1 billion while financial assets measured at fair value through other comprehensive income (formerly known as available-for-sale financial assets) also dropped by 12.3% to HKD86.7 billion when compared with the end of 2017. Besides in order to retain our liquid capital for economic change, cash and balances with banks and central banks, as well as placements with banks increased by 11.6% to HKD111.5 billion when compared with the end of 2017.

Deposits from customers increased by 0.2% to HKD354.1 billion as compared with that at the end of 2017, in which demand deposits and current accounts registered an ideal growth. On the other hand, deposits from other banks decreased by 52.7% to HKD34.6 billion and other debt securities issued also reduced by 2.6% to HKD14.5 billion, leading to a more optimal liability structure.

TO CUSTOMERS AND SHAREHOLDERS

As at December 31, 2018, CCB (Asia)'s Total Capital Ratio was 19.7%. The average liquidity coverage ratio for the year was 206.0% while the leverage ratio was 12.1%. Meanwhile, the Net Stable Funding Ratio was 139.4%. The Impaired Loan Ratio was 0.31%. All these ratios were maintained at sound levels and above the regulatory requirements.

This year, leveraging on parent bank's edge in financial technology, CCB (Asia) has introduced a brand new smart banking system with the hope of providing more convenient banking services to its customers. In addition, in light of Mainland China's development plan for the Guangdong-Hong Kong-Macao Greater Bay Area which was unveiled earlier this year, we are determined to grasp this historical opportunity by playing a part in the plan in which Hong Kong will strengthen its ties with Mainland China. We will also embrace the strategic development plan of parent bank and further expand our business, as well as meeting customers' demand by integrating our multi-functional banking services and building up our cross border financial product portfolio. Meanwhile, we will also keep a close eye on the business opportunities arising from the Belt and Road initiative and proactively capture these opportunities to further expand our business.

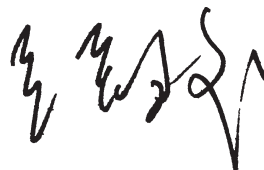
We will also adopt a delicacy management approach and strengthen our risk and compliance management. This will contribute to a steady progression of our bank and maintain a high quality growth which we believe is the best reward to our customers and shareholders for their support.

Last but not least, we would like to express our gratitude to our parent bank and our fellow Directors for their invaluable advice and support over the past year. We would also like to thank the management team and staff of CCB (Asia) for their diligence and commitment, providing excellent services to our customers that complement with our strategic plan in business development.



Jiang Xianzhou

Chairman and Executive Director



Zhang Jun

Vice Chairman, Executive Director & Chief Executive Officer

Hong Kong, March 22, 2019

BOARD OF DIRECTORS AND EXECUTIVE MANAGEMENT

In 2018

BOARD OF DIRECTORS

JIANG Xianzhou	Chairman, Executive Director
ZHANG Jun (appointed on March 26, 2018)	Vice Chairman, Executive Director & Chief Executive Officer
Miranda KWOK Pui Fong	Executive Director, President
MAO Yumin	Non-Executive Director
XUE Shengli	Non-Executive Director
Lord Peter LEVENE	Independent Non-Executive Director
WONG Kai Man BBS, JP	Independent Non-Executive Director
Rex AU YEUNG Pak-kuen JP (appointed on September 8, 2018)	Independent Non-Executive Director

RESIGNED DIRECTORS

WANG Hongzhang (resigned on March 22, 2018)	Chairman, Non-Executive Director
CHAN Wing Kee GBM, GBS, OBE, JP (resigned on September 8, 2018)	Independent Non-Executive Director
HU Zhanghong (resigned on December 6, 2018)	Non-Executive Director

SECRETARIES

YU Haibing	Secretary to the Board of Directors
Ted YAU Ka Bo	Company Secretary

BOARD OF DIRECTORS AND EXECUTIVE MANAGEMENT

In 2018



JIANG Xianzhou

Chairman and Executive Director

Mr. Jiang, aged 57, is the chairman and executive director of the Bank. He has over 30 years of experience in the financial sector, specializing in commercial banking and asset management. Prior to the current position as chairman and executive director of the Bank since March 2018, he was the vice chairman, executive director & chief executive officer of the Bank from May 2016 to March 2018, and the executive director and alternate chief executive of the Bank from 2014 to 2016. He was the chairman of China Construction Bank Principal Asset Management Co. Ltd., a subsidiary of China Construction Bank Corporation, from 2005 to 2014. Mr. Jiang helped spearhead the establishment of the subsidiary, which has now prospered and become a leading asset management company in the industry. Mr. Jiang has assumed numerous senior positions since joining China Construction Bank in 1986. He was promoted to deputy general manager of the Executive Office in 1995, and deputy general manager of the International Business Department in 1997. In 2004, he took over as general manager of the Institutional Business Department and the Fund Custody Department.

Mr. Jiang graduated from Dongbei University of Finance & Economics in 1982, receiving a Bachelor's Degree in Economics. He attained his Master's Degree in Finance from the Research Institute of Fiscal Science at the Ministry of Finance of the PRC in 1986. He went on to receive a Master of Science in International Banking at Heriot-Watt University in the UK in 1993.



ZHANG Jun

*Vice Chairman, Executive Director
and Chief Executive Officer*

Mr. Zhang, aged 52, is the vice chairman, executive director and chief executive officer of the Bank. Mr. Zhang joined China Construction Bank in 1988 and has over 30 years of banking experience. Before taking over his current position in March 2018, he was the general manager of China Construction Bank New York Branch since 2013. Mr. Zhang worked in the International Business Department of Shandong Branch of China Construction Bank for many years, and later served as deputy general manager of China Construction Bank Singapore Branch, Frankfurt Branch and was in charge of the project team for setting up the Ho Chi Minh City Branch. From September 2008 to April 2013, he served as the deputy general manager of China Construction Bank Hong Kong Branch.

Mr. Zhang is a senior economist. He graduated from Shandong University in 1998 with a Bachelor's Degree in Operations Research and obtained a MBA from University of Hull, United Kingdom in 1999. He is also a Chartered Financial Analyst (CFA) charterholder. He was the vice chairman of China General Chamber of Commerce — USA (CGCC) and the chairman of CGCC Finance Committee.

BOARD OF DIRECTORS AND EXECUTIVE MANAGEMENT

In 2018



**Miranda
KWOK Pui Fong**

President & Executive Director

Ms. Kwok, aged 58, is the president and executive director of the Bank. Ms. Kwok has been serving the Bank for over 34 years. Prior to July 2013, when China Construction Bank reorganized its Hong Kong business by integrating CCB (Asia) and the Hong Kong Branch, she had been the president and chief executive officer of the Bank. Ms. Kwok is a member of the Bank's senior management and Executive Committee that supports the overall bank management and corporate governance.

Ms. Kwok's banking career began in 1984 when she joined Bank of America, Hong Kong as a management trainee and had worked in diversified capacities of various divisions. In 1996, she was transferred to Bank of America (Asia) [renamed CCB (Asia) in December 2006] from Bank of America, Hong Kong Branch, and was promoted to chief credit officer and senior vice president, responsible for credit approval and portfolio review, special assets management, collection, credit policies and procedures etc. She was appointed chief risk officer in 2005 to manage credit, market and operational risk. In addition, she assumed responsibilities over compliance, internal control and the corporate secretariat. From 2008 to 2010, she assumed the role of head of Consumer Banking in charge of retail business, credit card and wealth management in Hong Kong and Macau.

Ms. Kwok is the vice president of the Hong Kong Institute of Bankers, the member of the EFAC Financial Infrastructure and Market Development Sub-Committee, Hong Kong Export Credit Insurance Corporation Advisory Board, Air Transport Licensing Authority as well as Financial Reporting Council. Ms. Kwok graduated with an Honorable Bachelor of Social Sciences Degree in Economics and Management from the University of Hong Kong in 1984, and graduated with honors from the Graduate School of Retail Bank Management of the Consumer Bankers Association in the United States in July 2001.



MAO Yumin

Non-Executive Director

Mr. Mao, aged 64, has served as non-executive director of the Bank since August 9, 2016 and is a member of the Strategy and Corporate Governance Committee of the Board of Directors, the Audit Committee of the Board of Directors, the Risk Committee of the Board of Directors and the Compliance Sub-Committee under the Risk Committee of the Board of Directors of the Bank.

Mr. Mao has over 30 years of experience in the banking and financial sector. Prior to his retirement in May 2016, Mr. Mao was the chief executive officer and executive director of China Construction Bank (Asia) from July 2013 to May 2016; the chief executive of China Construction Bank Hong Kong Branch from April 2011 to May 2016; the chief investment officer of China Construction Bank Corporation from September 2007 to March 2011; non-executive director and the chairman of CCB (London) from January 2009 to March 2011; and executive director and the vice chairman of CCB (Asia) from September 2007 to March 2011. Mr. Mao also served as non-executive director of CCB International (Holdings) Limited from March 2011 to January 2017.

Mr. Mao was the executive director and chief executive officer of Shanghai Ai Jian Corporation Limited from June 2006 to July 2007 (a company listed on the Shanghai Stock Exchange, stock code: 600643). He was the senior vice president and the executive director of Cathay International Holdings Limited from May 2003 to June 2006 (a company listed on the London Stock Exchange, stock code: CTI). From March 1997 to March 2003, Mr. Mao was the chief executive of China Construction Bank Hong Kong Branch, and was the general manager of International Business Department of China Construction Bank from May 1994 to December 1996.

Currently, Mr. Mao also holds directorships in various companies. He has served as non-executive director of Jiangsu Zeyun Pharmaceuticals Co., Ltd. since June 2016; independent non-executive director of China Life Insurance (Overseas) Company Limited and China Galaxy International Financial Holdings Limited since July 2016; non-executive director of HKBridge Financial Holdings Limited (a company listed on the Hong Kong Stock Exchange, stock code: 2323) since March 2017; and Vice Chairman and President of Macao Development Bank since February 4, 2019.

Mr. Mao received his Bachelor's Degree in Finance from Jiangxi University of Finance and Economics in 1983 and completed the Program for Management Development (the 70th Session) in Graduate School of Business Administration of Harvard University in 1995.

BOARD OF DIRECTORS AND EXECUTIVE MANAGEMENT

In 2018



XUE Shengli

Non-Executive Director

Mr. Xue, aged 52, has served as non-executive director of the Bank since June 19, 2015 and is a member of the Strategy and Corporate Governance Committee of the Board of Directors and the Nomination and Remuneration Committee of the Board of Directors of the Bank. He joined China Construction Bank Corporation ("CCB") in July 2014 as the general manager of the Human Resources Department. Prior to joining CCB, Mr. Xue had been working in the Organization Department of the CPC Central Committee since July 1996. From July 1987 to July 1996, Mr. Xue served in various positions in the People's Liberation Army. He has extensive experience in human resources management and has completed a large number of research studies in relation to CCB's human resources management after he joined CCB. Mr. Xue graduated from Jilin University in July 1987, receiving a Bachelor of Arts Degree in Chinese Language & Literature. Mr. Xue was awarded a Master of Laws Degree in Politics from Peking University in June 2005, and received a Doctoral Degree in Economics with specialization in Political Economics from Jilin University in June 2012.



Lord Peter LEVENE

Independent Non-Executive Director

Lord Levene, aged 77, has served as independent non-executive director of the Bank since September 23, 2013 and is the chairman of the Risk Committee of the Board of Directors and a member of the Audit Committee of the Board of Directors of the Bank. During the period from June 2006 to June 2012, he acted as independent non-executive director of China Construction Bank Corporation. Before that, he served as chairman of Lloyd's and held directorships in various other listed companies including director of J Sainsbury plc from 2001 to 2004, and director of Deutsche Boerse from 2004 to 2005. He is the chairman of Starr Underwriting Agents Limited and General Dynamics (UK) Limited and a board member of Haymarket Group Ltd and Eurotunnel SA. Lord Levene was awarded a Bachelor's Degree in Economics and Politics from the University of Manchester.

BOARD OF DIRECTORS AND EXECUTIVE MANAGEMENT

In 2018



WONG Kai Man BBS, JP

Independent Non-Executive Director

Mr. Wong, aged 68, has served as independent non-executive director of the Bank since July 4, 2016 and is the chairman of the Audit Committee of the Board of Directors, a member of the Nomination and Remuneration Committee of the Board of Directors and the Risk Committee of the Board of Directors, and the chairman of the Compliance Sub-Committee under the Risk Committee of the Board of Directors of the Bank.

He is an accountant with 32 years of experience in auditing, investigation, initial public offerings and computer auditing. He was an audit partner at PricewaterhouseCoopers ("PwC"), Hong Kong, founding head of its Capital Market Services Group and a member of PwC China/Hong Kong management board before retiring in June 2005.

Mr. Wong is currently a member of the Financial Reporting Council and an independent non-executive director of two listed companies in Hong Kong: SUNeVision Holdings Limited (stock code: 1686) and VTech Holdings Limited (stock code: 0303).

Mr. Wong was a member of the working group that set up the Growth Enterprise Market of the Stock Exchange of Hong Kong and its listing committee (1999–2003), and a non-executive director of the Securities and Futures Commission of Hong Kong (2009–2015). He was an independent non-executive director of China Construction Bank Corporation (2007–2013), Shangri-La Asia Limited (2006–2015) and Great Wall Pan Asia Holdings Limited (stock code: 583) (formerly known as Armada Holdings Limited and SCMP Group Limited) (2007–2016).

Mr. Wong was an Honorary Associate Professor of the School of Business, The University of Hong Kong (2005–2018), a Council Member of The University of Hong Kong (2011–2017), the City University of Hong Kong (2007–2012) and Lingnan University (1999–2006). He also serves on the boards of several charities and has served on government advisory committees and statutory bodies in the areas of land, immigration, energy, law-enforcement, education and technology.

Mr. Wong obtained his Bachelor of Science in Physics from The University of Hong Kong and Master of Business Administration from The Chinese University of Hong Kong. He is a fellow of the Association of Chartered Certified Accountants, United Kingdom and a fellow of the Hong Kong Institute of Certified Public Accountants.

Mr. Wong was appointed a Justice of the Peace in 2002, was awarded the Bronze Bauhinia Star in 2007 by the Government of the Special Administrative Region of Hong Kong. He was conferred an honorary fellow of Lingnan University, Hong Kong in 2007, City University of Hong Kong in 2013 and The University of Hong Kong in 2016.

BOARD OF DIRECTORS AND EXECUTIVE MANAGEMENT

In 2018



Rex AU YEUNG
Pak-kuen JP

Independent Non-Executive Director

Mr. Auyeung, aged 66, has been appointed as an independent non-executive director of the Bank with effect from September 8, 2018 and is the chairman of the Nomination and Remuneration Committee of the Board of Directors and a member of the Compliance Sub-Committee under the Risk Committee of the Board of Directors of the Bank.

Mr. Auyeung has recently been appointed as a non-executive director of MTR Corporation Limited (a company listed on the mainboard of The Stock Exchange of Hong Kong Limited, stock code: 66) with effect from March 7, 2019. He is also an independent non-executive director of Standard Life (Asia) Limited, Sampo Insurance China Co., Ltd. and the Senior Strategy and Business Advisor at Athenex Inc., a company listed on NASDAQ in the United States of America.

Mr. Auyeung has over 40 years of experience in the insurance industry in Canada and Hong Kong. Before his retirement in June 2017, Mr. Auyeung was Chairman — Asia of the Principal Financial Group Inc. (“PFG”), a Fortune 500 company, responsible for PFG’s overall businesses in Asia. During his time with PFG, Mr. Auyeung represented PFG and its member companies across Asia in building and expanding PFG’s relationship with clients, joint venture partners and strategic investors, and assisting in business development across all products lines of PFG.

Mr. Auyeung also actively serves the public sector and is currently the chairman of the Council of Lingnan University, an observer of the Independent Police Complaints Council Observers Scheme and a member of the Executive Committee of the Investor and Financial Education Council under the Securities and Futures Commission of Hong Kong (“SFC”). In addition, he is a member of the Investment Sub-committee of The Community Chest of Hong Kong, a board member of Bo Charity Foundation (Food Angel) and a convenor of the Jockey Club Community eHealth Care Project.

Mr. Auyeung was previously the chairman of Hong Kong Strategy for Financial Literacy Sub-committee on Stakeholder Coordination and Collaboration and a member of the Independent Review Committee on Hong Kong’s Franchised Bus Service. He was a full member of the Public Shareholders Group and a member of the Committee on Investment-Linked Assurance and Pooled Retirement Funds of SFC from 2000 to 2007 and from 1999 to 2006 respectively.

Mr. Auyeung holds a Bachelor of Environmental Studies (Urban and Regional Planning) Honours Degree from the University of Waterloo, Canada. He was awarded an Honorary Fellowship by the City University of Hong Kong in 2013 and was appointed a Justice of the Peace in 2018.

BOARD OF DIRECTORS AND EXECUTIVE MANAGEMENT

As of March 22, 2019

EXECUTIVE MANAGEMENT

JIANG Xianzhou	Chairman and Executive Director
ZHANG Jun	Vice Chairman, Executive Director and Chief Executive Officer
Miranda KWOK Pui Fong	President & Executive Director
GUO Zhipeng	Deputy Chief Executive
WU Jian	Deputy Chief Executive
LIN Ju	Deputy Chief Executive
MEI Ning	Deputy Chief Executive
Benny HA Yun Sang	General Manager, Head of Corporate Banking I Division
Kenneth WONG Kwok Leung	General Manager, Head of Corporate Banking II Division
Patrick LEE Yuk Wun	General Manager, Head of Commercial Banking Division
Mimi LEE Yim Mei	General Manager, Head of Institutional Banking Division
Ryan YING Jianjia	General Manager, Head of Products Division
Tiffany LIU Huifen	General Manager, Head of Private Banking Division
Sylvia NG Sau Wai	General Manager, Head of Consumer Banking Division
Jason SHEUNG Pui Tak	Deputy General Manager, Deputy Head of Cross-Border Financial Services Division
XIAO Jing	General Manager, Head of Credit Card & Consumer Finance Division
Simon LING Wai Chi	General Manager, Head of Marketing Division
DENG Huafeng	General Manager, Head of e-Banking Division
Ashley ZHANG Hong	General Manager, Head of Treasury Division
Justin WONG Hon Yu	Deputy General Manager, Deputy Head of Finance Division
Phoebe LEE Suet Ching	General Manager, Chief Risk Officer & Head of Risk Management Division
ZHOU Tianfeng	General Manager, Head of Credit Division
Johnny CHUNG Tin	General Manager, Head of Information Systems Division
Vincent LAM Chi Wai	General Manager, Head of Internal Audit Division
Jessie KWOK Yuen Wai	General Manager, Head of General Management Office
Grace LEE Shuk Ha	General Manager, Head of Human Resources Division
Victor PANG Yiu Hung	General Manager, Head of Operations Division
Christopher TSANG Hing Keung	Chief Compliance Officer
Helen YU Haibing	Deputy General Manager, Deputy Head of Strategic Planning & Corporate Development Division

SUBSIDIARY, JOINT VENTURE AND ASSOCIATED COMPANIES

As of March 22, 2019

SUBSIDIARY COMPANIES

CCB Nominees Limited

20/F, CCB Centre, 18 Wang Chiu Road, Kowloon Bay, Kowloon

Better Chief Limited

26/F, CCB Centre, 18 Wang Chiu Road, Kowloon Bay, Kowloon

Hong Kong (SAR) Hotel Limited

26/F, CCB Centre, 18 Wang Chiu Road, Kowloon Bay, Kowloon

CCB Securities Limited

18/F, CCB Centre, 18 Wang Chiu Road, Kowloon Bay, Kowloon

CCB Properties (Hong Kong) Holdings Limited

26/F, CCB Centre, 18 Wang Chiu Road, Kowloon Bay, Kowloon

CCB (Asia) Trustee Company Limited

G/F, 6 Des Voeux Road Central, Central, Hong Kong

CCB Hong Kong Property Management Company Limited

29/F, CCB Tower, 3 Connaught Road Central, Central, Hong Kong

CCB (Asia) Insurance Broker Limited

18/F, CCB Centre, 18 Wang Chiu Road, Kowloon Bay, Kowloon

JOINT VENTURE COMPANY

Diamond String Limited

11/F, Lai Sun Commercial Centre, 680 Cheung Sha Wan Road, Kowloon

ASSOCIATED COMPANY

QBE Hongkong & Shanghai Insurance Limited

33/F, Oxford House, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong

CORPORATE SOCIAL RESPONSIBILITY

As a corporation with deep roots in Hong Kong for over a century, China Construction Bank (Asia) [“CCB (Asia)”] continues to fulfil its social responsibility goals this year including making continuous contribution to Hong Kong, improving people’s livelihood and facilitating sustainable development in our community. In particular, we put strong focus on areas such as financial inclusion, youth development and social philanthropy. All of these community outreach activities echo the key mission of CCB (Asia) — “to assume full responsibilities as a corporate citizen”.

CONTINUOUS PROMOTION OF INCLUSIVE FINANCE



Over 40 children experiencing banking services in the simulated bank of CCB Centre to learn more about wealth management.

To embody CCB (Asia)’s principles of delivering customer-oriented services and facilitating financial inclusion, the Bank has opened a retail branch in the public housing area of Tin Shui Wai in a bid to meet financial needs of local residents residing in remote areas.

Furthermore, the bank has co-organized “Walking with Youth — a new milestone of wealth management” with The Boys’ & Girls’ Clubs Association of Hong Kong in 2018, a program in which children from low income families are invited to learn more about wealth management through interactive games and experience sharing in our simulated bank located in CCB Centre in Kowloon Bay.

NURTURING NEW GENERATION THROUGH EDUCATION

CCB (Asia) believes education is the key to community development and as such put strong focus on supporting adolescent growth, including donating teaching equipment and arranging teaching classes for students in remote villages. For two years in a row, CCB (Asia) gives out donations to CCB Hope Primary School in Guizhou Province to support its operation. In particular on October 15, 2018, CCB (Asia) donated HKD260,000 worth of teaching equipment. Our volunteers also travelled to the school to bring warm clothes to students to get them prepared for the harsh weather in winter.



CCB (Asia) donated HK\$260,000 worth of teaching supplies to CCB Hope Primary School.



CORPORATE SOCIAL RESPONSIBILITY

In order to educate our next generation the importance of environmental protection and better utilization of resources, CCB (Asia)'s Volunteer team took part in various activities in 2018, including organising the opening ceremony of an environmental protection program —“Children Love the Earth” as well as arranging tours to visit animals in farms. Moreover, CCB (Asia) organized field trips to Luk Keng of Fanling and Maipo which strengthened children's knowledge on ecosystem, migratory birds and wetlands.



For seven consecutive years, CCB (Asia) has partnered with The Boys' & Girls' Clubs Association of Hong Kong to organize the "Bringing Our Children a Brighter Future — Affiliated Youth Development Program". In 2018, the program, under the theme — "Children Love the Earth", focused on raising children's awareness on environmental protection.

STAFF ENGAGEMENT IN COMMUNITY SERVICES

CCB (Asia) encourages staff to give back to the society, spreading love and care to those in need and transmitting positive energy to the community.

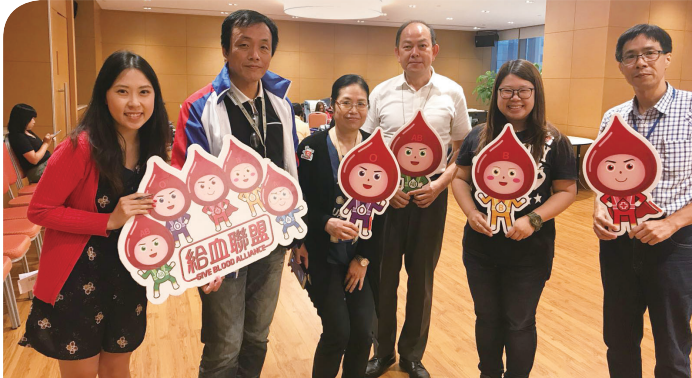


CCB (Asia) Volunteer team paid weekly visits to Choi Wan Estate to provide health checks for elderly residents, including blood pressure test, blood glucose test and body weight check. Around 110 residents benefited from the service each week.



CCB (Asia) Volunteer team provides monthly hairdressing services to elderly and children residing in Choi Wan Estate.

CORPORATE SOCIAL RESPONSIBILITY



CCB (Asia) Volunteer team collaborates with the Hong Kong Red Cross to organize blood donation sessions at the Bank's office premises, as part of a wider effort to encourage staff to participate in community programs.



SHAPING HONG KONG TO BECOME THE EVENT CAPITAL OF ASIA

In recent years, CCB (Asia) has been sponsoring major international mega events; these include becoming the title sponsor of Hong Kong International Dragon Boat Races and Hong Kong Wine & Dine Festival and also the parade route sponsor of the International Chinese New Year Night Parade. These events will not only bring unparalleled life experience to tourists and local residents but also help to shape Hong Kong's image as the event capital of Asia, strengthening social cohesion of the city.



CCB (Asia)'s Chinese New Year parade float — the "Cruise of New Year Fortune".



The Chief Executive of Hong Kong SAR Mrs Carrie Lam (center), Chairman of CCB (Asia) Mr Jiang Xianzhou (fourth left) and senior management of the Bank attended the Wine & Dine Festival.

CORPORATE SOCIAL RESPONSIBILITY



Athletes participating in the “Row for Charity” fundraising campaign, in which CCB (Asia) will make donations based on the total miles rowed to support Arts with the Disabled Association Hong Kong (“ADAHK”).



CCB (Asia) for the first time organized the “CCB (Asia) HKCEA Dragon Boat Invitational Race” targeting Chinese corporations, with the hope of providing an opportunity for Chinese enterprises to expand their network and participate in mega events in Hong Kong.

PROMOTING DISABILITY INCLUSION IN THE SOCIETY

CCB (Asia), for three years in a row, has become the title sponsor of events organized by the Arts with the Disabled Association Hong Kong (“ADAHK”) to promote disability inclusion. These events served as a platform to identify and nurture potential art talents, enabling disabled artists in Hong Kong to pursue their dreams. Furthermore, CCB (Asia) has also sponsored the ADAHK development fund, supporting potential artists to further brush up their skills by taking art related continuing education and training.

CCB (Asia) adopts ADAHK artists’ designs in its Dragon boat decorations, Chinese New Year red packet as well as monthly calendar, allowing the public to get a glimpse of the designs by these talented artists. ADAHK artists also perform at the bank’s corporate dinner event in the Wine & Dine Festival.



Opening ceremony of “Cross All Borders 2018” Exhibition.



CCB (Asia) exhibited designs of ADAHK artists in its Dragon Boat event.

CORPORATE SOCIAL RESPONSIBILITY



To further promote inclusive art, CCB (Asia) has set up an art gallery on the ground floor of CCB Tower in Central. Three exhibitions were held in 2018, including two exhibiting original artworks by ADAHK resident artists Liu Tungmui and Ko Nam, as well as one celebrating the 10th anniversary of “Cross All Borders”.

CHARITY RUN TO SHED LIGHT ON THE VISUALLY IMPAIRED



CCB (Asia) is the title sponsor of “Lifeline Express CCB (Asia) Charity Run/Walk”.

CCB (Asia) has become the title sponsor of “Lifeline Express CCB (Asia) Charity Run/Walk” for eight consecutive years. Over the years, the Bank has raised over HKD 22 million for Lifeline Express Hospital Eye-train and performed free surgeries on more than 11,000 underprivileged cataract patients in Mainland China, helping them to regain eyesight.

CORPORATE SOCIAL RESPONSIBILITY

CARING FOR OUR ASSOCIATES AND ADVOCATING THE CULTURE OF HAPPINESS

A Happiness Charter signing ceremony was hosted in March 2018 to advocate happiness culture among associates, followed by a series of “positive leadership” training program which aimed to promote good management behaviors. Apart from these initiatives, the Bank has also implemented a “mentorship program”; set up a column on the intranet and encouraged associates to contribute ideas on creating a happy working environment in the form of short videos. The Bank also continued to organize “Caring Week” this year in which healthy snacks were distributed to associates during that week.



CCB (Asia) Happiness Charter



CCB (Asia) fully supports Earth Hour.

CONTRIBUTING TO ENVIRONMENTAL PROTECTION

For seven consecutive years, CCB (Asia) has supported the Earth Hour organized by the World Wildlife Fund. Apart from switching off unnecessary lights at the time of the event, CCB (Asia) also encouraged staff participation with the hope of reducing energy consumption. Moreover, the Bank continues to sign up for the Charter on External Lighting launched by The Environment Bureau in the hope of mitigating problems of light nuisance and energy wastage caused by external lighting. Meanwhile, CCB (Asia) actively promotes its e-banking services, such as electronic cheques and electronic bills/statements in a bid to reduce paper consumption and make contribution to a greener earth.

AWARDS AND HONORS

2018 January

Quamnet Outstanding Enterprise Awards 2017
— Outstanding Cross-Border Financial Services
Quamnet



2018 January

IFPHK Accredited Professional Planning Firm 2018
Institute of Financial Planners of Hong Kong



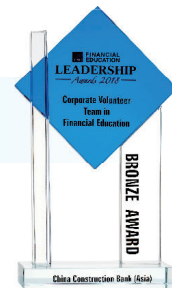
2018 January

IFPHK Financial Education Leadership Awards 2018
— Corporate Financial Education Leadership (Gold Award)
Institute of Financial Planners of Hong Kong



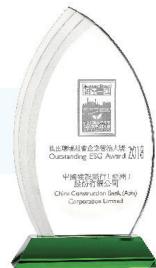
2018 January

IFPHK Financial Education Leadership Awards 2018
— Corporate Volunteer Team in Financial Education (Bronze Award)
Institute of Financial Planners of Hong Kong



2018 February

Outstanding ESG Award 2018
Economic Digest



2018 March

Caring Company 2018/19
The Hong Kong Council of Social Services



2018 March

GlobalCapital Asia Regional Capital Markets Awards 2017
— BEST SSA BOND
GlobalCapital



2018 May

Hong Kong Arts Development Award 2017
— Award for Arts Sponsorship
Hong Kong Arts Development Council



AWARDS AND HONORS

2018 May

Financial Institution Awards 2018
— Bank of the Year
Outstanding Performance
Bloomberg Businessweek
(Chinese edition)



2018 June

2018 Best SME's Partner Award
The Hong Kong General Chamber of Small and Medium Business



2018 June

2017 Best Social Responsibility Manager of China's Banking Industry
China Banking Association



2018 July

The 7th Outstanding Corporate Social Responsibility Award
The Mirror



2018 November

Merits of Achievement in Banking and Finance 2018
— RMB Service
CAPITAL



2018 December

PROchoice Award 2018
— Corporate Social Responsibility
Capital Weekly



2018 December

Social Capital Builder Logo Awards 2018
HKSAR Labour and Welfare Bureau



REPORT OF THE BOARD OF DIRECTORS

The directors have pleasure in submitting their annual report together with the audited consolidated financial statements for the year ended December 31, 2018.

PRINCIPAL PLACE OF BUSINESS

China Construction Bank (Asia) Corporation Limited ("the Bank") is a licensed bank incorporated and domiciled in Hong Kong and has its registered office and principal place of business at 28/F, CCB Tower, 3 Connaught Road Central, Central, Hong Kong.

PRINCIPAL ACTIVITIES

The principal activities of the Bank and its subsidiaries (collectively referred to as "the Group") are the provision of a range of banking and related financial services through the Bank's branches and subsidiaries. Other particulars of the Bank's subsidiaries are set out in Note 29 to the consolidated financial statements.

An analysis of the Group's performance for the year by operating segments is set out in Note 18 to the financial statements.

CONSOLIDATED FINANCIAL STATEMENTS

The profit of the Group for the financial year ended December 31, 2018 and the state of the Bank's and the Group's affairs as at that date are set out in the consolidated financial statements on pages 34 to 175.

DIVIDENDS

The directors do not recommend the payment of a final dividend for the year ended December 31, 2018 (2017: HKD Nil).

CHARITABLE DONATIONS

During the year, charitable donations made by the Group amounted to HKD1,336,000 (2017: HKD2,080,000).

CERTIFICATES OF DEPOSIT AND MEDIUM TERM NOTE ISSUED

During the year, the following notes were issued by the Bank under its Certificate of Deposit ("CD") Programme to raise funds for general corporate purposes:

Class	Issued under	Amount Issued HKD'000	Consideration received HKD'000
CDs	CD Programme	1,167,775	1,167,705

EQUITY LINKED AGREEMENTS

During the year, the Bank has not entered into any equity-linked agreement under Companies (Directors' Report) Regulation (Cap. 622D).

REPORT OF THE BOARD OF DIRECTORS

DIRECTORS

(a) Directors of the Bank

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

WANG Hongzhang (<i>Chairman</i>)	(resigned on March 22, 2018)
JIANG Xianzhou (<i>Chairman</i>)	(appointed Chairman on March 22, 2018)
ZHANG Jun (<i>Vice Chairman</i>)	(appointed Director and Vice Chairman on March 26, 2018)
CHAN Wing Kee GBM, GBS, OBE, JP	(resigned on September 8, 2018)
LORD LEVENE OF PORTSOKEN Peter Keith	
WONG Kai Man BBS, JP	
MAO Yumin	
XUE Shengli	
HU Zhanghong	(resigned on December 6, 2018)
Miranda KWOK Pui Fong	
AUYEUNG Rex Pak-kuen	(appointed on September 8, 2018)

Pursuant to Clause 111 of the Bank's Articles of Association, Mr. ZHANG Jun and Mr. AUYEUNG Rex Pak-kuen shall remain in office for the ensuing year, while the other remaining Directors of the Bank shall retire from office and being eligible offer themselves for re-election at the forthcoming annual general meeting of the Bank for three years up to the date of the annual general meeting of year 2022.

Mr. WANG Hongzhang resigned as Chairman of the Bank on March 22, 2018. Mr. CHAN Wing Kee resigned as Independent Non-Executive Director of the Bank on September 8, 2018. Mr. HU Zhanghong resigned as Non-Executive Director of the Bank on December 6, 2018. Mr. WANG Hongzhang, Mr. CHAN Wing Kee and Mr. HU Zhanghong have respectively confirmed that they have no disagreement with the Board and nothing relating to the affairs of the Bank needed to be brought to the attention of the shareholder of the Bank.

(b) Directors of the Bank's subsidiaries

During the year and up to the date of this report, Mr. JIANG Xianzhou and Ms. Miranda KWOK Pui Fong are also directors in certain subsidiaries of the Bank. Other directors of the Bank's subsidiaries during the year and up to the date of this report include:

CHOW Sai Keung	
CHENG Tat Kin	
LI Sai Cheong	
YUEN Yiu Leung	(resigned on December 12, 2018)
LIN Ju	
YAN Ka Lok	
YING Jian Jia	
GUO Zhipeng	(resigned on February 14, 2018)
KWOK Yuen Wai	
Sylvia NG Sau Wai	
LIU Lei	(appointed on April 12, 2018)
PANG Yiu Hung	(appointed on December 12, 2018)
WU Jian	(appointed on May 15, 2018)
LEE Yim Mei	(appointed on May 15, 2018)
MEI Ning	(appointed on February 14, 2018)

REPORT OF THE BOARD OF DIRECTORS

DIRECTORS' MATERIAL INTERESTS IN TRANSACTIONS, ARRANGEMENTS AND CONTRACTS

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

DIRECTORS' INTERESTS IN SHARES AND DEBENTURES

At no time during the year was the Bank, or any of its holding companies, subsidiaries, fellow subsidiaries, joint venture company or associated company a party to any arrangement to enable the directors of the Bank to hold any interests in the shares or debentures of, the Bank or its specified undertakings or any other body corporate.

MANAGEMENT CONTRACTS

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

PERMITTED INDEMNITY PROVISIONS

The Articles of Association provides that every director, secretary or other officer of the Bank shall be entitled to be indemnified by the Bank against all costs, charges, losses, expenses and liabilities incurred by him in the execution and/or discharge of his duties and/or the exercise of his powers and/or otherwise in relation to or in connection with his duties, powers or office. The Bank has maintained appropriate directors and officers liability insurance which provides personal protection for the directors and management against any financial loss arising from the potential exposures associated with supervising or managing the Bank.

COMPLIANCE WITH HONG KONG BANKING (DISCLOSURE) RULES

The consolidated financial statements for the year ended December 31, 2018 comply with the applicable disclosure provisions of the Banking (Disclosure) Rules.

AUDITOR

The Group's auditor was PricewaterhouseCoopers for the year of 2018. PricewaterhouseCoopers will retire and Ernst & Young will be appointed as the auditor of the Group for the financial year ending December 31, 2019 at the forthcoming Annual General Meeting.

By order of the board of directors



JIANG Xianzhou
Chairman and Executive Director

Hong Kong, March 22, 2019

INDEPENDENT AUDITOR'S REPORT

To the Members of China Construction Bank (Asia) Corporation Limited

(incorporated in Hong Kong with limited liability)

OPINION

What we have audited

The consolidated financial statements of China Construction Bank (Asia) Corporation Limited (the "Bank") and its subsidiaries (the "Group") set out on pages 34 to 175, which comprise:

- the consolidated statement of financial position as at December 31, 2018;
- 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 flow 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 December 31, 2018, 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 ("HKSA") 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.

INDEPENDENT AUDITOR'S REPORT

To the Members of China Construction Bank (Asia) Corporation Limited

(incorporated in Hong Kong with limited liability)

KEY AUDIT MATTERS (continued)

Key audit matters identified in our audit are summarised as follows:

- Credit Risk — Allowances for expected credit losses ("ECL allowances") on advances to customers
- Information Technology — IT systems and controls over financial reporting

Key Audit Matter

How our audit addressed the Key Audit Matter

#1 Credit Risk – Allowances for Expected Credit Losses ("ECL allowances") on advances to customers

As at December 31, 2018, the Group's gross advances to customers was HK\$256 billion against which ECL allowances of HK\$2.1 billion were set aside in accordance with HKFRS 9, which was effective from January 1, 2018.

Stages 1 and 2 ECL allowances were calculated using a number of models for different portfolios of advances to customers grouped by similar credit characteristics. The models required a number of data inputs which included, the historical loss experience in portfolios of similar risk characteristics, current loan data and forward-looking and macro-economic indicators. These data inputs required significant management judgement and assumptions.

The majority of stage 3 ECL allowances were based on the present value of the future cash flows, which were expected to be received over the lifetime of the advance from each individually significant credit impaired advance. Management's judgement about the borrower's financial situation had been applied in estimating the future cash flows.

We focused on this area because of the significance of the advances to customers and their ECL allowance, the judgement applied by management, and the limited experience available to back-test ECL measurement with actual results in this first year adoption of HKFRS 9. The ECL measurement involved applying new and complex models, processing numerous data inputs and relying on technical assumptions which may increase the risk of misstatement.

We tested the controls over the assessment of the credit quality, assignment of internal credit risk ratings, and timely identification, escalation, measurement of ECL allowances and reporting of credit-impaired advances to customers to management.

As part of these controls testing, we reviewed the minutes of the Group's Risk Management Committee, Credit Committee, Special Attention Credit Meeting and Special Assets Management Committee meetings, for the approval of the internal credit risk ratings and the ECL allowances made on advances to customers.

We critically assessed key assumptions and inputs in management's credit reviews on selected advances to customers and evaluated the reasonableness of the assigned credit risk ratings. We also validated, on a sample basis, whether the advances to customers with indication of significant increase in credit risk and credit impairment were appropriately and timely included in the lifetime ECL measurement for stages 2 and 3 advances to customers.

For stages 1 and 2 ECL allowances, we:

- assessed the design, the appropriateness of key assumptions used for material portfolios and the calculation methodologies of the ECL models. This included assessing the selection of economic indicators as forward-looking information. We also challenged management's assumptions used in the ECL models;

INDEPENDENT AUDITOR'S REPORT

To the Members of China Construction Bank (Asia) Corporation Limited

(incorporated in Hong Kong with limited liability)

KEY AUDIT MATTERS (continued)

Key Audit Matter

How our audit addressed the Key Audit Matter

#1 Credit Risk — Allowances for Expected Credit Losses ("ECL allowances") on advances to customers (continued)

As part of our audit we focused on (1) whether the identification of advances with significant increase in credit risk and credit-impaired advances was appropriate; (2) whether the models and key assumptions used in measuring the ECL allowances were considered acceptable; and (3) whether the critical data inputs used in the ECL models were supported by available evidence.

Please refer to Note 4(c)(ix), Note 6, Note 8(a) and Note 23 to the consolidated financial statements.

- tested the internal controls over the accuracy and completeness of critical data inputs used by the ECL models;
- examined and assessed critical data inputs to the ECL models on a sample basis; and
- tested ECL models' calculations for the significant portfolios of advances to customers.

For the majority of stage 3 ECL allowances, we assessed on a sample basis the appropriateness of the estimated future cash flows over the lifetime of the advances, taking into account the financial health of the borrowers, the recoverability of, and the underlying collateral for, the advances to customers. We recalculated a sample of calculations of the present value of estimated future cash flows.

Based on our procedures performed, we found (1) management's identification of advances with significant increase in credit risk and credit-impaired advances was appropriate; (2) management's judgement applied on the models and key assumptions used in measuring the ECL allowances were considered acceptable; and (3) the critical data inputs used in the ECL models were supported by available evidence.

INDEPENDENT AUDITOR'S REPORT

To the Members of China Construction Bank (Asia) Corporation Limited

(incorporated in Hong Kong with limited liability)

KEY AUDIT MATTERS (continued)

Key Audit Matter

How our audit addressed the Key Audit Matter

#2 Information Technology — IT systems and controls over financial reporting

The Group is highly dependent on IT systems to process and record transactions on a daily basis. Our audit approach relies extensively on IT application controls (e.g. automated system calculations and system interface controls) and manual controls which are dependent on outputs (e.g. system generated reports) of key IT systems ("IT dependent controls"). We have therefore focused our audit procedures around IT, including the following:

- IT general controls including those controls over logical access to key IT systems and data, programme changes, IT operations and program development; and
- IT application controls and IT dependent controls which we consider to be key for financial reporting purposes.

We consider key IT systems to include (1) key core banking, trading and settlement systems, and (2) financial accounting and reporting systems that generate financial information utilised in the preparation of the Group's consolidated financial statements.

As part of the audit of the consolidated financial statements of the Group, we performed risk assessment over the maintenance of daily transactions and the keeping of accounting records on key IT systems. IT application controls and IT dependent controls which are determined to have a material impact on the preparation of the consolidated financial statements were selected for testing. Entity level IT related controls, including the allocation of roles and responsibilities by management and the existence of policies and procedures were also considered during our risk assessment process.

We have tested, on a sample basis, the relevant IT related controls using a combination of different testing approaches based on the risk and nature of the corresponding controls. The relevant IT related controls being tested included:

(1) IT general controls

- user access maintenance at application, operation system and database levels;
- approval, testing and implementation of the change cycle, including both normal and emergency system changes to existing systems, and implementation of new systems; and
- IT operational controls over batch processing, backup and recovery, and incident management.

(2) IT application controls and IT dependent controls

- key automated system calculations;
- key automated system processing (e.g. system enforced segregation of duties);
- interfaces between key systems; and
- key system generated reports.

Based on the above audit procedures, we were able to place reliance on the IT systems and controls that were identified as key to the financial accounting and reporting processes.

INDEPENDENT AUDITOR'S REPORT

To the Members of China Construction Bank (Asia) Corporation Limited

(incorporated in Hong Kong with limited liability)

OTHER INFORMATION

The directors of the Company are responsible for the other information. The other information comprises the information included in Report of the directors, Unaudited supplementary financial information, About us, About CCB, Our history, To customers and shareholders, Board of directors and executive management, Subsidiary, joint venture and associated companies, Corporate social responsibility, Awards and honors and Service network, but does not include 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 and will 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.

INDEPENDENT AUDITOR'S REPORT

To the Members of China Construction Bank (Asia) Corporation Limited

(incorporated in Hong Kong with limited liability)

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 HKSA's 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 HKSA's, 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.

INDEPENDENT AUDITOR'S REPORT

To the Members of China Construction Bank (Asia) Corporation Limited

(incorporated in Hong Kong with limited liability)

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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.

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 Antoinette Hoon.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, March 22, 2019

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

	Note	2018	2017
Interest income		13,200,735	10,926,271
Interest expense		(7,080,767)	(5,981,104)
Net interest income	9	6,119,968	4,945,167
Fees and commission income		1,734,973	1,623,198
Fees and commission expense		(147,506)	(178,582)
Net fees and commission income	10	1,587,467	1,444,616
Net trading income	11	416,524	853,510
Net gains from financial instruments designated at fair value through profit or loss	12	33,828	17,672
Net gains from disposal of financial assets measured at fair value through other comprehensive income		41	–
Net gains from disposal of available-for-sale financial assets		–	76,646
Other operating income	13	64,409	70,620
Total operating income		8,222,237	7,408,231
Operating expenses	14	(3,206,427)	(3,075,969)
Operating profit before impairment losses		5,015,810	4,332,262
Charges on expected credit losses	15	(587,980)	–
Charges on impairment allowances	15	–	(366,999)
Operating profit		4,427,830	3,965,263
(Losses)/gains on disposal of fixed assets		(1,605)	42
Share of profit/(losses) of joint venture/associate	30, 31	(22,972)	(28,162)
Impairment charges on joint venture/associate	30, 31	(47,000)	–
Profit before taxation		4,356,253	3,937,143
Taxation	17	(781,701)	(668,993)
Profit for the year		3,574,552	3,268,150

The accompanying notes are the integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

	2018	2017
Profit for the year	3,574,552	3,268,150
Other comprehensive income/(losses)		
Items that may be reclassified subsequently to profit or loss:		
Available-for-sale investment revaluation reserve:		
Changes in fair value recognised during the year	–	(266,550)
Reclassification adjustments for amounts transferred to profit or loss	–	(49,383)
Tax effect	–	54,256
Debt instruments measured at fair value through other comprehensive income:		
Changes in fair value recognised during the year	288,725	–
Reclassification adjustments for amounts transferred to profit or loss	42,194	–
Expected credit losses recognised in profit or loss	(15,511)	–
Tax effect	(51,864)	–
Item that may not be reclassified subsequently to profit or loss:		
Equity instruments designated at fair value through other comprehensive income	5,931	–
Other comprehensive income/(losses) for the year, net of tax	269,475	(261,677)
Total comprehensive income for the year	3,844,027	3,006,473

The accompanying notes are the integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

	Note	2018	2017
ASSETS			
Cash and balances with banks and central banks	19	78,238,697	81,673,241
Placements with banks	20	31,753,841	17,997,303
Advances to banks		–	262,498
Advances to customers and trade bills	23	254,471,410	288,009,874
Financial assets held under resale agreements	21	1,514,983	–
Financial assets measured at fair value through profit or loss	22	3,816,227	–
Financial assets measured at fair value through other comprehensive income	24	86,744,559	–
Financial assets measured at amortised cost	26	12,065,832	–
Available-for-sale financial assets	25	–	98,956,057
Held-to-maturity investments	27	–	17,458,857
Derivative financial instruments	28	2,756,470	6,788,337
Interest in a joint venture	30	1,955,713	2,044,996
Interest in an associate	31	69,223	199,912
Deferred tax assets	32	396,042	234,912
Fixed assets	33	3,200,961	3,325,095
Other assets	34	3,985,945	4,073,631
Total assets		480,969,903	521,024,713

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

	Note	2018	2017
LIABILITIES			
Deposits and balances of banks	35	32,167,403	73,223,622
Deposits from customers	37	354,129,879	353,269,333
Financial assets sold under repurchase agreements	36	2,420,859	–
Other debt securities issued	38	14,515,909	14,917,044
Derivative financial instruments	28	2,142,242	6,563,076
Current tax payable	32	252,269	167,208
Deferred tax liabilities	32	21,508	20,902
Other liabilities	39	7,008,032	7,733,982
Subordinated debt	40	5,833,798	5,812,111
Total liabilities		418,491,899	461,707,278
EQUITY			
Share capital	41	28,827,843	28,827,843
Other equity instruments	42	7,811,732	7,812,200
Reserves	43	25,838,429	22,677,392
Total equity		62,478,004	59,317,435
Total equity and liabilities		480,969,903	521,024,713

Approved and authorised for issue by the Board of Directors on March 22, 2019.

JIANG Xianzhou

Chairman and Executive Director

ZHANG Jun

*Vice Chairman, Executive Director and
Chief Executive Officer*

The accompanying notes are the integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

	Note	Share capital	Other equity instruments	General reserve	Investment revaluation reserve	Regulatory reserve	Other reserve	Merger reserve	Retained earnings	Total
Balance as at December 31, 2017		28,827,843	7,812,200	750,956	(562,295)	2,307,924	15,913	62,262	20,102,632	59,317,435
Impact on transition to HKFRS 9	5(a)	-	-	-	118,890	-	-	-	(433,450)	(314,560)
Restated balance as at January 1, 2018		28,827,843	7,812,200	750,956	(443,405)	2,307,924	15,913	62,262	19,669,182	59,002,875
Changes in equity for 2018:										
Profit for the year		-	-	-	-	-	-	-	3,574,552	3,574,552
Other comprehensive income, net of tax		-	-	-	269,475	-	-	-	-	269,475
Total comprehensive income for the year		-	-	-	269,475	-	-	-	3,574,552	3,844,027
Cost for issuance for other equity instruments	42	-	(468)	-	-	-	-	-	-	(468)
Coupon paid for other equity instruments		-	-	-	-	-	-	-	(368,430)	(368,430)
Regulatory reserve		-	-	-	-	(1,730,958)	-	-	1,730,958	-
Balance as at December 31, 2018		28,827,843	7,811,732	750,956	(173,930)	576,966	15,913	62,262	24,606,262	62,478,004

The accompanying notes are the integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

	Note	Share capital	Other equity instruments	General reserve	Investment revaluation reserve	Regulatory reserve	Other reserve	Merger reserve	Retained earnings	Total
Balance as at January 1, 2017		28,827,843	–	750,956	(300,618)	2,307,924	15,913	62,262	16,834,482	48,498,762
Changes in equity for 2017:										
Profit for the year		–	–	–	–	–	–	–	3,268,150	3,268,150
Other comprehensive losses, net of tax		–	–	–	(261,677)	–	–	–	–	(261,677)
Total comprehensive income for the year		–	–	–	(261,677)	–	–	–	3,268,150	3,006,473
Issues of other equity instruments	42	–	7,812,200	–	–	–	–	–	–	7,812,200
Balance as at December 31, 2017		28,827,843	7,812,200	750,956	(562,295)	2,307,924	15,913	62,262	20,102,632	59,317,435

The accompanying notes are the integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

	Note	2018	2017
Net cash outflow from operations	49(a)	(6,102,124)	(40,727,606)
Hong Kong Profits Tax paid		(766,131)	(588,543)
Mainland tax paid		(55,128)	(19,459)
Net cash outflow from operating activities		(6,923,383)	(41,335,608)
Investing activities			
Purchase of financial assets measured at fair value through other comprehensive income (2017: available-for-sale financial assets)		(12,884,587)	(39,285,389)
Purchase of financial assets measured at amortised cost (2017: held-to-maturity investments)		(2,837,820)	(550,567)
Proceeds received from redemption and disposal of financial assets measured at fair value through other comprehensive income (2017: available-for-sale financial assets)		26,263,611	29,315,860
Proceeds received from redemption of financial assets measured at amortised cost (2017: held-to-maturity investments)		6,077,001	10,378,450
Purchase of property and equipment		(191,635)	(155,370)
Dividends received from a joint venture		150,000	–
Dividends received from listed and unlisted investments		5,903	3,782
Net cash inflow/(outflow) from investing activities		16,582,473	(293,234)
Financing activities			
Proceeds from other equity instruments issued	42	–	7,812,200
Cost paid for issuance for other equity instruments		(468)	–
Interest paid on subordinated debt		(249,788)	(248,400)
Coupon paid for other equity instruments		(368,430)	–
Net cash (outflow)/inflow from financing activities		(618,686)	7,563,800
Increase/(decrease) in cash and cash equivalents		9,040,404	(34,065,042)
Cash and cash equivalents as at January 1		90,139,671	121,855,435
Effect of foreign exchange rate changes		(943,112)	2,349,278
Cash and cash equivalents as at December 31	49(b)	98,236,963	90,139,671
Cash flows from operating activities include:			
Interest received		13,168,428	10,768,929
Interest paid		(6,753,675)	(5,528,878)

The accompanying notes are the integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

1 GENERAL INFORMATION

The consolidated financial statements for the year ended December 31, 2018 comprise China Construction Bank (Asia) Corporation Limited ("the Bank") and its subsidiaries (together referred to as "the Group") and the Group's interest in an associate and a joint venture. The consolidated financial statements have been approved by the Board of Directors on March 22, 2019.

2 STATEMENT OF COMPLIANCE

These consolidated financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collectively include all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and accounting principles generally accepted in Hong Kong. These financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance (Cap. 622).

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Bank. Note 5 provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group and the Bank for the current and prior accounting periods reflected in these consolidated financial statements.

3 BASIS OF PREPARATION

The Group uses the calendar year as the accounting year, which is from January 1 to December 31.

(a) Going concern

These financial statements are prepared on a going concern basis, as the Directors are satisfied that the Group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

(b) Basis of measurement

These financial statements have been prepared on the historical cost basis except that: (i) financial instruments at fair value through profit or loss ("FVPL") are measured at fair value; (ii) financial instruments at fair value through other comprehensive income ("FVOCI") are measured at fair value; (iii) derivative financial instruments are measured at fair value; (iv) financial instruments designated under fair value hedge; (v) certain non-financial assets are measured at designated cost. The measurement basis of major assets and liabilities are further explained in Note 4.

(c) Functional and presentation currency

These financial statements are presented in Hong Kong Dollars, unless otherwise stated, rounded to the nearest thousand, which is the functional currency of the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

3 BASIS OF PREPARATION (continued)

(d) Use of estimates and judgments

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

The estimates and associated assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Judgments that have a significant effect on the financial statements and estimates with a significant risk of material adjustments in the subsequent period are discussed in Note 6.

(e) Local regulatory reporting

In preparing the capital adequacy ratios of the Group, they are prepared according to the basis of consolidation for regulatory purposes. The main difference between the consolidation basis for accounting and regulatory purposes is that the former includes the Bank and all its subsidiaries, an associate and a joint venture whereas the latter excludes CCB Securities Limited ("CCBS"), CCB Nominees Limited ("CCBN") and CCB (Asia) Trustee Company Limited ("CCBT") which conduct non-banking related business. Details of the subsidiaries which are not included in consolidation for regulatory purposes are as follows:

Name of Company	Principal activities	Total assets		Total equity	
		December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017
CCBS	Securities brokerage business	897,628	898,539	605,904	602,879
CCBN	Custodian and nominee services	39,588	39,029	38,947	38,972
CCBT	Trustee and custodian business	73,962	66,489	39,776	21,313

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Consolidated financial statements

(i) Subsidiaries

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group has the power over the activities of the entity, and is exposed to, or has the rights to the variable returns from its involvement with the entity, and has the ability to affect those returns through its power over the activities of 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.

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. The Group is considered to consolidate another entity if, in addition to ongoing involvement with the entity, it had a key role in establishing the entity or in bringing together relevant counterparties so the transaction that is the purpose of the entity could occur. The Group is generally not considered to consolidate another entity if the only involvement with the entity is merely administrative.

The financial results and performance of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. When preparing the consolidated financial statements, the Group makes necessary adjustments on the accounting period and accounting policies of subsidiaries to comply with those of the Group.

Intragroup balances and transactions, and any profits or losses arising from intragroup transactions are eliminated in full in preparing the consolidated financial statements.

When the Group ceases to have control, retained interest in the entity is remeasured to its fair value at the date when control is lost, 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.

In the Bank's statement of financial position, its investments in subsidiaries are stated at cost less impairment losses, if any (Note 4(h)).

(ii) Associates and joint arrangements

An associate is an enterprise in which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policy decisions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(a) Consolidated financial statements (continued)

(ii) Associates and joint arrangements (continued)

Joint arrangement is an arrangement of which two or more parties have joint control. The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement. Joint control is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing the control. The Group has assessed the nature of its joint arrangements and determined them to be joint ventures.

Investments in associates or joint ventures are accounted for using the equity method in the consolidated financial statements and are initially recorded at acquisition cost, and adjusted thereafter for the post acquisition change in the Group's share of net assets of the associates or joint ventures. The Group's share of the post-acquisition, post-tax results of the associates or joint ventures for the year is recognised in the consolidated statement of comprehensive income. The Group's interest in associates or joint ventures is included from the date that significant influence or joint control commences until the date that significant influence or joint control ceases.

Profits and losses resulting from transactions between the Group and its associates or joint ventures are eliminated to the extent of the Group's interest in the associates or joint ventures.

The Group discontinues recognising its share of net losses of the associates or joint ventures after the carrying amount of investments in associates and joint ventures together with any long-term interests that in substance form part of the Group's net investment in the associates or joint ventures are reduced to zero, except to the extent that the Group has incurred legal or constructive obligations to assume additional losses. Where the associates or joint ventures make net profits subsequently, the Group resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

The carrying amount of equity-accounted investments is tested for impairment in accordance with the policy described in Note 4(h), and netted by impairment losses, if any.

(b) Translation of foreign currency transactions

Foreign currency transactions are, on initial recognition, translated into the functional currency at the spot exchange rates at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are translated into the functional currency at the spot exchange rates at that date. The resulting exchange differences are recognised in net trading income/(losses). Non-monetary items denominated in foreign currencies that are measured at historical cost are translated into functional currency using the spot exchange rates at the transaction dates. Non-monetary items denominated in foreign currencies that are measured at fair value are translated using the spot exchange rates at the dates the fair values are determined; exchange differences are recognised in profit or loss as trading income, except for the differences arising from the translation of financial instruments measured at fair value through other comprehensive income, which are recognised in other comprehensive income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments

(i) Financial instruments measured at amortised cost

Financial assets that are held to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest, such as most loans and advances to banks and customers and some debt securities, are measured at amortised cost. In addition, most financial liabilities are measured at amortised cost. The carrying value of these financial assets at initial recognition includes the directly attributed transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income, unless the loan becomes impaired.

Interest income from these financial assets is included in profit or loss using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss. Impairment losses are presented as a separate line item in the statement of profit or loss.

The Group may commit to underwriting loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. When the Group intends to hold the loan, the loan commitment is included in the impairment calculations set out in this policy.

(ii) Financial assets measured at fair value through other comprehensive income

Financial assets held for a business model that is achieved by both selling and collecting contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at FVOCI. These comprise primarily debt securities. They are recognised on the trade date when the Group enters into contractual arrangements to purchase and are normally derecognised when they are either sold or redeemed.

They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognised in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the statement of profit or loss as "Net gains/(losses) from financial assets measured at fair value through other comprehensive income". Financial assets measured at FVOCI are included in the impairment calculations set out in this policy and impairment is recognised in profit or loss.

(iii) Equity securities designated to be measured at fair value through other comprehensive income

The equity securities for which fair value movements are shown in other comprehensive income, which the Group has made an irrevocable election at the time of initial recognition to account for, are business facilitation and other similar investments where the Group holds the investments other than to generate a capital return. Gains or losses on the derecognition of these equity securities are not transferred to profit or loss. Otherwise equity securities are measured at FVPL (Note 4(c)(iv)).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(iii) Equity securities designated to be measured at fair value through other comprehensive income (continued)

Dividends from equity securities that clearly represents a recovery of part of the cost of the investment are presented in other comprehensive income.

Dividends from equity securities are recognised in profit or loss when the Group's right to receive payments is established.

(iv) Financial instruments measured at fair value through profit or loss

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below and are so designated irrevocably at inception:

- the use of the designation removes or significantly reduces an accounting mismatch;
- when a group of financial assets and liabilities or a group of financial liabilities is managed and its performance is evaluated on the fair value basis, in accordance with a documented risk management or investment strategy; and
- where the financial liabilities contains one or more non-closely related embedded derivatives.

Designated financial assets are recognised when the Group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when the rights to the cash flows expire or are transferred. Subsequent changes in fair value are recognised in the statement of profit or loss in "Net gains from financial instruments designated at fair value through profit or loss".

Designated financial liabilities are recognised when the Group enters into contracts with counterparties, which is generally on settlement date, and are normally derecognised when extinguished. Subsequent changes in fair value arising from changes in the Group's own credit risk are included in other comprehensive income. All other fair value changes are recognised in the statement of profit or loss in "Net gains from financial instruments designated at fair value through profit or loss". If the treatment of the impact of changes in the financial liabilities' own credit risk will create or enlarge the accounting mismatch in profit or loss, the Group shall recognise the entire gain or loss of the financial liabilities (including the amount of the impact of changes in its own credit risk) in profit and loss.

Under the above criterion, the main class of financial instruments designated by the Group is long-term debt securities issued. The interest and/or foreign exchange exposure on certain fixed rate debt securities issued has been matched with the interest and/or foreign exchange exposure on certain swaps as part of a documented risk management strategy.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(v) Financial assets held under resale agreements and financial assets sold under repurchase agreements

Financial assets held under resale agreements are transactions where the Group acquires financial assets which will be resold at a predetermined price at a future date under resale agreements. Financial assets sold under repurchase agreements are transactions where the Group sells financial assets which will be repurchased at a predetermined price at a future date under repurchase agreements.

The cash advanced or received is recognised as amounts held under resale or sold under repurchase agreements in the statement of financial position. Assets held under resale agreements are not recognised. Assets sold under repurchase agreements continue to be recognised in the statement of financial position.

The difference between the purchase and resale consideration, and that between the sale and repurchase consideration, is amortised over the period of the respective transaction using the effective interest method and is included in interest income and interest expenses respectively.

(vi) Derivatives

Derivatives are financial instruments that derive their value from the price of underlying item such as equities, interest rates or other indices. Derivatives are recognised initially and are subsequently measured at fair value. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. This includes embedded derivatives in financial liabilities which are bifurcated from the host contract when they meet the definition of a derivative on a stand-alone basis.

Where the derivatives are managed with debt securities issued by the Group that are designated at fair value, the contractual interest is shown in "Interest expense" together with the interest payable on the issued debt.

(vii) Recognition and derecognition

All financial assets and financial liabilities are recognised in the statement of financial position, when and only when, the Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial asset if the part being considered for derecognition meets one of the following conditions: (i) the contractual rights to receive the cash flows from the financial asset expire; (ii) the contractual rights to receive the cash flows of the financial asset have been transferred and the Group transfers substantially all the risks and rewards of ownership of the financial asset; or (iii) the Group retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to the eventual recipient in an agreement that meets all the conditions of transfer of cash flows and transfers substantially all the risks and rewards of ownership of the financial asset.

The difference between the carrying amount of the financial asset derecognised and the consideration received and the cumulative changes in fair value previously recognised in investment revaluation reserve are recognised in profit or loss. Any cumulative changes in fair value previously recognised in equity investment securities designated as FVOCI is not recognised in profit or loss on derecognition but recognised in retained earnings.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(vii) Recognition and derecognition (continued)

If the Group neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, but retains control, the Group continues to recognise the financial asset to the extent of its continuing involvement in the financial asset. If the Group has not retained control, it derecognises the financial asset and recognises separately as assets or liabilities any rights and obligations created or retained in the transfer.

The financial liability is derecognised only when: (i) the underlying present obligation specified in the contracts is discharged, cancelled or expired, or (ii) an agreement between the Group and an existing lender to replace the original financial liability with a new financial liability with substantially different terms, or a substantial modification of the terms of an existing financial liability is accounted for as an extinguishment of the original financial liability and recognition of a new financial liability.

The difference between the carrying amount of the financial liability derecognised and the consideration paid is recognised in profit or loss. Any cumulative changes in fair value of financial liabilities designated under the fair value option that are attributable to a reporting entity's own credit risk are recognised in other comprehensive income and these amounts are not transferred to profit or loss upon derecognition.

(viii) Measurement

At initial recognition, the Group measures a financial instrument at its fair value plus, in the case of a financial instrument not at FVPL, transaction costs that are directly attributable to the acquisition or issue of the financial instrument. Transaction costs for financial instruments carried at FVPL are expensed immediately in profit or loss.

(ix) Impairment of financial assets measured at amortised cost and at fair value through other comprehensive income

Expected credit losses ("ECL") are recognised for loans and advances to banks and customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instruments measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts.

The expected credit losses refers to the weighted average of the credit losses of financial instruments that are weighted by the risk of default. Credit loss refers to the difference between all contractual cash flows receivable from the contract and all cash flows expected to be received discounted at the original real interest rate by the Group, that is, the present value of all cash shortages. Among them, financial assets that have been purchased or sourced by the Group and have suffered credit-impairment shall be discounted according to the effective interest rate of the financial assets after credit adjustments.

The Group's method of measuring expected credit losses of financial instruments reflects the following elements: (i) unbiased weighted average probability determined by the results of evaluating a range of possible outcomes; (ii) time value of money; (iii) reasonable and evidence-based information about past events, current conditions, and future economic forecasts that are available at no additional cost or effort at the end of the reporting period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(ix) Impairment of financial assets measured at amortised cost and at fair value through other comprehensive income (continued)

At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months (or less, where the remaining life is less than 12 months) ("12-month ECL").

In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ("lifetime ECL"). Financial assets where 12-month ECL is recognised are considered to be "stage 1"; financial assets which are considered to have experienced a significant increase in credit risk are in "stage 2" where lifetime ECL is measured; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit-impaired are in "stage 3" where lifetime ECL is measured. Purchased or originated credit-impaired financial assets ("POCI") are treated differently as set out below.

For debt instruments measured at FVOCI, the Group recognises the allowance of impairment in other comprehensive income and impairment losses or gains in profit and loss, which should not change the book value of the financial assets set out in the statement of financial position.

Credit-impaired

The Group determines that a financial instrument is credit-impaired and in stage 3 satisfies the criteria described in Note 8(a)(xii)(3).

Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

For loss provision measured at the amount equivalent to the lifetime expected credit losses of the financial instrument previously, if, at the end of the current reporting period, the financial instrument is no longer having significant increase in credit risk since the initial recognition, the Group measures its loss provision based on the amount of its expected credit losses for the next 12 months, and the reversal of the loss provision arising from it is recognised in profit or loss for the current reporting period.

If, in a subsequent period, the amount of the impairment loss on financial assets decreased and the decrease in expected credit losses, the previously recognised impairment loss was reversed. The amount of the reversal was recognised in profit or loss. The reversal shall not result in a carrying amount of the financial asset that exceeded the amortised cost at the date of the reversal had the impairment not been recognised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(ix) Impairment of financial assets measured at amortised cost and at fair value through other comprehensive income (continued)

Write-off

When the Group determined that a loan had no reasonable prospect of recovery after the Group had completed all the necessary legal or other proceedings, the loan was written off against its allowance for impairment losses. If in a subsequent period the loan written off was recovered, the amount recovered will be recognised in profit or loss through impairment losses.

Rescheduled loans

Loans are identified as rescheduled and classified as credit-impaired when the contractual payment terms are modified due to significant credit distress of the borrower. Rescheduled loans remain classified as credit-impaired until certain specific conditions are met by the end of the observation period of normally 6 months, with the approval from management.

A loan that is rescheduled is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms or if the terms of an existing agreement are modified such that the rescheduled loan is a substantially different financial instrument. Any new loans that arise following derecognition events in these circumstances are considered to be POCI and will continue to be disclosed as rescheduled loans.

Significant increase in credit risk

An assessment of whether credit risk has increased significantly is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly have experienced a significant increase in credit risk, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on internal credit qualitative factors and a backstop of 30 days past due. The definition of these three criteria are described in Note 8(a)(xii)(2).

Unimpaired and without significant increase in credit risk

ECL resulting from default events that are possible within the next 12 months ("12-month ECL") are recognised for financial instruments that remain in Stage 1.

Purchased or originated credit-impaired ("POCI")

Financial assets that are purchased or originated at a deep discount that reflects the incurred credit losses are considered to be POCI. This population includes the recognition of a new financial instrument where concessions have been granted for economic or contractual reasons relating to the borrower's financial difficulty that otherwise would not have been considered. The amount of change-in-lifetime ECL is recognised in profit or loss until the POCI is derecognised, even if the lifetime ECL are less than the amount of ECL included in the estimated cash flows on initial recognition.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(ix) Impairment of financial assets measured at amortised cost and at fair value through other comprehensive income (continued)

Movement between stages

Financial assets can be transferred between the different categories (other than POCI) depending on their relative increase in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit-impairment as described above. Rescheduled loans that are not POCI will continue to be in stage 3 until certain specific conditions are met by the end of the observation period of normally 6 months, with the approval from management.

Measurement of ECL

The assessment of credit risk, and the estimation of ECL, are unbiased and probability-weighted, and incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money.

In general, the Group calculates ECL using three main components, PD, a loss given default ("LGD") and the exposure at default ("EAD").

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively. The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money.

The ECL for stage 3 financial assets is determined on an individual basis. At the end of each reporting period, the Group recognises the amount of the change in lifetime expected credit losses as an impairment loss in profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(ix) Impairment of financial assets measured at amortised cost and at fair value through other comprehensive income (continued)

Period over which ECL is measured

Expected credit losses is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the Group is exposed to credit risk. Where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit the Group's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period the Group remains exposed to credit risk that is not mitigated by credit risk management actions. If the Group cannot separately identify the ECL on the undrawn commitment component from those on the drawn commitment, the ECL on the undrawn commitment are recognised together with the loss allowance for the loan. To the extent that the combined ECL exceed the gross carrying amount of the loan, the ECL are recognised as a provision.

Forward-looking information

The Group incorporates forward-looking information in the measurement of ECL. The mechanism of the model incorporation is discussed in Note 8 (a)(xii)(5).

(x) Hedge accounting

The Group uses derivatives primarily to hedge its exposure to foreign exchange and interest rate risks. Derivatives are recognised at fair value at the trade date upon initial recognition, and subsequently measured at fair value. The positive fair value is recognised as an asset while the negative fair value is recognised as a liability.

The method of recognising resulting fair value gain or loss depends on whether the derivative is designated and qualified as a hedging instrument, and if so, the nature of the item being hedged. For derivatives not designated or qualified as hedging instruments, including those that are intended to provide effective economic hedges of specific interest rate and foreign exchange risks, but not qualified for hedge accounting, changes in the fair value of these derivatives are recognised in "net trading income/(loss)" of the statement of profit or loss.

The Group documents, at inception, the economic relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transaction. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. These criteria should be met before a hedge can be qualified to be accounted for under hedge accounting.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(x) Hedge accounting (continued)

Fair value hedge

Fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss.

The changes in fair value of hedging instruments that are designated and qualify as fair value hedges are recorded in “net trading income/(losses)” of the statement of profit or loss, together with the changes in fair value of the hedged item attributable to the hedged risk. The net difference is recognised as ineffectiveness in the profit or loss.

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

Cash flow hedge

Cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction that could ultimately affect the profit or loss.

The effective portion of changes in the fair value of hedging instruments that are designated and qualify as cash flow hedges is recognised in other comprehensive income and accumulated in equity in the “cash flow hedge reserve”. The ineffective portion is recognised immediately in the “net trading income/(loss)” of the statement of profit or loss.

Amounts accumulated in equity are reclassified to the profit or loss in the same periods when the hedged item affects the profit or loss.

When a hedging instrument expires or is sold, or the hedge designation is revoked or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss on the hedging instrument existing in equity at the time remains in equity and is reclassified to the profit or loss when the forecast transaction ultimately occurs. When a forecast transaction is no longer expected to occur, the cumulative gain or loss existing in equity is immediately transferred to the profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(xi) Embedded derivatives

Certain derivatives are embedded into non-derivative hybrid instruments (the host contracts). If the hybrid contract contains a host that is a financial asset, then the Group assesses the entire contract for classification and measurement purposes. Otherwise, the embedded derivatives are treated as separate derivatives when:

- their economic characteristics and risks are not closely related to those of the host contract;
- a separate instrument with the same terms would meet the definition of a derivative; and
- the hybrid contract is not measured at FVPL.

These embedded derivatives are separately accounted for at fair value, with changes in fair value recognised in the statement of profit or loss unless the Group chooses to designate the hybrid contracts at FVPL.

(xii) Differences between HKAS 39 and HKFRS 9

Classification and measurement

Key similarities and differences between HKAS 39 and HKFRS 9 for the classification and measurement of financial assets are set out below. There are no differences for financial liabilities, except for the presentation of gains and losses on financial liabilities designated at fair value and the requirements to reconsider fair value designation on transition to HKFRS 9.

	HKAS 39	HKFRS 9
Criteria	The Group classified financial instruments into different categories at inception, depending on the purposes for which the assets were acquired or the liabilities were incurred. The categories were: financial assets and financial liabilities at FVPL, held-to-maturity investments, loans and receivables, available-for-sale financial assets ("AFS") and other financial liabilities.	<i>Business model:</i> the business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g., financial assets are held for trading purposes), then the financial assets are classified as part of "other" business model and measured at FVPL. Factors considered by the Group in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(xii) Differences between HKAS 39 and HKFRS 9 (continued)

Classification and measurement (continued)

	HKAS 39	HKFRS 9
		<i>SPPI</i>: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e., interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at FVPL.
Recognition	Financial assets are measured at amortised cost (loans & receivables and held to maturity), AFS, or FVPL (derivatives and trading) based on the nature of the instrument and the purpose for which it is held. Embedded derivatives are separated from their host contract unless the contract as a whole is measured at FVPL. The fair value option applies where there are non-closely related embedded derivatives that are not bifurcated, financial instruments are managed on a fair value basis or where measuring at FVPL would reduce or eliminate an accounting mismatch.	Debt instruments are measured at amortised cost or FVOCI based on their contractual terms and the business model in which they are held as set out in the accounting policies above. The concept of embedded derivatives does not apply to financial assets. Therefore, the fair value option only applies where it would reduce or eliminate an accounting mismatch. Equity securities are measured at FVPL unless the option has been exercised to measure at FVOCI.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(xii) Differences between HKAS 39 and HKFRS 9 (continued)

Classification and measurement (continued)

	HKAS 39	HKFRS 9
Derecognition	Upon disposal of AFS securities (debt instruments and equity securities) the cumulative gains or losses in other comprehensive income are recognised in profit or loss.	Upon disposal of debt instruments measured at FVOCI the cumulative gains or losses in other comprehensive income are recognised in profit or loss. Cumulative gains or losses in other comprehensive income are not recognised in profit or loss on the disposal of equity securities measured at FVOCI.

A reconciliation of presentational and measurement differences resulting from the adoption of HKFRS 9 at January 1, 2018 is set out in Note 5. In general:

- loans and advances to banks and to customers that are classified as loans and receivables under HKAS 39 are measured at amortised cost under HKFRS 9, with a small minority at FVPL because of their contractual cash flow characteristics or the business model within which they are held;
- financial assets designated at FVPL remain at FVPL, because it is required under HKFRS 9 or the designation will continue;
- debt securities classified as available-for-sale are measured at amortised cost or FVOCI because of their contractual cash flow characteristics or the business model within which they are held;
- debt securities classified as held to maturity are measured at amortised cost; and
- all equity securities remain measured at fair value. The equity securities for which fair value movements are shown in other comprehensive income are for business facilitation and other similar investments where the Group holds the investments other than to generate a capital return.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(xii) Differences between HKAS 39 and HKFRS 9 (continued)

Impairment

Under HKFRS 9, the scope of impairment also covers loans and advances to banks and customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instruments measured at FVOCI, and certain loan commitments and financial guarantee contracts. The recognition and measurement of impairment is intended to be more forward-looking than under HKAS 39 and the resulting impairment charge may be more volatile. The adoption has resulted in an increase in the total level of impairment allowance as set out on Note 5, since all financial instruments are assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is larger than the population for which there is objective evidence of impairment in accordance with HKAS 39.

	HKAS 39	HKFRS 9
Scope	For amortised cost assets, impairment is recognised when there is objective evidence of impairment. Losses are measured by comparing the carrying amount with the discounted future cash flows. Losses which may arise from future events are not recognised. For AFS financial assets, impairment is recognised when there is objective evidence of a shortfall in the recovery of future cash flows. Impairment is measured as the decrease in fair value below the original cost at initial recognition.	Under HKFRS 9, the scope of impairment covers loans and advances to banks and customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instruments measured at FVOCI, and certain loan commitments and financial guarantee contracts. Impairment is not recognised on equity securities which are measured at FVOCI. Impairment is recognised for all financial assets in scope at either 12-month ECL or lifetime ECL. All reasonable and supportable information, including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date is used in measuring ECL.
Application	Accounting policies generally make a distinction between individually significant loans and homogeneous groups of loans which are assessed collectively.	The distinction between individual and collective assessment is less relevant. In general, whether loans are managed through credit risk systems is relevant because of differences in the types of information available and the way credit risk is managed.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(xii) Differences between HKAS 39 and HKFRS 9 (continued)

Impairment (continued)

	HKAS 39	HKFRS 9
Impaired	The criteria used to determine whether there is objective evidence of impairment are the same for individually significant loans assessed under HKAS 39 and for HKFRS 9. The determination of the realisable value of collateral is based on the most recently updated market value at the time the impairment assessment is performed and is not adjusted for expected future changes in market prices. Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans that are not considered individually significant using either roll rate methodologies or historical loss rate experience for loans. Under these methodologies, impairment allowance are recognised at a portfolio level. However, loans are classified as impaired for presentation purposes when they are more than 90 days past due or have been renegotiated for credit risk reasons.	The stage 3 population is very similar to impaired loans under HKAS 39 which are considered individually significant. For loans, individual discounted future cash flow calculations continue to be performed. However, the net realisable value of collateral is adjusted for expected future changes in market and the losses reflecting future cash flows under different scenarios are probability-weighted to determine the ECL rather than using the best estimate of future cash flows. For credit card, stage 3 is determined by considering the relevant objective evidence, primarily whether contractual payments of either principal or interest are 90 days past due or above, or a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition, or the loan is otherwise considered to be in default. The accounting policies setting out the criteria for loans to be transferred to stage 3 and for POCI financial assets are set out in Note 4(c) (ix).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(xii) Differences between HKAS 39 and HKFRS 9 (continued)

Impairment (continued)

	HKAS 39	HKFRS 9
Stage 2	This is not required in HKAS 39.	The accounting policies setting out the criteria for loans to be transferred to stage 2 and the measurement of lifetime ECL are set out in Note 4(c)(ix).
Stage 1	This is not an HKAS 39 concept. However, incurred but not yet identified impairment is assessed for loans which have no evidence of impairment but have been specifically identified by estimating a collective allowance determined after taking into account factors including the estimated period between impairment occurring and the loss being identified. This is assessed empirically on a periodic basis and may vary over time. Similarly, for homogeneous groups of loans and advances which are assessed under HKAS 39 on a collective basis, the inherent loss is determined using risk factors including the period of time between loss identification and write-off which is regularly benchmarked against actual outcomes.	Financial instruments which are not considered to have significantly increased in credit risk have loss allowance measured at an amount equal to 12-month ECL. This 12-month time horizon is likely to be equal to or longer than the period estimated under HKAS 39 (typically between 6 and 12 months). The measurement of 12-month ECL is set out in Note 4(c)(ix).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

(xiii) Fair value measurement

If there is an active market for financial instruments, the fair value of financial instruments is based on the prices within the bid-ask spread that is most representative of fair value in the circumstances, and without any deduction for transaction costs that may occur on sales or disposals. A quoted price is from an active market where price information is readily and regularly available from an exchange, dealer, industry group or pricing service agency and that price information represents actual and regularly occurring orderly transactions.

If a quoted market price is not available, the fair value of the financial instruments is estimated using valuation techniques. Valuation techniques applied include the price used by market participants in an orderly transaction, reference to the fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. The Group selects valuation techniques that are commonly accepted by market participants for pricing the instruments and these techniques have been demonstrated to provide reliable estimates of prices obtained in actual market transactions. Periodically, the Group reviews the valuation techniques and tests them for validity.

(xiv) Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when the Group has a legally enforceable right to offset the recognised amounts and the transactions are intended to be settled on a net basis, or by realising the asset and settling the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the company or the counterparty.

(d) Fixed assets

Fixed assets are assets held by the Group for the conduct of business and are expected to be used for more than one year. Construction in progress is the property and equipment under construction, which is transferred to fixed assets when ready for its intended use.

(i) Cost

Fixed assets are initially recognised at cost. The cost of a purchased fixed asset comprises the purchase price, related taxes, and any directly attributable expenditure for bringing the asset to working condition for its intended use. The cost of a self-constructed fixed asset comprises those expenditures necessarily incurred for bringing the asset to working condition for its intended use.

Where the individual components of an item of fixed asset have different useful lives or provide benefits to the Group in different patterns thus necessitating use of different depreciation rates or methods, they are recognised as separate fixed assets.

Subsequent costs, including the cost of replacing part of an item of fixed assets, are recognised in the carrying amount of the item if the recognition criteria are satisfied, and the carrying amount of the replaced part is derecognised. Expenditures relating to ordinary maintenance of fixed assets are recognised in profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Fixed assets (continued)

(ii) Depreciation and impairment

Depreciation is calculated to write-off to the profit or loss the cost of items of fixed assets, less their estimated residual value, if any, using the straight-line method over their estimated useful lives. Impaired fixed assets are depreciated net of accumulated impairment losses. No depreciation is provided on construction in progress.

The estimated useful lives of respective fixed assets are as follows:

Types of assets	Estimated useful lives
— Freehold land	indefinite
— Leasehold land classified as held under finance leases	the unexpired term of lease
— Buildings (over interests in leasehold land classified as held under finance lease)	period of lease term, ranged from 6 years to 34 years
— Buildings (over freehold land)	50 years
— Leasehold improvements	shorter of lease term or their estimated useful lives, 7 years
— Furniture and equipment	2–8 years

The Group reviews the estimated useful life and the depreciation method applied at least once a financial year.

Impairment losses on fixed assets are accounted for in accordance with the accounting policies as set out in Note 4(h).

(iii) Disposal

Gains or losses arising from the retirement or disposal of a fixed asset are determined as the difference between the net disposal proceeds and the carrying amount of the fixed asset and are recognised in profit or loss on the date of retirement or disposal.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Lease

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee, irrespective of whether the legal title to the asset is eventually transferred or not. An operating lease is a lease other than a finance lease.

(i) Finance lease

Where the Group is a lessor under finance leases, an amount representing the sum of the minimum lease receivables and initial direct costs at the commencement of the lease term, is included in "Advance to customers and trade bills" on statement of financial position as a lease receivable. Unrecognised finance income under finance leases is amortised using the effective interest rate method over the lease term. Hire purchase contracts having the characteristics of finance leases are accounted for in the same manner as finance leases.

Impairment losses on lease receivables are accounted for in accordance with the accounting policies as set out in Note 4(c)(iv).

(ii) Operating lease

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to the profit or loss, using the straight-line method, over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased assets. Lease incentives received are recognised in profit or loss as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the consolidated statement of comprehensive income in the accounting period in which they are incurred.

(f) Intangible assets

Intangible assets are initially recognised at cost. Intangible assets that have an indefinite estimated useful life are tested for impairment annually. Impaired intangible assets are amortised net of accumulated impairment losses.

Impairment losses on intangible assets are accounted for in accordance with the accounting policies as set out in Note 4(h).

(g) Repossessed assets

In the recovery of impaired loans and advances, the Group may take possession of assets held as collateral through court proceedings or voluntary delivery of possession by the borrowers. Repossessed assets are recognised and reported in "Other assets" in the statement of financial position when the Group intends to achieve an orderly realisation of the impaired assets and the Group is no longer seeking repayment from the borrower.

When the Group seizes assets to compensate for the losses of loans and advances and interest receivable, the repossessed assets are initially recognised at fair value, plus any taxes paid for the seizure of the assets, litigation fees and other expenses incurred for collecting the repossessed assets. Repossessed assets are recognised at the carrying value, net of allowance for impairment losses (Note 4(h)).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Allowances for impairment losses on non-financial assets

At the end of each reporting period, the Group assesses whether there is any indication that a non-financial asset may be impaired. If any indication exists that an asset may be impaired, the Group estimates the recoverable amount of the asset.

The recoverable amount is the higher of an asset's fair value less costs of disposal ("FVLCD") and value in use. If there is no reason to believe that a non-financial asset's value in use materially exceeds its fair value less costs of disposal, the non-financial asset's fair value less costs of disposal may be used as its recoverable amount.

The fair value of an asset is the price that would be received to sell the asset in an orderly transaction between market participants at the measurement date. When estimating the fair value of non-financial assets which are equity investments, the Group applies a market approach whereby the fair value is estimated based on price to book multiple or other information derived from comparable quoted equity securities. In addition, the Group also makes management judgements in estimating the fair value which involve significant unobservable inputs and were subject to substantial uncertainty. If the actual fair value of such asset is lower than management's estimate, additional impairment charge would be required.

If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That reduction is recognised as an impairment loss and charged to the profit or loss.

If, in a subsequent period, the amount of impairment loss of the non-financial asset decreases and the decrease can be linked objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the profit or loss. A reversal of impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior periods.

(i) Employee benefits

Employee benefits are all forms of consideration given and compensations incurred by the Group in exchange for services rendered by employees or the termination of the employment relationship. Employee benefits are recognised as a liability in the period in which the associated services are rendered by its employees, with a corresponding increase in cost of relevant assets or the expenses in profit or loss. Where payment or settlement is deferred and the effect of discount would be material, these amounts are stated at their present values in the statement of financial position.

The Group contributes to defined contribution retirement schemes under either recognised Occupational Retirement Scheme ("ORSO") or Mandatory Provident Fund Schemes ("MPF") that are available to employees. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the funds do not hold sufficient assets to pay all employees the benefits relating to employee service in current or prior periods.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(j) Provisions and contingent liabilities

A provision is recognised in the statement of financial position if, as the result of a past event, the Group has a present legal or constructive obligation that can be reliably estimated and it is probable that an outflow of economic benefits will be required to settle the obligation. A provision is initially measured at the best estimate of the expenditure required to settle the related present obligation. Factors pertaining to a contingency such as the risks, uncertainties and time value of money are taken into account as a whole in reaching the best estimate. Where the effect of the time value of money is material, the best estimate is determined by discounting the related future cash outflows.

A potential obligation arising from a past transaction or event whose existence can only be confirmed by the occurrence or non-occurrence of future uncertain events; or a present obligation that arises from past transactions or events where it is not probable that an outflow of economic benefits is required to settle the obligation or the amount of the obligation cannot be measured reliably, is disclosed as a contingent liability unless the probability of outflow of economic benefit is remote.

(k) Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. A financial instrument issued is an equity instrument if, and only if, both conditions (i) and (ii) below are met: (i) The financial instrument includes no contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Group; and (ii) If the financial instrument will or may be settled in the Group's own equity instruments, it is a non-derivative instrument that includes no contractual obligations for the Group to deliver a variable number of its own equity instruments; or a derivative that will be settled only by the Group exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

Equity instruments issued by the Group are recorded at the fair value of proceeds received, net of direct issuance expenses.

(l) Financial guarantees and loan commitments

Financial guarantees are contracts that require the Group as the guarantor (the "issuer") to make specified payments to reimburse the beneficiary of the guarantee (the "holder") for a loss the holder incurs when a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

The fair value of the guarantee (being the guarantee fees received) is initially recognised as deferred income in "Other liabilities" and subsequently measured at the higher of the amount determined in accordance with the expected credit loss model under HKFRS 9 Financial Instruments or the amount initially recognised less, where appropriate, the cumulative amount of income recognised in accordance with the principles of HKFRS 15 Revenue from Contracts with Customers. The deferred income is amortised in profit or loss over the term of the guarantee as income from financial guarantees issued. Provisions are recognised in the statement of financial position if and when it becomes probable that the holder of the guarantee will call upon the Group under the guarantee, and the amount of that claim on the Group is expected to exceed the carrying amount of the deferred income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(l) Financial guarantees and loan commitments (continued)

Loan commitments provided by the Group are measured as the amount of the loss allowance as described in note 8(a)(xii). The Group has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For loan commitments and financial guarantee contracts, the loss allowance is recognised as a provision. However, for contracts that include both a loan and an undrawn commitment and the Group cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognised together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognised as a provision.

(m) Income recognition

From January 1, 2018, the Group recognises revenue when control of a good or service transfers to a customer. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. The Group recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Group expects to be entitled in exchange for those goods or services. The Group applies the following steps in its revenue recognition:

Step 1: Identify the contract(s) with a customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract

Step 5: Recognise revenue when (or as) the Group satisfies a performance obligation.

(i) Interest income

Interest income and expense for interest bearing financial instruments are recognised in profit or loss using the effective interest method. Interest income includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective interest basis. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to gross carrying amount of the financial asset or the amortised cost of the financial liability.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Income recognition (continued)

(i) Interest income (continued)

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Group estimates future cash flows considering all contractual terms of the financial instrument, but not ECL. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL. The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any ECL allowance (or impairment allowance before January 1, 2018).

The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusting for ECL allowance.

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest. The effective interest rate is also revised for fair value hedge adjustments at the date amortisation of the hedge adjustment begins.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Income recognition (continued)

(ii) Fees and commission income

Fees and commission income is earned from a diverse range of services provided by the Group to its customers and is recognised as the related services are performed.

The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

Type of service	Nature and timing of satisfaction of performance obligations	Revenue recognition
Investment services, securities and insurance brokerage services, credit card service, remittance, settlement and account management fees	Performance obligations are satisfied when the Group transfer the promised service to the customer.	Fees income is recognised at a point in time.
Credit facilities fees	Performance obligations are satisfied over time when a customer simultaneously receives and consumes a service provided by the Group.	Fees income should be recognised over the term of credit facilities.

(iii) Finance income from finance leases and hire purchase contracts

Finance income implicit in finance lease and hire purchase payments is recognised as interest income over the period of the leases so as to produce an approximately constant periodic rate of return on the outstanding net investment in the leases for each accounting period. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

(iv) Dividend income

Dividend income from unlisted equity investments is recognised in profit or loss on the date when the Group's right to receive payment is established. Dividend income from a listed equity investment is recognised when the share price of the investment goes ex-dividend.

From January 1, 2018, dividends on equity instruments designated at FVOCI that clearly represents a recovery of part of the cost of the investment are presented in other comprehensive income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(n) Income tax

Current income tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantially enacted at the end of each reporting period, and any adjustment to tax payable in respect of previous periods. Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax also arises from unused tax losses and unused tax credits. A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Current income tax and movements in deferred tax balances are recognised in profit or loss except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.

At the end of each reporting period, deferred tax assets and deferred tax liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled according to the requirements of tax laws. The Group also considers the possibility of realisation and the settlement of deferred tax assets and deferred tax liabilities in the calculation.

Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Group has the legally enforceable right to offset current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on the same taxable entity. Otherwise, the balances of deferred tax assets and deferred tax liabilities, and movements therein, are presented separately from each other and are not offset.

(o) Cash equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(p) Related parties

If the Group has the power, directly or indirectly, to control, jointly control or exercise significant influence over another party, or vice versa, or where the Group and one or more parties are subject to common control or joint control from another party, they are considered to be related parties. Related parties may be individuals or enterprises. The Group's related parties include but are not limited to the following:

- (i) the Bank's immediate and ultimate parent companies;
- (ii) the Bank's subsidiaries;
- (iii) other entities which are controlled by the Bank's immediate and ultimate parent companies;
- (iv) an investor who has joint control over the Group;

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Related parties (continued)

- (v) an investor who can exercise significant influence over the Group;
- (vi) an associate of the Group;
- (vii) a joint venture entity of the Group;
- (viii) principal individual investors of the Group, and close family members of such individuals (principal individual investors are the individual investors who have the power, directly or indirectly, to control, jointly control or exercise significant influence over another party);
- (ix) key management personnel of the Group and close family members of such individuals (key management personnel represent those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director of that entity);
- (x) key management personnel of the Group's parents and close family members of such individuals;
- (xi) other entities that are controlled or jointly controlled by the Group's principal individual investors, key management personnel, or close family members of such individuals;
- (xii) a post-employment benefit plan for the benefit of employees of the Group, or of any entity that is a related party of the Group; and
- (xiii) other entities, or any member of a Group of which it is a part, provides key management personnel services to the Group or the Group's immediate and ultimate parent companies.

(q) Operating segments

The identification of operating segments of the Group is on the basis of internal reports that are regularly reviewed by the Executive Committee of the Board of Directors in order to allocate resources to the segment and assess its performance. On the basis of the operating segments, the Group identifies the reportable segments, using a combination of factors including products and services, geographical areas, regulatory environments etc., which the management has chosen for organisation. The operating segments that meet the specified criteria have been aggregated, and the operating segments that meet quantitative thresholds have been reported separately.

The amount reported for each operating segment item is the measure reported to the chief operating decision makers for the purposes of allocating resources to the segment and assessing its performance. Segment information is prepared in conformity with the accounting policies adopted for preparing and presenting the consolidated financial statements of the Group.

(r) Comparatives

Certain comparative figures have been adjusted to conform with the presentation and disclosures in the current year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CHANGES IN ACCOUNTING POLICIES

The Group has initially adopted HKFRS 9 “Financial Instruments” and HKFRS 15 “Revenue from Contracts with Customers” from January 1, 2018.

A number of other new standards are also effective from January 1, 2018 but they do not have a material effect on the Group’s financial statements. The Group has not applied any new standards or interpretations that are not yet effective for the current accounting period.

Except for the changes below, the Group has consistently applied the accounting policies as set out in Note 4 to all periods presented in these consolidated financial statements.

(a) HKFRS 9 Financial Instruments

The Group has adopted HKFRS 9 “Financial Instruments” with the date of transition of January 1, 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements. The Group did not early adopt any of HKFRS 9 in previous periods.

As permitted by the transitional provisions of HKFRS 9, the Group elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current period.

Consequently, for notes disclosures, the consequential amendments to HKFRS 7 disclosures have also only been applied to the current period. Notes disclosures of the comparative period repeat those disclosures made in the prior year.

Set out below are disclosures relating to the impact of the adoption of HKFRS 9 on the Group. Further details of the specific HKFRS 9 accounting policies applied in the current period (as well as the previous HKAS 39 accounting policies applied in the comparative period) are described in more detail in Note 4(c).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CHANGES IN ACCOUNTING POLICIES (continued)

(a) HKFRS 9 Financial Instruments (continued)

The total impact on the Group's equity as at December 31, 2017 and January 1, 2018 is as follows:

	Effect on investment revaluation reserve	Effect on retained earnings
Closing balance as at December 31, 2017	(562,295)	20,102,632
Reclassify loans and advances to customers from loans and receivables to financial assets measured fair value through profit or loss	–	11,074
Reclassify debt securities from available-for-sale financial assets to financial assets measured at amortised cost	42,047	–
Reclassify debt securities from held-to-maturity investments to financial assets measured at fair value through other comprehensive income	2,514	–
Increase in ECL for cash and balances with banks and central banks and placements with banks at amortised cost	–	(2,918)
Increase in ECL for advances to banks at amortised cost	–	(233)
Increase in ECL for loans and advances at amortised cost	–	(207,733)
Increase in ECL for other assets	–	(26,540)
Increase in ECL for loan commitments	–	(218,554)
Increase in ECL for debt investments measured at amortised cost	–	(1,987)
Increase in ECL for debt investments measured at fair value through other comprehensive income	82,210	(82,210)
Changes in deferred tax assets	(7,881)	95,651
	118,890	(433,450)
Opening balance as at January 1, 2018	(443,405)	19,669,182

(i) Classification and measurement

On January 1, 2018 (the date of initial application of HKFRS 9), the Group's management has assessed which business models apply to the financial assets held by the Group and has classified its financial instruments into the appropriate HKFRS 9 measurement categories.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CHANGES IN ACCOUNTING POLICIES (continued)

(a) HKFRS 9 Financial Instruments (continued)

(i) Classification and measurement (continued)

The following table reconciles the carrying amounts of financial assets and financial liabilities, from their measurement category in accordance with HKAS 39 to their new measurement categories upon transition to HKFRS 9 on January 1, 2018:

				HKFRS 9 reclassification to					HKFRS 9		HKFRS 9	
Remarks	HKAS 39 measurement category *	HKFRS 9 measurement category *	HKAS 39 carrying amount at December 31, 2017	Fair value through profit or loss	Fair value through other comprehensive income	Amortised cost	Carrying amount post reclassification	HKFRS 9 remeasurement including expected credit losses			HKFRS 9 carrying amount at January 1, 2018	
Assets												
Cash and balances with												
banks and central banks	AC (Loans and receivables)	AC	81,673,241	-	-	-	81,673,241	(1,619)			81,671,622	
Placements with banks	AC (Loans and receivables)	AC	17,997,303	-	-	-	17,997,303	(1,299)			17,996,004	
Advances to banks	AC (Loans and receivables)	AC	262,498	-	-	-	262,498	(233)			262,265	
Financial assets measured												
at fair value through profit or loss	1	N/A	FVPL	-	5,510,425	-	-	5,510,425	11,074		5,521,499	
Advances to customers												
and trade bills	4	AC (Loans and receivables)	AC	288,009,874	(5,510,425)	-	-	282,499,449	(207,733)		282,291,716	
Financial assets measured at fair												
value through other												
comprehensive income	2, 3	N/A	FVOCI	-	-	100,992,142	-	100,992,142	44,561		101,036,703	
Available-for-sale financial assets	3	FVOCI	N/A	98,956,057	-	(92,734,047)	(6,222,010)	-	-		-	
Financial assets measured at												
amortised cost	4	N/A	AC	-	-	-	15,422,772	15,422,772	(1,987)		15,420,785	
Held-to-maturity investments	2	AC (Held to maturity)	N/A	17,458,857	-	(8,258,095)	(9,200,762)	-	-		-	
Derivative financial instruments		FVPL	FVPL	6,788,337	-	-	-	6,788,337	-		6,788,337	
Interest in a joint venture		N/A	N/A	2,044,996	-	-	-	2,044,996	-		2,044,996	
Interest in an associate		N/A	N/A	199,912	-	-	-	199,912	-		199,912	
Deferred tax assets		N/A	N/A	234,912	-	-	-	234,912	87,770		322,682	
Fixed assets		N/A	N/A	3,325,095	-	-	-	3,325,095	-		3,325,095	
Other assets	4	AC (Loans and receivables)	AC	4,073,631	-	-	-	4,073,631	(26,540)		4,047,091	
Total assets			521,024,713	-	-	-	521,024,713	(96,006)		520,928,707		

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CHANGES IN ACCOUNTING POLICIES (continued)

(a) HKFRS 9 Financial Instruments (continued)

(i) Classification and measurement (continued)

Remarks	HKAS 39 measurement category *	HKFRS 9 measurement category *	HKAS 39 carrying amount at December 31, 2017	HKFRS 9 reclassification to			Carrying amount post reclassification	HKFRS 9 remeasurement including expected credit losses	HKFRS 9 carrying amount at January 1, 2018
				Fair value through profit or loss	Fair value through other comprehensive income	Amortised cost			
Liabilities									
Deposits and balances of banks	AC	AC	73,223,622	-	-	-	73,223,622	-	73,223,622
Deposits from customers	AC	AC	353,269,333	-	-	-	353,269,333	-	353,269,333
Other debt securities issued	AC	AC	14,917,044	-	-	-	14,917,044	-	14,917,044
Derivative financial instruments	FVPL	FVPL	6,563,076	-	-	-	6,563,076	-	6,563,076
Current tax payable	N/A	N/A	167,208	-	-	-	167,208	-	167,208
Deferred tax liabilities	N/A	N/A	20,902	-	-	-	20,902	-	20,902
Other liabilities	4	AC	7,733,982	-	-	-	7,733,982	218,554	7,952,536
Subordinated debt	N/A	N/A	5,812,111	-	-	-	5,812,111	-	5,812,111
Total liabilities			461,707,278	-	-	-	461,707,278	218,554	461,925,832
Equity									
Share capital			28,827,843	-	-	-	28,827,843	-	28,827,843
Other equity instruments			7,812,200	-	-	-	7,812,200	-	7,812,200
Reserves	5		22,677,392	-	-	-	22,677,392	(314,560)	22,362,832
Total equity			59,317,435	-	-	-	59,317,435	(314,560)	59,002,875
Total equity and liabilities			521,024,713	-	-	-	521,024,713	(96,006)	520,928,707

Notes (*):

"FVPL" refer to financial assets measured at fair value through profit or loss

"FVOCI" refer to financial assets measured at fair value through other comprehensive income

"AC" refer to financial assets measured at amortised cost

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CHANGES IN ACCOUNTING POLICIES (continued)

(a) HKFRS 9 Financial Instruments (continued)

(i) Classification and measurement (continued)

Remark to effects of reclassification upon adoption of HKFRS 9

1. "Advances to customers and trade bills" of \$5,510,425 previously classified as loans and receivables under HKAS 39 have been reclassified to fair value through profit or loss as a result of "other" business model classification under HKFRS 9. This resulted in an amount of \$11,074 upward remeasurement of the financial assets due to the fair value gains and the gains were remeasured in the retained earnings on January 1, 2018.
2. Debt instruments of \$8,258,095 previously classified as held-to-maturity under HKAS 39 have been reclassified to fair value through other comprehensive income as a result of "both collecting contractual cash flows and selling financial assets" business model classification under HKFRS 9. This resulted in a \$2,514 upward remeasurement of the financial assets now measured at fair value through other comprehensive income excluding expected credit losses. Assuming no those instruments not being reclassified during the year, the fair value loss of \$41,850 should recognised be in other comprehensive income.
3. Debt instruments of \$6,222,010 previously classified as available-for-sale under HKAS 39 have been reclassified to amortised costs as a result of "hold-to-collect" business model classification under HKFRS 9. This resulted in a \$42,047 upward remeasurement of the financial assets now measured at amortised costs excluding expected credit losses.
4. HKFRS 9 expected credit losses on financial assets measured at amortised cost have decreased net assets by \$457,965, principally comprising of \$1,619 in the carrying value of assets classified as "Cash and balances with banks and central banks", \$1,299 in the carrying value of assets classified as "Placements with banks", \$233 in the carrying value of assets classified as "Advances to banks", \$207,733 in the carrying value of assets classified as "Advances to customers and trade bills", \$218,554 for loan commitments in the carrying value of liabilities classified as "Other liabilities", \$1,987 in the carrying value of assets classified as "Financial assets measured at amortised cost", and \$26,540 in the carrying value of assets classified in "Other assets".
5. While HKFRS 9 ECL has no effect on the carrying value of FVOCI financial assets, which remain measured at fair value, the adoption of HKFRS 9 results in a transfer from the investment revaluation reserve to retained earnings to reflect the cumulative impairment recognised in profit or loss in accordance with HKFRS 9. The amount transferred from "Investment revaluation reserve" to "Retained earnings" was \$82,210.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CHANGES IN ACCOUNTING POLICIES (continued)

(a) HKFRS 9 Financial Instruments (continued)

(ii) Impairment

Reconciliation of impairment allowances under HKAS 39 and provision under HKAS 37 to expected credit losses under HKFRS 9

The following table reconciles the prior period's closing impairment allowances measured in accordance with the HKAS 39 incurred loss model to the new impairment allowances measured in accordance with the HKFRS 9 expected credit loss model at January 1, 2018.

Measurement category	Loss allowances under HKAS 39/ provision under HKAS 37	Fair value through profit or loss	Fair value through other comprehensive income	Amortised cost	Stage 3	Stage 1 and stage 2	Total
Loans and receivables (HKAS 39)/ Financial assets measured at amortised cost (HKFRS 9)*							
Cash and balances with banks and central banks	–	–	–	–	–	1,619	1,619
Placements with banks	–	–	–	–	–	1,299	1,299
Advances to banks	–	–	–	–	–	233	233
Advances to customers and trade bills	1,315,570	–	–	–	–	207,733	1,523,303
Other assets	2,349	–	–	–	–	26,540	28,889
Expected credit losses on January 1, 2018	1,317,919	–	–	–	–	237,424	1,555,343
Held to maturity (HKAS 39)/ Financial assets measured at amortised cost (HKFRS 9)							
Investment securities	9,058	–	–	–	–	1,987	11,045
Available for sale financial instruments (HKAS 39)/ Financial assets at FVOCI (HKFRS 9)							
Investment securities	–	–	–	–	–	82,210	82,210
Loan commitments and financial guarantee contracts							
Loan commitments	–	–	–	–	–	218,554	218,554
	1,326,977	–	–	–	–	540,175	1,867,152

* Included within this measurement category are other financial assets measured at amortised cost, which include intergroup receivables and other receivables. Management considers the expected credit losses on these assets without loss history as remote.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CHANGES IN ACCOUNTING POLICIES (continued)

(b) HKFRS 15 Revenue from Contracts with Customers

HKFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced HKAS 18 Revenue, HKAS 11 Construction Contracts and related interpretations.

The Group initially applied HKFRS 15 on January 1, 2018 retrospectively in accordance with HKAS 8 without any practical expedients. The timing or amount of the Group's fees and commission income from contracts with customers was not impacted by the adoption of HKFRS 15. The application of HKFRS 15 did not result in material financial impact.

The performance obligations and revenue recognition policies of fees and commission income of the Group is set out in Note 4(m)(ii).

6 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The measurement of the expected credit loss allowances for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions, as the credit risk exposure varies with changes in future economic and market conditions, credit behavior (e.g., the likelihood of customers defaulting and the resulting losses), expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties.

The Group measures credit risk using Probability of Default ("PD"), Exposure at Default ("EAD") and Loss Given Default ("LGD"). This is similar to the approach used for the purposes of measuring expected credit losses under HKFRS 9. Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in Note 8(a), which also sets out key sensitivities of the ECL to changes in these elements.

A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing groups of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgements and estimates made by the Group in the above areas is set out in Note 8(a).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

7 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED THAT ARE RELEVANT TO THE GROUP BUT NOT YET EFFECTIVE

The Group has not applied the following new and revised HKFRSs and HKASs that have been issued that are relevant to the Group but are not yet effective, in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except the following set out below:

HKAS 28 (2011) Investments in Associates and Joint Ventures

These amendments address an inconsistency between HKFRS 10 and HKAS 28 in the sale or contribution of assets between an investor and its associate or joint venture. A full gain or loss is recognised when a transaction involves a business. A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if those assets are in a subsidiary. The effective date of this amendment is yet to be determined. The application of this new standard has no material financial impact to the Group.

Amendments to HKAS 28 clarify that companies account for long-term interests in an associate or joint venture apply HKFRS 9 Financial Instruments to which the equity method is not applied.

Annual Improvements to HKFRSs 2015–2017 Cycle

This cycle of annual improvements contains amendments to four standards. Among them, HKFRS 3 Business Combinations has clarified that when a party to a joint arrangement obtains control of a business that is a joint operation and has rights and obligations to the joint operation immediately before the acquisition date, the transaction is a business combination achieved in stages. HKFRS 11 Joint Arrangements has clarified that, when a party participating in, but not having a joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business, previously held interests in the joint operation are not remeasured. HKAS 12 Income Taxes has clarified that an entity shall recognise the income tax consequences of dividends when it recognises a liability to pay a dividend. HKAS 23 Borrowing Costs has clarified the criteria of borrowing costs eligible for capitalisation.

HKFRS 16 Leases

The Group will apply the standard from its mandatory adoption of January 1, 2019. The Group intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. All right-of-use assets will be measured at the amount of the lease liabilities on adoption (adjusted for any prepaid or accrued lease expenses).

HKFRS 16 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 leased 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 change.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

7 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED THAT ARE RELEVANT TO THE GROUP BUT NOT YET EFFECTIVE (continued)

HKFRS 16 Leases (continued)

The Group has set up a project team which has reviewed all of the Group's leasing arrangements as of December 31, 2018 in light of the new lease accounting rules in HKFRS 16. The standard will affect primarily the accounting for Group's operating leases. The Group, as a lessee, applied practical expedients on a lease-by-lease basis in translation. As at the reporting date, the Group has non-cancellable operating lease commitments of \$2,331,604, see Note 48. Of these commitments, approximately \$323,797 relate to short-term leases and low value leases which will both be recognised on a straight-line basis as expense in profit or loss.

For the remaining lease commitments the Group expects to recognise right-of-use assets of approximately \$1,899,988 on January 1, 2019, lease liabilities of \$1,954,697 (after adjustments for prepayments and accrued lease payments as at December 31, 2018).

The Group expects that net profit after tax will decrease by approximately \$4,104 for 2019 as a result of adopting the new rules.

Operating cash flows will increase and financing cash flows decrease by approximately \$258,559 as repayment of the principal portion of the lease liabilities will be classified as cash flows from financing activities.

The Group's activities as a lessor are not material and hence the Group does not expect any significant impact on the financial statements. However, some additional disclosures will be required from 2019.

HKFRS 17 Insurance Contracts

HKFRS 17 supersedes HKFRS 4 Insurance Contracts. The new standard aims to provide a common global insurance accounting standard that makes the insurers financial statements more useful and consistent.

HKAS 19 Employee Benefits

The amendments require a company to use updated assumptions to determine current service cost and net interest for the remainder of the reporting period after a change is made to a plan.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT

The Group derives the majority of its revenue from managing risk from customer transactions. Effectively assessing and managing all types of risk is central to the success of the Group. Apart from a prudential risk culture, the Group has established risk governance, structure, risk management processes including policies and procedures for the identification, measurement, control and monitoring of credit, liquidity, operational, market and capital risks, by means of which risk and return are evaluated with the goal of producing sustainable revenue and reducing income volatilities.

The Board of Directors of the Bank, with the assistance of the Risk Committee, provides effective oversight over the affairs of the Group, the governance framework and practices through delegation of authority to the functional committees and the senior management. The Risk Committee shall review regularly the Group's Risk Appetite Statement and recommend for the Board's approval. The Chief Executive Officer is responsible for overseeing all lines of businesses within the Group, supported by the Executive Committee of the Board of Directors comprising the senior management members. In addition, led by the senior management members, the functional committees including the Risk Management Committee, the Asset and Liability Committee ("ALCO"), the Information Technology Committee, Credit Committee, and Internal Control, Compliance and Operations Committee approve policies and procedures formulated by various working committees and functional management to identify, analyse, manage and control credit risk, market risk, liquidity risk, operational risk and capital risks through the use of reliable and up-to-date management and information systems. Policies and procedures are updated on an ongoing basis to reflect changes in markets, products and industry best practices. The internal auditors also perform risk-based audits to ensure the soundness of the governance and compliance with the relevant policies and procedures.

The Group has established policies and procedures to govern the launch of new products and services. A functional committee, Product Innovation and Approval Committee, is delegated by the Executive Committee of the Board of Directors to review and approve new product and service. Comprising of management members from key functional areas, the functional committee convenes meetings to assess and discuss product proposals of the Group. This aims to ensure that risks are properly identified and effective control measures are in place to mitigate any risks involved prior to the roll-out of any new products or services.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk

Credit risk is the risk of loss arising from a borrower's or counterparty's inability to meet its obligations. Credit risk exists in the Group's loans, leases, credit cards, trade finance and treasury transactions. There is also credit risk in off-balance sheet financial arrangements such as loan commitments, trade-related contingencies and transaction-related contingencies.

The Group has appointed the intermediate holding company, China Construction Bank Corporation, as its credit adviser. Risk Management Division is responsible for providing centralised management and control of different types of risks including credit risk. Whereas credit approval matters are handled by the Credit Division. Both divisions are independent of the business units, and supervised by the Deputy Chief Executive overseeing Risk Management. In addition, functional committees, namely Risk Management Committee and Credit Committee are set up under the Executive Committee and the Risk Committee to provide guidance in the respective risk areas. The Risk Management Committee is a central forum for overseeing the Group's overall asset quality as well as resolving all the important risk or governance issues on credit risk, operational risk, market risk, liquidity risk, interest rate risk, strategic risk and reputation risk. It is chaired by the Deputy Chief Executive overseeing Risk Management or the Chief Risk Officer (also the Head of Risk Management Division), and the other members are the Head of Legal and Compliance Division, the Head of Finance Division, the Deputy Head of Risk Management Division supervising Operational Risk and the Head of Market Risk. The Credit Committee is responsible for loan quality maintenance, authority delegation, credit related policy-making and maintenance, credit approval and credit risk management issues. It is chaired by the Deputy Chief Executive overseeing Risk Management or the Chief Risk Officer (also the Head of Risk Management Division), and the other members are Head of Credit Division, Deputy Head of Risk Management Division and designated individual credit approver(s).

Overall, credit risks of the Group are managed through the following processes:

- Ensuring the Group's risk profile is in line with the risk appetite and strategies set by the Bank;
- Establishing credit policies and procedures of the Group and issuing lending and monitoring guidelines to credit officers and business units. Credit policies and procedures are constantly revisited and updated whenever warranted to accommodate portfolio development, market changes and regulatory requirements;
- Making appropriate lending authority delegation via the Credit Committee according to the risk, size and nature of the transactions;

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

- Maintaining the internal risk rating system for measurement of credit risk exposures. The Group adopts a two dimensional risk rating methodology for the corporate portfolio, for which risk ratings are assigned to the obligor and facility separately. This system provides granularity in the rating scale and hence more refined risk differentiation for better risk and reward analysis and enhanced risk quantification. For a certain part of the consumer portfolio, in-house scoring models are also adopted to measure the credit risk involved;
- Monitoring and controlling large exposures, connected lending, product and industry concentration based on established policies and internal risk limits to ensure prudent credit decisions are made and that the Group complies with statutory requirements and supervisory guidelines;
- Monitoring criticised loans and managing recoveries of problem assets. Collection and problem asset management are separately handled by specialised teams with the relevant experience and expert knowledge;
- Assessing collective and individual loan impairment losses and allowances regularly to ensure the adequacy of impairment allowances;
- Managing and monitoring the Group's loan quality;
- Supervising the stress-testing programme to provide a forward-looking assessment of the Group's risk exposures under stressed conditions, and enable the Group to project tail risks on a bank-wide basis, to quantify such potential losses and the impact on the Bank in terms of profitability, liquidity and capital adequacy; and
- Co-ordinating and driving credit related initiatives throughout the Group to ensure compliance with regulatory requirements.

(i) Credit risk for advances

In addition to underwriting standards, the Group manages credit risks through an effective and prudent credit approval process. In making credit recommendations and decisions, only officers with appropriate banking experience and product knowledge are delegated with credit approval authorities. There is a post-approval review process where applicable to ensure quality of the credit decisions made, to identify negative trends which need attention or actions, and to ensure adherence to existing policies and procedures.

In the approval process, the credit officers assess the purpose and structure of the loan, the ability of a particular borrower or counterparty to service the proposed facilities, as well as the nature of the underlying collateral where applicable. Credit approval guidelines are issued from time to time to enhance the credit acceptance process as appropriate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(i) Credit risk for advances (continued)

The Group categorises its loans and leases into either consumer or corporate and commercial credits and monitors their risks separately as discussed below:

- Consumer credits are grouped by products and their risk attributes for purposes of evaluating credit risk, and on-going monitoring of asset quality. Standard credit underwriting criteria are established and exceptional approvals for deviations from such criteria are required and monitored.
- Corporate and commercial credits are evaluated for customers' default risk, taking into consideration the related credit enhancements. To support the credit assessment, internal risk ratings will be assigned to customers. These risk ratings are monitored regularly and updated upon any changes in the borrower's or counterparty's financial position, repayment ability and the related credit enhancements.

(ii) Credit risk for treasury transactions

The credit risk of the Group's investment in debt securities and treasury hedging transactions is managed by the use of both internal and external credit ratings and credit limits set on individual counterparties. Internal and external credit ratings, and news on each counterparty are closely tracked and monitored.

(iii) Credit-related commitments

The risks involved in credit-related commitments and contingencies are essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are therefore subject to the same credit approval, portfolio maintenance and collateral requirements as for customers applying for loans.

(iv) Collateral and other credit enhancements

The Group obtains collateral in respect of loans advanced to mitigate the credit risk of the transactions and has established policies and guidelines on the eligibility and valuation of collateral and other credit enhancements. However, the approval of credits will be based on the assessment of debt servicing ability rather than solely dependent on collateral or other credit enhancements. The main collateral types and credit enhancements include charges over properties, standby letters of credit issued by banks, securities, deposits, account receivables, vehicles and guarantees.

(v) Risk concentration

The Group sets various risk limits to control exposure to countries, individual counterparties, industries, intra-group exposures and loan portfolios to avoid excessive risk concentration.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(vi) Credit review and audit

The internal auditors conduct periodic reviews and independent audits of the Group's credit portfolio and credit risk management process. The purpose is to ensure due compliance with established credit policies and procedures, and to evaluate the effectiveness of the credit management process and control mechanism. The results of these reviews and audits are regularly reported to the Audit Committee at the Board of Directors level for effective oversight and monitoring.

(vii) Maximum exposure

	2018	2017
Credit risk exposures relating to assets in statement of financial position by class are as follows:		
Cash and balances with banks and central banks	78,238,697	81,673,241
Placements with banks	31,753,841	17,997,303
Advances to banks	–	262,498
Financial assets held under resale agreements	1,514,983	–
Advances to customers and trade bills	254,471,410	288,009,874
Financial assets measured at fair value through profit or loss	3,816,227	–
Financial assets measured at fair value through other comprehensive income — debt securities	86,696,690	–
Financial assets measured at amortised cost	12,065,832	–
Available-for-sale financial assets — debt securities	–	98,914,120
Held-to-maturity investments	–	17,458,857
Derivative financial instruments	2,756,470	6,788,337
Other assets	3,872,541	3,914,861
Credit risk exposures relating to items not included in statement of financial position are as follows:		
Financial guarantees	10,600,214	4,645,849
Loan commitments and other credit related commitments	78,594,028	80,635,213
	564,380,933	600,300,153

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(vii) Maximum exposure (continued)

The above table shows the maximum credit risk exposure to the Group as at December 31, 2018 and 2017, without taking account of any collateral held, master netting agreements 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 loan commitments and other credit related 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 sought on these balances.

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 banks and other financial institutions	These exposures are generally considered to be low risk due to the nature of the counterparties. Collateral is generally not sought on these balances.
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.
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 if both the Bank and the counterparty elect to settle on a net basis or in the event of default of either party.
Financial assets measured at fair value through other comprehensive income (HKFRS 9)/Available-for-sale financial assets — debt securities (HKAS 39)	The fair values of these securities have reflected the credit risk. No collateral is sought directly from the issuer or the counterparty.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(vii) Maximum exposure (continued)

Credit risk mitigation, collateral and other credit enhancements (continued)

Financial assets measured at amortised cost	The amortised costs of these securities have reflected the credit risk. No collateral is sought directly from the issuer or the counterparty.
Financial assets held under resale agreements	These exposures are secured. Types of collaterals include securities issued by government and policy banks. These issuers are generally considered to be low risk.
Advances to customers and trade bills	These exposures are secured, partially secured or unsecured depending on the type of customers and the products offered to them. Types of collaterals include residential properties, other properties, standby letters of credit acceptable to the Group and bank deposits, etc. Other credit enhancements mainly represent recognised guarantee. Analysis of gross advances to customers covered by collateral is listed in Unaudited Supplementary Financial Information Note 4(a)(i).
Contingent liabilities and commitments	The components and nature of contingent liabilities and commitments is disclosed in Note 46. Regarding the commitments that are unconditionally cancellable without prior notice, the Group would assess the necessity to withdraw the credit line in case the credit quality of a borrower deteriorates. Accordingly, these commitments do not expose the Group to significant credit risk. The exposure on commitments that are not unconditionally cancellable including letter of credit, letter of guarantee issued and other loan commitments and credit related liabilities are secured, partially secured or unsecured depending on the type of customers and the products offered to them.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(viii) Credit quality of gross advances to customers and trade bills and gross advances to banks

	2017
Gross advances to customers	
Neither past due nor impaired	282,313,138
Past due but not impaired	5,078,696
Impaired	635,678
	288,027,512
Trade bills	
Neither past due nor impaired	1,330,163
Past due but not impaired	438
Impaired	140,132
	1,470,733
Gross advances to banks	
Neither past due nor impaired	262,498

(1) Neither past due nor impaired

The credit grading of gross advances and trade bills and gross advances to banks that were neither past due nor impaired can be analysed by reference to the loan classification system as defined by the Hong Kong Monetary Authority ("HKMA") as follows:

	2017
Gross advances to customers	
Pass	281,245,850
Special mention	1,067,288
	282,313,138
Trade bills	
Pass	1,330,163
Gross advances to banks	
Pass	262,498

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(viii) Credit quality of gross advances to customers and trade bills and gross advances to banks (continued)

(2) *The aging analysis of gross advances to customers and trade bills which were past due but not impaired are as follows:*

	2017
Gross advances to customers	
Overdue three months or less	5,078,696
Trade bills	
Overdue three months or less	438

(3) *Past due advances and trade bills*

Any advances and trade bills are categorised as past due advances and trade bills when there are unpaid balances after their contractual maturity dates.

(4) *Impaired advances and trade bills*

Classified or impaired advances to customers and trade bills follow the definition set out in the Banking (Disclosure) Rules and represent advances which are either classified as "sub-standard" or below under the Group's classification of loan quality, or individually assessed to be impaired. Details are shown in Note 23(e).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(ix) Credit quality of financial assets other than advances

The following table presents an analysis of investments in debt securities by rating agency designation at the reporting date, based on Standard and Poor's Ratings Services, or their equivalents, to the respective issues of the debt securities. In the absence of such issue ratings, the ratings designated for the issuers are reported. If there are different ratings for the same securities, the securities are reported against the lower rating.

	2017
AAA	5,018,238
AA+ to A-	97,968,052
Lower than A-	8,227,004
Unrated	5,168,741
	116,382,035
Of which classified as	
Available-for-sale financial assets	98,914,120
Held-to-maturity investments	17,467,915
	116,382,035

(x) Collateral and other credit enhancements held against financial assets

Advances to customers and trade bills

As at December 31, 2018, the estimated fair value of the collateral and other credit enhancements held against lifetime ECL credit-impaired advances to customers and trade bills is \$549,723.

Collateral mainly includes residential properties, commercial and industrial properties and automobiles.

Financial assets held under resale agreements

Detail of the fair value of the collateral held against the financial assets under resale agreements described in Note 50.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(x) Collateral and other credit enhancements held against financial assets (continued)

Derivatives

The International Swaps and Derivatives Association ("ISDA") Master Agreement is our preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of over the counter ("OTC") products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or another pre-agreed termination event occurs. It is common, and the Group's preferred practice, for the parties to execute a Credit Support Annex ("CSA") in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the counterparty risk inherent in outstanding positions. The majority of our CSAs are with financial institutional clients.

(xi) Repossession of collateral

During the year, the Group obtained assets by taking possession of collateral with the carrying amount as follows:

	2018	2017
Nature of collateral		
Residential properties	–	55,758
Other assets	369	55
	369	55,813

(xii) Expected credit loss measurement

HKFRS 9 outlines a "three-stage" model for impairment based on changes in credit quality since initial recognition as summarised as below:

A financial instrument that is not credit-impaired on initial recognition is classified under Stage 1 and has its credit risk continuously monitored by the Group. If a significant increase in credit risk ("SICR") since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired. If the financial instrument is credit-impaired, the financial instrument is then moved to Stage 3.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xii) Expected credit loss measurement (continued)

Financial instruments in Stage 1 have their ECL measured at the amount equal to the portion of lifetime expected credit losses that result from possible default events within the next 12 months. Instruments in Stage 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. A key and fundamental concept in measuring ECL in accordance with HKFRS 9 is that forward looking information should be considered. Separately, for purchased or originated credit-impaired financial assets, since those financial assets are credit-impaired on initial recognition, their ECL is always measured on a lifetime basis.

The financial instruments are measured internally by their internal credit ratings ranging from 1 to 19 based on the borrowers' repayment ability and likelihood of individual counterparties being default. Then, as part of internal key management reporting, the Group maps the internal credit ratings by their credit quality at Stage 1 (Pass/Normal), Stage 2 (Special-mentioned), Stage 3 (Sub-standard, Doubtful and Loss) respectively.

(1) *Significant increase in credit risk (SICR)*

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analyses, based on the Group's historical experience and expert credit assessment, and forward-looking information.

The Group uses four criteria for determining whether there has been a significant increase in credit risk:

- Notch downgrade;
- Special Mention;
- Qualitative indicators; and
- A backstop of 30 days past due.

For notch downgrade the objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing the credit ratings of corresponding obligor between two dates, i.e. the reporting date and the initial recognition date of the exposure ("Notch Difference").

The Notch Difference is estimated for each obligor at the reporting date, whenever it exceeds the relative notch difference threshold, SICR is identified. The average notch downgraded of each obligor to be identified as SICR is 5.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xii) Expected credit loss measurement (continued)

(1) Significant increase in credit risk (SICR) (continued)

Qualitative Indicators

If the borrower is on the watch list and meets one or more of following criteria:

- Significant increase in credit spread;
- Significant adverse change in business, financial and/or economic conditions in which the borrower operates;
- Actual or expected significant adverse change in operating results of the borrower; and
- Early signs of liquidity problems such as delay in servicing of trade creditors/loans.

The assessment of SICR is performed on an annual basis at a portfolio level for all financial instruments held by the Group. In relation to wholesale financial instruments, where a watch list is used to monitor credit risk, this assessment is performed at the counterparty level on a periodic basis. The criteria used to identify SICR are monitored and reviewed on an annual basis.

(2) Backstop

A backstop is applied and the financial instrument considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on the contractual payments.

The Group has not used the low credit risk exemption for any financial instruments in the year ended 31 December 2018.

(3) Definition of default and credit-impaired assets

The Group defines a financial instrument as in default and credit-impaired, when it meets one or more of the following criteria:

- borrower is more than 90 days past due on its contractual payments;
- significant financial difficulty of the borrower or issuer;
- a breach of contract, such as a default or delinquency in interest or principal payments;

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xii) Expected credit loss measurement (continued)

(3) Definition of default and credit-impaired assets (continued)

- the Group, for economic or legal reasons and in relation to the borrower's or issuer's financial difficulty, granting to the borrower a concession that the Group would not otherwise consider;
- restructure of the borrowing terms as a result of deterioration of the financial position;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- significant decrease in market value of the collateral and the repayment ability of borrowers are in doubt;
- disappearance of an active market for financial assets because of significant financial event of borrowers;
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Group, including adverse changes in the payment status of borrowers in the Group, an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices in the relevant area, or adverse changes in industry conditions that affect the borrowers in the Group;
- significant changes in the technological, market, economic or legal environment that have an adverse effect on the borrower or issuer;
- a significant or prolonged decline in the fair value of an investment below its cost; and
- other objective evidence indicating there is an impairment of the financial asset.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default ("PD"), Exposure at Default ("EAD") and Loss Given Default ("LGD") throughout the Group's expected loss calculations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xii) Expected credit loss measurement (continued)

(4) *Measuring ECL — Explanation of inputs, assumptions and estimation techniques*

The Expected Credit Loss ("ECL") is measured on either a 12-month (12M) or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. The Group will account for expected credit losses within the next 12 months as Stage 1 and to recognise lifetime expected credit losses as Stage 2 when there has been a significant increase in credit risk since initial recognition. Lifetime expected credit losses will be also recognised for credit-impaired financial instruments as Stage 3. Expected credit losses are the discounted product of the PD, EAD and LGD, defined as follows:

The PD represents the likelihood of a borrower defaulting on its financial obligation.

EAD is based on the amounts the Group expected to be owed at the time of default.

LGD represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD).

The 12-month ECL is determined by projecting the PD, LGD and EAD for each individual exposure or collective segment. These three components are multiplied together. This effectively calculates an ECL for coming 12-months, which is then discounted back to the reporting date. The discount rate used in ECL calculation is the original effective interest rate or an approximation thereof. The lifetime ECL is developed by summing all ECL throughout the expected lifetime of the financial instruments. The expected lifetime is determined by historical data for revolving products or actual remaining tenor for instalment products.

For revolving products, the exposure at default is predicted by taking current drawn balance and adding a "credit conversion factor" or "Utilisation Rate", which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type based on analysis of the Group's historical default data.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xii) Expected credit loss measurement (continued)

(4) *Measuring ECL — Explanation of inputs, assumptions and estimation techniques (continued)*

The 12-month and lifetime LGDs are determined based on the factors which impact the recoveries made post default. These vary by product type.

- For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/book value due to forced sales, time to repossession and recovery costs observed; and
- For unsecured products, LGDs are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGDs are influenced by collection strategies, including contracted debt sales and price.

Forward-looking economic information is also included in determining the 12-month ECL and lifetime ECL. These assumptions vary by product type.

There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

(5) *Forward-looking information incorporated in the ECL models*

The calculation of ECL incorporates forward-looking information. The Group has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio.

These economic variables and their associated impact on the PD and LGD vary by financial instrument. Expert judgment has also been applied in this process. Forecasts of these economic variables (the “base economic scenario”) are provided by the external economic data provider on a monthly basis and provide the best estimate view of the economy over next five years. After five years, to project the economic variables out of the full remaining lifetime of each instrument, a static approach has been used. The impact of these economic variables on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact change these variables have had historically on default rates and on the components of LGD and EAD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xii) Expected credit loss measurement (continued)

(5) Forward-looking information incorporated in the ECL models (continued)

In addition to the base economic scenario, the Group also adopt other possible scenarios, upside and downside economic scenarios, along with scenario weightings. The scenario weightings are determined by a combination of statistical analysis and expert credit judgement, taking account of the range of possible outcomes each chosen scenario is representative of. The assessment of SICR is performed using the Notch Difference under each of the base and the other scenarios, along with qualitative and backstop indicators. This determines whether the whole financial instrument is in Stage 1, Stage 2 or Stage 3 and hence whether 12-month or lifetime ECL should be recorded. Following this assessment, the Group measures ECL as either a probability weighted 12 month ECL (Stage 1) or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting. In 2018, the average weight of upside, base and downside scenarios are 0.15, 0.51 and 0.34.

Economic variable assumptions

The most significant period-end assumptions of these economic factors used for the ECL estimate as at January 1, 2018 and December 31, 2018 are set out below.

The variables are the average of probability weighted values between Years 2018–2022 and between Years 2019–2023 respectively.

	As at December 31, 2018	As at January 1, 2018
Hong Kong GDP Growth Rate	+2.96%	+2.85%
Hong Kong Residential Property Price Index	+0.44%	+1.03%
Hong Kong Unemployment Rate	4.44%	4.26%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xii) Expected credit loss measurement (continued)

(5) Forward-looking information incorporated in the ECL models (continued)

Sensitivity analysis

The Hong Kong Residential Property Price Index has been identified as the significant economic variables affecting ECL and the sensitivity of this economic factor has been demonstrated as below.

House price index	-10%	2018 No change	+10%
Impact on ECL	32,229	–	(29,806)

Sensitivity analysis for probability weighted average for Good, Bad & Base Scenarios:

Probability Weighted Average Sensitivity	2018 Change in ECL allowances (%)
Shifting 5% probability from Base Scenario to Good Scenario	-0.65%
Shifting 5% probability from Base Scenario to Bad Scenario	+7.91%

Sensitivity analysis of the change in ECL allowances assuming all Early Warning Customers transfer from Stage 1 (12-month ECL) to Stage 2 (Lifetime ECL):

Stage 1 to Stage 2 Sensitivity	2018 Change in ECL allowances
Early Warning Obligor to Stage 2	28,400

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xii) Expected credit loss measurement (continued)

(6) *Grouping of instruments for losses measured on a collective basis*

For expected credit loss provisions modelled on a collective basis, a grouping of exposures is performed on the basis of shared risk characteristics, such that risk exposures within a group are considered homogeneous. In performing this grouping, there must be sufficient information for the Group to achieve statistical credibility. Where sufficient information is not available internally, the Group has considered benchmarking internal/external supplementary data for modelling purposes. The characteristics and any supplementary data used to determine groupings are outlined below:

Retail — Groupings for collective measurement

Credit Rating Band/Day Past Due

Product type (e.g. residential mortgage, overdraft, credit card loan)

Wholesale — Groupings for collective measurement

Credit Rating band

Customer Type & Product Type

The following exposures are assessed individually:

Retail

Stage 3 loans — Credit-impaired or repossession

Wholesale

Stage 3 facilities — Credit-impaired or repossession

The appropriateness of grouping is monitored and reviewed on periodic basis by the Risk Management Division.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xiii) Distribution of financial instruments to which the impairment requirements in HKFRS 9 are applied, by credit quality (in accordance with Note 8(a)(xii)) and by staging:

	Gross carrying/notional amount						ECL allowances	Net amount
	Normal	Special mentioned	Sub-standard	Doubtful	Loss	Total		
On balance sheet:								
Placements with and advances to bank at amortised cost — stage 1	31,758,244	-	-	-	-	31,758,244	(4,403)	31,753,841
Advances to customer and trade bills at amortised cost:								
Advances to customers	252,552,166	2,990,087	659,381	7,148	121,801	256,330,583	(2,066,893)	254,263,690
Stage 1	240,561,546	939	-	-	-	240,562,485	(1,089,388)	239,473,097
Stage 2	11,990,620	2,988,755	-	-	-	14,979,375	(780,326)	14,199,049
Stage 3	-	393	659,381	7,148	121,801	788,723	(197,179)	591,544
Trade bills	207,756	-	-	-	3,052	210,808	(3,088)	207,720
Stage 1	207,756	-	-	-	-	207,756	(36)	207,720
Stage 3	-	-	-	-	3,052	3,052	(3,052)	-
Other financial assets measured at amortised cost:								
Cash and balances with banks and central banks — stage 1	78,240,159	-	-	-	-	78,240,159	(1,462)	78,238,697
Financial assets held under resale agreements — stage 1	1,514,983	-	-	-	-	1,514,983	-	1,514,983
Financial assets measured at amortised cost — stage 1	12,090,571	-	-	-	-	12,090,571	(24,739)	12,065,832

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(xiii) Distribution of financial instruments to which the impairment requirements in HKFRS 9 are applied, by credit quality (in accordance with Note 8(a)(xii)) and by staging: (continued)

	Gross carrying/notional amount						ECL allowances	Net amount
	Normal	Special mentioned	Sub-standard	Doubtful	Loss	Total		
On balance sheet: (continued)								
Other assets	3,982,469	3,580	4,646	1	1,566	3,992,262	(6,317)	3,985,945
Stage 1	3,980,726	1	-	-	-	3,980,727	(4,783)	3,975,944
Stage 2	1,743	3,534	-	-	-	5,277	(1,483)	3,794
Stage 3	-	45	4,646	1	1,566	6,258	(51)	6,207
Financial assets measured at fair value through other comprehensive income — stage 1	86,744,559	-	-	-	-	86,744,559	(66,700)	86,677,859
Total gross carrying amount/ fair value on balance sheet	467,090,907	2,993,667	664,027	7,149	126,419	470,882,169	(2,173,602)	468,708,567
Off balance sheet:								
Loans and other credit related commitments — stage 1	88,609,788	-	-	-	-	88,609,788	(201,896)	88,407,892
Total nominal amount off balance sheet	88,609,788	-	-	-	-	88,609,788	(201,896)	88,407,892
Total at December 31, 2018	555,700,695	2,993,667	664,027	7,149	126,419	559,491,957	(2,375,498)	557,116,459

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk

Liquidity risk is the risk that the Group may not be able to fund the increase in assets or meet obligations as they fall due without incurring unacceptable losses. This may be caused by market disruption or liquidity squeeze whereby the Group may only unwind specific exposures at significantly discounted values.

The purpose of liquidity management is to ensure sufficient cash flows to meet all financial commitments and to capitalise on opportunities for business expansion. This includes the Group's ability to meet deposit withdrawals either on demand or at contractual maturity, to repay borrowings as they mature, to comply with the statutory liquidity ratio, and to make new loans and investments as opportunities arise.

The Bank has established a set of liquidity risk management policies which set out the liquidity risk management framework of the Bank according to the requirements of HKMA's Supervisory Policy Manuals "Regulatory Framework for Supervision of Liquidity Risk (LM1)" and "Sound Systems and Controls for Liquidity Risk Management (LM2)" updated in 2016.

Liquidity risk management framework

The Board of Directors is ultimately responsible for having an effective liquidity risk management framework in place. Risk Committee ("RC") is one of the committees set up under the Board. The duties of RC are to approve a risk management framework that is sound and in line with the Group's business objectives and risk profile, to approve key liquidity risk management policies and to ensure that the liquidity management framework and policies are duly implemented and maintained by the Group.

Risk Management Committee ("RMC") is set up under the Risk Committee and the Executive Committee to oversee the Group's overall asset quality as well as resolve all important risk-related or governance issues including those on liquidity risk. The RMC is responsible for providing guidance and overseeing the Group's liquidity risk management strategy and development; review or approve liquidity risk management policies and review the Bank's liquidity risk position.

Asset and Liability Committee ("ALCO") is a functional committee set up under the Executive Committee to oversee the liquidity risk management in light of the business strategy.

Regular meetings of various committees are held to review the compliance status of liquidity measurements and the needs for change in strategy and policy. Daily liquidity management is performed by the Treasury. Risk Management Division is responsible for the daily monitoring of the liquidity limits and measurements, and submits regular reports of the liquidity profile to ALCO and RMC. Internal Audit periodically performs independent reviews to ensure effectiveness of the Group's liquidity risk management framework and implementation of the established policies.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Funding Strategies

The objective of the Bank's funding strategy is to strive for a balance between business growth opportunities and funding stability. The Bank seeks to maintain diversified and stable funding sources with an appropriate mix of liabilities including customer deposits, interbank borrowings, issuance of negotiable certificates of deposit and debt instruments.

The annual budgeted statement of financial position of the Bank, which contains a plan for the composition of various sources of liabilities, is approved by the Board of Directors in each calendar year. Various considerations such as the target business growth, market sentiment, target financial ratios and regulatory requirements would be taken into account in the process of budgeting.

To manage currency mismatch and avoid over-reliance on the currency swap market, the Bank sets limits on swapped fund ratios of major currency positions which are subject to daily monitoring. The swapped fund ratios limit the extent of one currency's assets being funded by other currencies through the swap market.

The funding support provided by China Construction Bank Head Office is one of the key sources of liquidity backstop during times of liquidity stress.

Liquidity cushion

The extent of the Bank's maturity mismatch and the sufficiency of liquidity cushion are governed by various liquidity metrics and measurement tools such as maturity mismatch limits and liquidity stress test.

The marketability of the Bank's liquidity cushion is periodically reviewed in keeping with market conditions. The size of the liquidity cushion being maintained must be sufficient to meet intraday payments and settlement obligations on a timely basis under both normal and stressed conditions.

Stress scenario analysis

Liquidity Stress Testing is regularly conducted to project the Bank's cash flows under stress scenarios for evaluation of the sufficiency of the liquidity cushion. The stress scenarios cover institution-specific crisis scenario, general market crisis scenario and combined crisis scenario. The cash flows under each stress scenario are determined by applying a set of prescribed stress assumptions to the Bank's cash flow projection. Customer behavioural patterns of some products including customer deposits are applied in the stress test. The stress test results are regularly reported to the RMC and ALCO. The definition of liquidity cushion being held by the Bank is consistent to the definition of High Quality Liquid Assets for purposes of determining the Bank's Liquidity Coverage Ratio. The liquidity cushion should be able to cover projected cash outflows under various prescribed stress scenarios.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Contingency Funding Plan (CFP)

The Bank has a CFP that sets out the Bank's strategies for identifying the occurrence of a liquidity event and the operational procedures for addressing such emergency situation if it really takes place. The CFP contains a set of early warning indicators that helps to identify any emerging liquidity risks at an early stage. The CFP also includes detailed action steps and properly assigned responsibilities within the liquidity risk management framework. The list of potential funding sources, with due consideration of their reliability, priority and the expected available time during liquidity crisis, is included.

The Bank has not entered into any agreement or arrangement under which the Bank has to fulfil contingent funding obligations.

Liquidity measurements

(i) Maturity analysis

The maturity analysis lists out the assets and liabilities by their remaining maturities into different time buckets. The gap amount for each time bucket represents the liquidity exposure after netting the assets and liabilities maturing in the same bucket. The Group maintains daily gap limits for each time bucket to manage liquidity risk. For some liabilities without prescribed maturity date such as demand deposits from customers, the liabilities are listed in the bucket of "Repayable on Demand", resulting in a larger negative gap in this time bucket. The Group considers this is an inherent risk to a consumer and commercial bank that offers demand deposit products to customers. By experience demand deposits have stable outstanding and the negative gap does not materialise into an immediate outflow of liquidity. However, to mitigate the liquidity risk, inter-bank and other borrowing facilities, as well as contingency funding plan are in place to cover withdrawals at unexpected levels of demand. Apart from customer deposits, the Bank has other sources to fund the earning assets, such as inter-bank borrowings, certificates of deposit issued, funding support from the parent bank and CCBA's share capital.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Liquidity measurements (continued)

(i) Maturity analysis (continued)

The table below sets out the maturity profile of assets and liabilities analysed by the remaining period to repayment as at the reporting date:

As at December 31, 2018

	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated	Total
Assets								
Cash and balances with banks and central banks	9,471,052	68,767,645	-	-	-	-	-	78,238,697
Placements with banks	-	-	26,196,110	5,557,731	-	-	-	31,753,841
Advances to customers and trade bills	1,644,755	49,217,967	16,427,878	44,863,650	103,427,172	38,889,988	-	254,471,410
Financial assets held under resale agreements	-	-	1,514,983	-	-	-	-	1,514,983
Financial assets measured at fair value through profit or loss	9,689	264,048	20,571	788,294	2,143,168	314,103	276,354	3,816,227
Financial assets measured at fair value through other comprehensive income	-	1,057,630	10,403,539	27,225,936	46,161,867	1,847,718	47,869	86,744,559
Financial assets measured at amortised cost	-	-	751,662	5,447,284	5,866,886	-	-	12,065,832
Derivative financial instruments	-	737,855	325,626	668,824	998,584	25,581	-	2,756,470
Interest in a joint venture	-	-	-	-	-	-	1,955,713	1,955,713
Interest in an associate	-	-	-	-	-	-	69,223	69,223
Deferred tax assets	-	-	-	-	-	-	396,042	396,042
Fixed assets	-	-	-	-	-	-	3,200,961	3,200,961
Other assets	1,404	1,848,740	755,679	750,819	553,379	19,616	56,308	3,985,945
Total assets	11,126,900	121,893,885	56,396,048	85,302,538	159,151,056	41,097,006	6,002,470	480,969,903
Liabilities								
Deposits and balances of banks	1,729,630	24,873,698	3,178,640	2,385,435	-	-	-	32,167,403
Deposits from customers	96,556,754	86,723,205	93,877,086	75,642,642	1,330,192	-	-	354,129,879
Financial assets sold under repurchase agreements	-	-	2,420,859	-	-	-	-	2,420,859
Other debt securities issued	-	-	-	8,221,574	5,612,326	682,009	-	14,515,909
Derivative financial instruments	-	690,699	402,967	1,023,782	8,942	15,852	-	2,142,242
Current tax payable	-	-	-	252,269	-	-	-	252,269
Deferred tax liabilities	-	-	-	-	-	-	21,508	21,508
Other liabilities	37,618	1,845,481	825,038	1,618,255	28,597	-	2,653,043	7,008,032
Subordinated debt	-	-	-	-	-	5,833,798	-	5,833,798
Total liabilities	98,324,002	114,133,083	100,704,590	89,143,957	6,980,057	6,531,659	2,674,551	418,491,899
Net (liabilities)/assets gap	(87,197,102)	7,760,802	(44,308,542)	(3,841,419)	152,170,999	34,565,347	3,327,919	62,478,004
Of which:								
Debt securities included in:								
— financial assets measured at fair value through other comprehensive income	-	1,057,630	10,403,539	27,225,936	46,161,867	1,847,718	-	86,696,690
— financial assets measured at amortised cost	-	-	751,662	5,447,284	5,866,886	-	-	12,065,832

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Liquidity measurements (continued)

(i) Maturity analysis (continued)

As at December 31, 2017

	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated	Total
Assets								
Cash and balances with banks and central banks	5,392,269	76,280,972	–	–	–	–	–	81,673,241
Placements with banks	–	–	10,854,026	7,143,277	–	–	–	17,997,303
Advances to banks	–	–	–	262,498	–	–	–	262,498
Advances to customers and trade bills	430,809	42,325,025	17,272,621	66,714,956	118,134,034	43,132,429	–	288,009,874
Available-for-sale financial assets	–	7,374,488	2,596,488	15,118,066	72,768,216	1,056,862	41,937	98,956,057
Held-to-maturity investments	–	–	4,000,000	1,140,000	12,318,857	–	–	17,458,857
Derivative financial instruments	–	1,499,044	1,642,519	2,683,789	939,226	23,759	–	6,788,337
Interest in a joint venture	–	–	–	–	–	–	2,044,996	2,044,996
Interest in an associate	–	–	–	–	–	–	199,912	199,912
Deferred tax assets	–	–	–	–	–	–	234,912	234,912
Fixed assets	–	–	–	–	–	–	3,325,095	3,325,095
Other assets	46,482	2,249,527	598,044	698,657	424,274	28,554	28,093	4,073,631
Total assets	5,869,560	129,729,056	36,963,698	93,761,243	204,584,607	44,241,604	5,874,945	521,024,713
Liabilities								
Deposits and balances of banks	2,623,699	60,235,867	7,749,241	36,728	2,578,087	–	–	73,223,622
Deposits from customers	83,182,075	89,789,297	101,054,309	77,955,479	1,288,173	–	–	353,269,333
Other debt securities issued	–	–	–	–	14,199,239	717,805	–	14,917,044
Derivative financial instruments	–	1,740,741	1,867,501	2,633,901	320,773	160	–	6,563,076
Current tax payable	–	–	–	167,208	–	–	–	167,208
Deferred tax liabilities	–	–	–	–	–	–	20,902	20,902
Other liabilities	6,448	2,782,736	473,989	1,371,025	273,616	–	2,826,168	7,733,982
Subordinated debt	–	–	–	–	–	5,812,111	–	5,812,111
Total liabilities	85,812,222	154,548,641	111,145,040	82,164,341	18,659,888	6,530,076	2,847,070	461,707,278
Net (liabilities)/assets gap	(79,942,662)	(24,819,585)	(74,181,342)	11,596,902	185,924,719	37,711,528	3,027,875	59,317,435
Of which:								
Debt securities included in:								
— available-for-sale financial assets	–	7,374,488	2,596,488	15,118,066	72,768,216	1,056,862	–	98,914,120
— held-to-maturity investments	–	–	4,000,000	1,140,000	12,318,857	–	–	17,458,857

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Liquidity measurements (continued)

(ii) Undiscounted cash flows by contractual maturities

The following table details the remaining contractual maturities at the reporting date of the Group's financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the reporting date) and the earliest date to pay.

As at December 31, 2018

	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated	Total
Non-derivative financial liabilities								
Deposits and balances of banks	1,729,630	24,883,719	3,193,427	2,450,155	-	-	-	32,256,931
Deposits from customers	96,556,754	86,800,999	94,254,779	76,677,880	1,383,494	-	-	355,673,906
Financial assets sold under repurchase agreements	-	-	2,436,901	-	-	-	-	2,436,901
Other debt securities issued	-	76,337	67,159	8,446,239	5,880,901	709,878	-	15,180,514
Current tax payable	-	-	-	252,269	-	-	-	252,269
Deferred tax liabilities	-	-	-	-	-	-	21,508	21,508
Other liabilities	37,618	1,845,481	825,038	1,618,255	28,597	-	2,653,043	7,008,032
Subordinated debt	-	-	124,781	124,781	998,249	6,121,612	-	7,369,423
	98,324,002	113,606,536	100,902,085	89,569,579	8,291,241	6,831,490	2,674,551	420,199,484
Cash inflow/(outflow) of derivatives settled on a net basis	-	(1,749)	186,282	371,006	445,997	294,790	-	1,296,326
Cash flow of derivatives settled on a gross basis								
— inflow	-	149,805,349	73,590,834	61,160,812	9,877,647	1,502,769	-	295,937,411
— outflow	-	149,539,530	73,699,588	61,219,314	8,562,111	638,535	-	293,659,078
Contingent liabilities and commitments								
— contingent liabilities	461,778	104,794	649,106	2,159,754	6,657,328	1,000	-	10,033,760
— commitments	53,713,318	15,786	531,265	8,751,022	15,550,015	14,622	-	78,576,028

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Liquidity measurements (continued)

(iii) Undiscounted cash flows by contractual maturities (continued)

As at December 31, 2017

	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Undated	Total
Non-derivative financial liabilities								
Deposits and balances of banks	2,623,699	60,252,524	7,782,927	36,845	2,685,144	–	–	73,381,139
Deposits from customers	83,257,877	89,863,212	101,147,384	78,030,745	1,289,525	–	–	353,588,743
Other debt securities issued	–	110,159	159,945	362,540	15,369,123	798,797	–	16,800,564
Current tax payable	–	–	–	167,208	–	–	–	167,208
Deferred tax liabilities	–	–	–	–	–	–	20,902	20,902
Other liabilities	6,448	2,782,736	473,989	1,371,025	273,616	–	2,826,168	7,733,982
Subordinated debt	–	–	124,542	124,542	996,336	6,358,968	–	7,604,388
	85,888,024	153,008,631	109,688,787	80,092,905	20,613,744	7,157,765	2,847,070	459,296,926
Cash (outflow)/inflow of derivatives settled on a net basis								
	–	(167,803)	(166,938)	(635,969)	1,000,287	419,847	–	449,424
Cash flow of derivatives settled on a gross basis								
— inflow	–	20,570,002	28,450,899	90,754,980	4,152,254	729,915	–	144,658,050
— outflow	–	20,731,273	28,746,284	91,511,462	4,244,111	203,830	–	145,436,960
Contingent liabilities and commitments								
— contingent liabilities	570,859	201,393	518,429	598,372	2,196,537	102,492	–	4,188,082
— commitments	53,002,350	3,502,310	3,185,604	7,994,150	12,806,713	144,086	–	80,635,213

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk

Market risk management by the Group

Market risk is the risk of loss arising from adverse changes in market rates and prices such as foreign exchange rates and interest rates and prices of debt securities. Market risk arises from both the Group's trading and non-trading business. A trading book consists of positions in financial instruments held either with trading intent or in order to hedge other elements of the trading book. Non-trading book records those financial instruments which are not included in the trading book. The Group's exposure to market risk arises from its day-to-day activities associated with loans, deposits, securities held for liquidity purposes and trading activities.

The Group's Risk Management Committee is responsible for overseeing the market risk of the Group. The Group's market risk framework comprises market risk management policies and control procedures with appropriate delegation of market risk limits.

The Group's trading activities are primarily related to foreign exchange and money market transactions. The Group manages its exposure to market risk through the establishment of various trading limits and the risk exposure is calculated by the Bank system and externally developed risk engine. Trading book position is monitored by both end-of-day and intraday reports. Any excess will be promptly investigated and communicated with Treasury and then reported to RMC. In addition to the overall limits, documented trading policies and procedures define acceptable boundaries within which traders can execute transactions in their assigned markets. The limits, policies and procedures, and risk measurement methodology are updated and reviewed at least annually and seek for RMC's approval to make sure the controls are sound and valid.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

Value-at-Risk ("VaR") for the Group

VaR is a technique which estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence. The Group uses VaR to measure and report the market risk position, which covers the overall FX and the trading book interest rate risk exposures. The Group sets up total VaR limit to control the market risk exposure. The standalone interest rate VaR and foreign exchange VaR are also reported below for reference. The Group adopts historical simulation approach to calculate VaR at a 99% confidence level for a one-day holding period.

The table below shows the VaR for the Group.

	2018	2017
VaR	1,351	859
VaR for interest rate risk	1,074	1,043
VaR for foreign exchange risk	428	449

(i) Currency risk

Currency risk management by the Group

The Group's foreign currency positions arise from treasury activities and foreign exchange dealing to support the commercial and consumer banking operations. The Group has formulated a foreign exchange policy in managing the Group's foreign exchange risk. The foreign currency positions are managed within established limits, including open risk position limits.

In addition to adopting VaR to measure foreign exchange risk, a stress testing programme was developed to assess the potential loss that the Group may incur from the foreign exchange positions. The stress testing programme incorporates sensitivity analysis on changes in foreign exchange rates with various degree of severity. The methodology and assumptions of stress testing programme are properly documented, and approved by the Executive Committee and reviewed by the Risk Committee, with its update at least once a year or when the portfolio or the market conditions changes significantly.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

(i) Currency risk (continued)

Currency risk management by the Group (continued)

The following table indicates the currency concentration of the Group's assets and liabilities.

As at December 31, 2018

	HKD	USD	EUR	RMB	Others	Total
Assets						
Cash and balances with banks and central banks	14,213,157	48,077,641	106,666	15,193,648	647,585	78,238,697
Placements with banks	14,324,203	17,429,133	–	505	–	31,753,841
Advances to customers and trade bills	146,872,342	80,000,017	19,618,577	3,567,996	4,412,478	254,471,410
Financial assets held under resale agreements	–	1,514,983	–	–	–	1,514,983
Financial assets measured at fair value through profit or loss	2,781,237	1,034,990	–	–	–	3,816,227
Financial assets measured at fair value through other comprehensive income	16,431,790	46,725,002	2,328,450	21,259,317	–	86,744,559
Financial assets measured at amortised cost	5,629,782	4,145,836	107,295	2,182,919	–	12,065,832
Derivative financial instruments	14,470	1,767,393	670,406	229,353	74,848	2,756,470
Interest in a joint venture	1,955,713	–	–	–	–	1,955,713
Interest in an associate	69,223	–	–	–	–	69,223
Deferred tax assets	396,042	–	–	–	–	396,042
Fixed assets	3,200,961	–	–	–	–	3,200,961
Other assets	1,555,190	1,825,335	116,218	411,262	77,940	3,985,945
Spot assets	207,444,110	202,520,330	22,947,612	42,845,000	5,212,851	480,969,903
Liabilities						
Deposits and balances of banks	299,254	25,881,231	181,624	3,206,793	2,598,501	32,167,403
Deposits from customers	201,723,931	91,385,296	8,345,739	46,184,237	6,490,676	354,129,879
Financial assets sold under repurchase agreements	–	–	–	2,420,859	–	2,420,859
Other debt securities issued	15,891	4,682,707	4,475,054	2,957,849	2,384,408	14,515,909
Derivative financial instruments	106,094	312,615	42,783	1,097,442	583,308	2,142,242
Current tax payable	250,218	–	–	2,051	–	252,269
Deferred tax liabilities	21,508	–	–	–	–	21,508
Other liabilities	4,809,048	1,470,941	79,486	553,919	94,638	7,008,032
Subordinated debt	–	5,833,798	–	–	–	5,833,798
Spot liabilities	207,225,944	129,566,588	13,124,686	56,423,150	12,151,531	418,491,899
Forward purchases	88,918,298	110,857,199	7,046,960	68,618,968	14,892,106	290,333,531
Forward sales	(34,540,927)	(174,934,084)	(16,249,497)	(55,640,316)	(8,448,352)	(289,813,176)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

(i) Currency risk (continued)

Currency risk management by the Group (continued)

As at December 31, 2017

	HKD	USD	EUR	RMB	Others	Total
Assets						
Cash and balances with banks and central banks	4,578,742	49,112,510	156,310	27,505,091	320,588	81,673,241
Placements with banks	1,000,000	4,063,488	–	12,933,815	–	17,997,303
Advances to banks	–	262,498	–	–	–	262,498
Advances to customers and trade bills	149,763,129	94,797,423	31,359,973	7,163,276	4,926,073	288,009,874
Available-for-sale financial assets	17,781,563	52,107,014	3,548,315	25,519,165	–	98,956,057
Held-to-maturity investments	10,785,226	4,845,686	112,235	1,715,710	–	17,458,857
Derivative financial instruments	21,757	552,919	1,079,827	4,875,697	258,137	6,788,337
Interest in a joint venture	2,044,996	–	–	–	–	2,044,996
Interest in an associate	199,912	–	–	–	–	199,912
Deferred tax assets	234,912	–	–	–	–	234,912
Fixed assets	3,325,095	–	–	–	–	3,325,095
Other assets	1,571,831	1,395,445	139,100	843,800	123,455	4,073,631
Spot assets	191,307,163	207,136,983	36,395,760	80,556,554	5,628,253	521,024,713
Liabilities						
Deposits and balances of banks	2,321,256	56,749,602	7,234	11,498,219	2,647,311	73,223,622
Deposits from customers	200,000,697	85,304,841	8,975,815	53,072,442	5,915,538	353,269,333
Other debt securities issued	45,601	4,671,063	4,682,391	3,116,252	2,401,737	14,917,044
Derivative financial instruments	6,479,862	67,765	15,449	–	–	6,563,076
Current tax payable	163,430	–	–	3,778	–	167,208
Deferred tax liabilities	20,902	–	–	–	–	20,902
Other liabilities	4,147,679	2,492,012	107,037	934,150	53,104	7,733,982
Subordinated debt	–	5,812,111	–	–	–	5,812,111
Spot liabilities	213,179,427	155,097,394	13,787,926	68,624,841	11,017,690	461,707,278
Forward purchases	101,460,858	219,049,589	22,236,511	133,823,203	18,142,585	494,712,746
Forward sales	(34,085,158)	(262,925,434)	(43,743,612)	(141,172,903)	(12,480,537)	(494,407,644)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

(ii) Interest rate risk

Interest rate risk management by the Group

The Group's interest rate exposure arises from the positions in the banking book and proprietary trading. The interest rate risk exposure in the banking book arises from its normal course of banking activities, such as lending, accepting deposits, investing in securities for liquidity purposes and issuance of debts as needed to fund assets. The governing objective in interest rate risk management is to minimise the potential significant loss as a result of changes in interest rates. The Group holds weekly interest rate setting meetings to review the latest market rate movements and the overall portfolio yield. Interest rate risk is managed on a daily basis by the Treasury Division within the limits approved by the Risk Management Committee. The instruments used to manage interest rate risk include interest rate swaps and other derivatives.

The Group is exposed to two major sources of interest rate risk, namely, repricing risk and basis risk.

Repricing risk arises from the timing differences in rate changes and cash flows that occur in the repricing and maturity of fixed and floating rate assets and liabilities, and, to a much less significant extent, contingent liabilities and commitments (e.g. loan commitments). The Group uses forward rate agreements and interest rate swaps to mitigate the repricing risk. The Group generally monitors mismatches by monthly time buckets up to one year and by yearly time buckets thereafter.

Basis risk arises from different pricing basis of assets and liabilities, which results in changes in the yield on assets and cost of liabilities by different amount within the same repricing period. For example, loan assets are being tied to the Hong Kong dollar prime rate, and deposit liabilities tied to the Hong Kong Interbank Offer Rate ("HIBOR"). Basis risk primarily occurs in the Group's Hong Kong dollar books. The Group has established stress testing programme to assess the potential erosion of net interest income that the Group may incur from basis risk.

The Group mainly uses two methodologies to measure and monitor its interest rate risk exposure. One methodology is VaR measurement. Another methodology is using stress test to assess the banking book interest rate risk ("IRRBB"). The IRRBB stress-testing has further incorporated the repricing gap and several types of yield curve movement. For interest rate risk monitoring purpose, the Risk Management Committee reviews the IRRBB stress-testing from time to time, in particular when reviewing the repricing limits.

Change of 100 basis points in interest rates would change the Group's profit for the year and retained earnings as follows:

	Increase/(decrease) in Group's profit for the year and retained earnings	
	2018	2017
Increase by 100 basis points	614,872	319,007
Decrease by 100 basis points	(614,872)	(319,007)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

(ii) Interest rate risk (continued)

Interest rate repricing gap

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

Interest rate repricing gap as at December 31, 2018

	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Non-interest bearing	Total
Assets							
Cash and balances with banks and central banks	68,767,645	-	-	-	-	9,470,052	78,238,697
Placements with banks	-	26,196,110	5,557,731	-	-	-	31,753,841
Advances to banks	-	-	-	-	-	-	-
Advances to customers and trade bills	176,103,914	60,311,333	9,642,189	6,962,345	212,410	1,239,219	254,471,410
Financial assets held under resale agreements	-	1,514,983	-	-	-	-	1,514,983
Financial assets measured at fair value through profit or loss	3,330,184	200,000	-	-	-	286,043	3,816,227
Financial assets measured at fair value through other comprehensive income	1,057,630	15,210,835	29,402,799	39,177,708	1,847,718	47,869	86,744,559
Financial assets measured at amortised cost	-	4,905,509	2,447,714	4,712,609	-	-	12,065,832
Derivative financial instruments	-	-	-	-	-	2,756,470	2,756,470
Interest in a joint venture	-	-	-	-	-	1,955,713	1,955,713
Interest in an associate	-	-	-	-	-	69,223	69,223
Deferred tax assets	-	-	-	-	-	396,042	396,042
Fixed assets	-	-	-	-	-	3,200,961	3,200,961
Other assets	-	-	-	-	-	3,985,945	3,985,945
Total assets	249,259,373	108,338,770	47,050,433	50,852,662	2,060,128	23,408,537	480,969,903
Liabilities							
Deposits and balances of banks	25,042,585	5,564,075	-	-	-	1,560,743	32,167,403
Deposits from customers	147,563,082	101,009,845	77,887,766	1,277,586	-	26,391,600	354,129,879
Financial assets sold under repurchase agreements	-	2,420,859	-	-	-	-	2,420,859
Other debt securities issued	-	-	8,231,761	5,606,399	677,749	-	14,515,909
Derivative financial instruments	-	-	-	-	-	2,142,242	2,142,242
Current tax payable	-	-	-	-	-	252,269	252,269
Deferred tax liabilities	-	-	-	-	-	21,508	21,508
Other liabilities	-	-	-	-	-	7,008,032	7,008,032
Subordinated debt	-	-	5,833,798	-	-	-	5,833,798
Total liabilities	172,605,667	108,994,779	91,953,325	6,883,985	677,749	37,376,394	418,491,899
Net repricing gap	76,653,706	(656,009)	(44,902,892)	43,968,677	1,382,379		

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

(ii) Interest rate risk (continued)

Interest rate repricing gap as at December 31, 2017

	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Non-interest bearing	Total
Assets							
Cash and balances with banks and central banks	76,280,972	-	-	-	-	5,392,269	81,673,241
Placements with banks	-	10,854,026	7,143,277	-	-	-	17,997,303
Advances to banks	-	-	262,498	-	-	-	262,498
Advances to customers and trade bills	180,209,660	76,646,025	21,644,476	8,851,178	23,004	635,531	288,009,874
Available-for-sale financial assets	8,429,490	3,743,985	16,852,741	68,831,041	1,056,863	41,937	98,956,057
Held-to-maturity investments	140,000	12,479,036	-	4,839,821	-	-	17,458,857
Derivative financial instruments	-	-	-	-	-	6,788,337	6,788,337
Interest in a joint venture	-	-	-	-	-	2,044,996	2,044,996
Interest in an associate	-	-	-	-	-	199,912	199,912
Deferred tax assets	-	-	-	-	-	234,912	234,912
Fixed assets	-	-	-	-	-	3,325,095	3,325,095
Other assets	-	-	-	-	-	4,073,631	4,073,631
Total assets	265,060,122	103,723,072	45,902,992	82,522,040	1,079,867	22,736,620	521,024,713
Liabilities							
Deposits and balances of banks	60,404,754	10,327,328	36,728	-	-	2,454,812	73,223,622
Deposits from customers	153,976,368	101,054,101	77,965,066	1,277,586	-	18,996,212	353,269,333
Other debt securities issued	-	-	-	14,212,087	704,957	-	14,917,044
Derivative financial instruments	-	-	-	-	-	6,563,076	6,563,076
Current tax payable	-	-	-	-	-	167,208	167,208
Deferred tax liabilities	-	-	-	-	-	20,902	20,902
Other liabilities	-	-	-	-	-	7,733,982	7,733,982
Subordinated debt	-	-	-	5,812,111	-	-	5,812,111
Total liabilities	214,381,122	111,381,429	78,001,794	21,301,784	704,957	35,936,192	461,707,278
Net repricing gap	50,679,000	(7,658,357)	(32,098,802)	61,220,256	374,910		

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(d) Capital management

Being an authorised institution incorporated in Hong Kong, the Bank is regulated by the HKMA who sets and monitors capital requirements for the Bank as well as the consolidated position for the banking subsidiaries as prescribed by the HKMA. A non-banking financial subsidiary, CCBS, is subject to the supervision and capital requirements of the Hong Kong Securities and Futures Commission.

According to the Banking (Capital) Rules ("Capital Rules"), the Group is required to maintain adequate regulatory capital and capital buffers to support credit risk, market risk and operational risk.

In addition to meeting the regulatory requirements, the Group's primary objectives when managing capital are 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, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between higher shareholder returns and the advantages and security afforded by a sound capital position, and, when necessary, makes adjustments to the capital structure in light of changes in economic conditions.

The Group monitors its capital structure on the basis of the capital adequacy ratios and capital buffers as calculated in accordance with the Capital Rules and the Group's policy on the management of capital is updated regularly to incorporate latest regulatory requirements.

The Group maintains a policy on internal capital adequacy assessment process ("CAAP") that sets out the methodologies, assumptions and techniques in assessing the capital requirements on the residual risks that are not covered by the Capital Rules and establishing the internal capital targets.

Throughout the years ended December 31, 2018 and 2017, the Group has complied with the capital requirements imposed by the HKMA. Additional information is disclosed in Unaudited Supplementary Financial Information Note 3.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(e) Fair value of financial assets and liabilities

(i) Financial assets and liabilities measured at fair value

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. The Group measures fair value using the following hierarchy method:

- | | |
|----------|--|
| Level 1: | fair values measured using quoted market prices (unadjusted) in active markets for identical financial instruments. |
| Level 2: | fair values measured using valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes quoted prices in active markets for similar financial instruments, or quoted prices for identical or similar instruments in markets that are considered less than active, or other valuation techniques where all significant inputs are directly or indirectly observable from market data. |
| Level 3: | fair values measured using significant unobservable inputs. This category includes inputs to valuation techniques not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments. |

Where available, the most suitable measure for fair value is the quoted market price. In the absence of organised secondary markets for most of the unlisted securities and over-the-counter derivatives, direct market prices of these financial instruments may not be available. The fair values of such instruments are therefore calculated based on established valuation techniques using current market parameters or market prices provided by counterparties.

Options traded over the counter are valued using broker quotes price. For other derivative financial instruments, the Group uses estimated discounted cash flows to determine their fair value and the discount rate used is a market rate at the end of the reporting period applicable for an instrument with similar terms and conditions. The fair value of interest rate swaps and currency swaps are calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the reporting date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(e) Fair value of financial assets and liabilities (continued)

(i) Financial assets and liabilities measured at fair value (continued)

The table below analyses financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value treatment is categorised:

As at December 31, 2018	Level 1	Level 2	Level 3	Total
Assets				
Financial assets measured at fair value through profit or loss				
Debt securities	27,611	248,743	–	276,354
Other debt instruments	–	3,539,873	–	3,539,873
Financial assets measured at fair value through other comprehensive income				
Treasury bills	18,272,499	5,726,713	–	23,999,212
Certificates of deposit	–	3,148,734	–	3,148,734
Debt securities	43,965,645	15,583,099	–	59,548,744
Equity securities	30,627	–	17,242	47,869
Derivative financial instruments				
Exchange rate contracts				
Forwards	–	1,702,391	–	1,702,391
Options purchased	–	7,812	–	7,812
Interest rate swaps	–	394,072	–	394,072
Currency swaps	–	652,195	–	652,195
	62,296,382	31,003,632	17,242	93,317,256
Liabilities				
Other debt securities issued	–	4,745,374	–	4,745,374
Derivative financial instruments				
Exchange rate contracts				
Forwards	–	1,756,689	–	1,756,689
Options written	–	7,812	–	7,812
Interest rate swaps	–	86,832	–	86,832
Currency swaps	–	290,909	–	290,909
Subordinated debt	–	5,833,798	–	5,833,798
	–	12,721,414	–	12,721,414

The previously acquired unlisted equity shares of \$ 17,242 (2017: \$17,242), which was classified as available-for-sale financial assets and marked at cost. After the adoption of HKFRS 9 on January 1, 2018, it is measured at fair value under FVOCI. As there is no active trading market for the private equities and no observable inputs in order to reliably estimate the fair value of these unlisted equity securities. As a result, the cost is the best estimation of fair value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(e) Fair value of financial assets and liabilities (continued)

(i) Financial assets and liabilities measured at fair value (continued)

As at December 31, 2017	Level 1	Level 2	Total
Assets			
Available-for-sale securities			
Treasury bills	26,049,592	4,127,375	30,176,967
Certificates of deposit	–	664,085	664,085
Debt securities	50,719,977	17,353,091	68,073,068
Equity securities	24,695	–	24,695
Derivatives financial instruments			
Exchange rate contracts			
Forwards	–	5,672,279	5,672,279
Options purchased	–	142,764	142,764
Interest rate swaps	–	333,325	333,325
Currency swaps	–	635,737	635,737
Equity options purchased	–	4,137	4,137
Equity swaps	–	95	95
	76,794,264	28,932,888	105,727,152
Liabilities			
Other debt securities issued	–	4,789,126	4,789,126
Derivatives financial instruments			
Exchange rate contracts			
Forwards	–	6,093,294	6,093,294
Options written	–	142,764	142,764
Interest rate swaps	–	85,382	85,382
Currency swaps	–	237,404	237,404
Equity options issued	–	95	95
Equity swaps	–	4,137	4,137
Subordinated debt	–	5,812,111	5,812,111
	–	17,164,313	17,164,313

There were no significant transfers between instruments in Level 1 and Level 2 for the year ended December 31, 2018 and 2017.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(e) Fair value of financial assets and liabilities (continued)

(ii) Financial assets and liabilities not measured at fair value

Financial assets and liabilities that are not presented at their fair value on the statement of financial position mainly represent cash and balances with banks and central banks, placements with banks, advances to customers and trade bills, and financial assets measured at amortised cost. These financial assets are measured at amortised cost less expected credit losses. Financial liabilities not presented at their fair value on the statement of financial position mainly represent deposits and balances of banks, deposits from customers, and other debt securities issued at amortised costs. These financial liabilities are measured at amortised cost.

The Group assessed that, except for medium term notes in other debt securities measured at amortised cost and their fair values are stated in Note 38, the differences between fair values and carrying amounts of those financial assets and liabilities not presented on the Group's consolidated statement of financial position at their fair values are minimal as most of the Group's financial assets and liabilities are either short-term or priced at floating rates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(f) Offsetting financial assets and financial liabilities

(i) Financial assets

The following financial assets are subject to offsetting, enforceable master netting arrangements or similar agreements.

As at December 31, 2018

	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 offset in the statement of financial position		Net amount
				Financial instruments	Cash collateral received	
Derivative financial assets	2,756,470	–	2,756,470	(1,303,861)	(167,784)	1,284,825
Financial assets held under resale agreements	1,514,983	–	1,514,983	(1,504,765)	–	10,218
Other assets	175,504	(172,184)	3,320	–	–	3,320
	4,446,957	(172,184)	4,274,773	(2,808,626)	(167,784)	1,298,363

As at December 31, 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 amount
				Financial instruments	Cash collateral received	
Derivative financial assets	6,788,337	–	6,788,337	(2,684,468)	(1,356,736)	2,747,133
Other assets	295,536	(238,968)	56,568	–	–	56,568
	7,083,873	(238,968)	6,844,905	(2,684,468)	(1,356,736)	2,803,701

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

8 FINANCIAL RISK MANAGEMENT (continued)

(f) Offsetting financial assets and financial liabilities (continued)

(ii) Financial liabilities

The following financial liabilities are subject to offsetting, enforceable master netting arrangements and similar agreements.

As at December 31, 2018

	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		
				Financial instruments	Cash collateral advanced	Net amount
Derivative financial liabilities	2,142,242	–	2,142,242	(1,303,861)	215,550	1,053,931
Financial assets sold under repurchase agreements	2,420,859	–	2,420,859	(2,406,835)	–	14,024
Other liabilities	191,948	(172,184)	19,764	–	–	19,764
	4,755,049	(172,184)	4,582,865	(3,710,696)	215,550	1,087,719

As at December 31, 2017

	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		
				Financial instruments	Cash collateral advanced	Net amount
Derivative financial liabilities	6,563,076	–	6,563,076	(2,684,468)	136,923	4,015,531
Other liabilities	239,344	(238,968)	376	–	–	376
	6,802,420	(238,968)	6,563,452	(2,684,468)	136,923	4,015,907

For the financial assets and liabilities subject to enforceable master netting arrangements or similar arrangements above, each agreement between the Group and the counterparty allows for net settlement of the relevant financial assets and liabilities when both elect to settle on a net basis, in the absence of such an election, financial assets and liabilities will be settled on a gross basis, however, each party to the master netting agreement or similar agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

9 NET INTEREST INCOME

	2018	2017
Interest income		
<i>Interest income arising from financial assets that are not measured at fair value through profit or loss</i>		
Placements and advances to banks	1,685,690	1,388,314
Advances to customers and trade bills	8,795,098	6,791,642
Financial assets measured at fair value through other comprehensive income	2,290,091	–
Available-for-sale financial assets	–	2,325,239
Financial assets measured at amortised cost	429,856	–
Held-to-maturity investments	–	421,076
Total interest income	13,200,735	10,926,271
Interest expense		
<i>Interest expense arising from financial liabilities that are not measured at fair value through profit or loss</i>		
Deposits and balances of banks	495,079	610,086
Deposits from customers	5,944,053	4,585,344
Certificates of deposit and other debt securities issued	274,946	421,410
	6,714,078	5,616,840
<i>Interest expense arising from financial liabilities that are measured at fair value through profit or loss</i>		
Certificates of deposit issued	35,392	34,997
	35,392	34,997
<i>Interest expense arising from financial liabilities under fair value hedge</i>		
Certificates of deposit and other debt securities issued	76,424	75,997
Subordinated debt	254,873	253,270
	331,297	329,267
Total interest expense	7,080,767	5,981,104
Net interest income	6,119,968	4,945,167

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

10 NET FEES AND COMMISSION INCOME

	2018	2017
Fees and commission income		
Investment services	161,457	175,613
Securities broking and related services	144,678	154,568
Insurance	176,046	260,213
Remittance, settlement and account management fees	138,558	114,468
Fees received from intermediate holding company (Note 45(a))	555,673	557,042
Trade finance	50,108	48,148
Cards	144,272	139,647
Credit facilities	360,026	169,367
Others	4,155	4,132
Total fees and commission income	1,734,973	1,623,198
Fees and commission expense		
Cards	(45,325)	(46,079)
Brokerage	(12,647)	(13,845)
Fees paid to intermediate holding company and fellow subsidiaries (Note 45(a))	(35,151)	(69,593)
Settlement accounts	(13,921)	(15,128)
Others	(40,462)	(33,937)
Total fees and commission expense	(147,506)	(178,582)
Net fees and commission income	1,587,467	1,444,616

The fees and commission income above include income of \$554,406 (2017: \$337,162) and expenses of \$55,261 (2017: \$46,931) relating to financial assets and financial liabilities not measured at fair value through profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

11 NET TRADING INCOME

	2018	2017
Gains/(losses) from trading activities		
Foreign exchange	275,087	940,673
Interest rate derivatives	(42,980)	(87,284)
Other debt instruments	157,758	3,944
Other trading	16,256	38,889
	406,121	896,222
Net gains/(losses) from hedging activities		
Fair value hedges		
— Net gain on hedging instruments	65,312	2,488
— Net loss on hedged items	(54,909)	(45,200)
	10,403	(42,712)
Total	416,524	853,510

"Foreign exchange" under "Net trading income" includes a net gain of \$63,995 (2017: a gain of \$255,320) arising from gains and losses from spot and forward contracts, options, and the income and costs from foreign exchange swaps contracts which were used for economically hedging the assets and liabilities of the Bank and net translation gains and losses on foreign currency denominated assets and liabilities.

12 NET GAINS FROM FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

	2018	2017
Net gains from certificates of deposit issued	33,821	17,672
Net gains from other securities	7	—
Total	33,828	17,672

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

13 OTHER OPERATING INCOME

	2018	2017
Dividend income from equity financial assets measured at fair value through other comprehensive income		
Unlisted	3,925	–
Listed	134	–
	4,059	–
Dividend income from available-for-sale equity financial assets		
Unlisted	–	3,680
Listed	–	102
	–	3,782
Dividend income from equity financial assets measured at fair value through profit and loss		
Unlisted	1,692	–
Listed	152	–
	1,844	–
Others	58,506	66,838
Total	64,409	70,620

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

14 OPERATING EXPENSES

	2018	2017
Staff costs		
Salaries and other benefits	1,678,163	1,541,444
Pension and provident fund costs	101,100	116,868
	1,779,263	1,658,312
Premises and equipment expenses (excluding depreciation)		
Rental of premises	412,053	397,753
Maintenance	63,498	69,270
Leasing of equipment	36,707	31,921
Utilities	17,941	17,526
Others	126,249	115,812
	656,448	632,282
Auditor's remuneration	7,464	8,200
Depreciation	314,164	297,610
Marketing expenses	217,245	252,516
Professional fees	52,383	44,264
Other operating expenses	179,460	182,785
	770,716	785,375
Total	3,206,427	3,075,969

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

15 CHARGES ON EXPECTED CREDIT LOSSES/IMPAIRMENT ALLOWANCES

	2018	2017
New allowances, net of allowance releases	630,915	404,240
Recoveries of amounts previously written off	(42,935)	(37,241)
Net charges on expected credit losses (2017: impairment allowances)	587,980	366,999
Attributable to		
Balances with banks and central banks and placements with banks	2,715	–
Advances to customers and trade bills (Note 23)	626,311	368,316
Repossessioned assets	–	(1,636)
Financial assets measured at fair value through other comprehensive income (Note 24)	(15,510)	–
Financial assets measured at amortised cost (Note 26)	13,694	–
Held to maturity investments	–	319
Other assets (Note 34)	(22,572)	–
Loan commitments (Note 46)	(16,658)	–
Net charges on expected credit losses (2017: impairment allowances)	587,980	366,999

16 BENEFITS AND INTERESTS OF DIRECTORS

(i) Directors' emoluments

	2018	2017
Fees	2,400	2,463
Salaries	11,722	7,576
Discretionary bonuses	4,655	5,246
Other emoluments	4	15
Contributions to provident fund	1,178	760
Total	19,959	16,060

(ii) Directors' material interests in transactions, arrangements or contracts

No significant transactions, arrangements and contracts in relation to the Group's business to which the Bank, or any of its holding companies, subsidiaries, fellow subsidiaries, joint venture or associate was a party and in which a director of the Bank had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

17 TAXATION

(a) Taxation in the consolidated statement of profit or loss represents:

	2018	2017
Current tax — Hong Kong Profits Tax		
Provision for the year	853,229	687,799
Under/(over)-provision in respect of prior years	5,382	(93)
	858,611	687,706
Current tax — Overseas		
Provision for the year	711	1,077
Withholding tax in the Mainland	46,997	19,683
	47,708	20,760
Deferred tax		
Origination and reversal of temporary differences	(124,618)	(39,473)
	781,701	668,993

The provision of Hong Kong Profits Tax for 2018 is calculated at 16.5% (2017: 16.5%) of the estimated assessable profits for the year. Taxation for overseas transactions are charged at the appropriate current rates of taxation ruling in the countries in which the transactions took place.

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2018	2017
Profit before taxation	4,356,253	3,937,143
Notional tax on profit before tax, calculated at the rates applicable to profits in the countries concerned	718,782	649,629
Income not subject to taxation	(12,012)	(10,112)
Expenses not deductible for taxation purposes	21,946	8,383
Under/(over)-provision in prior years	5,382	(93)
Foreign withholding tax	46,997	19,683
Tax effect of temporary differences not recognised and reversal of previously recognised deferred tax assets	606	1,503
Actual tax expense	781,701	668,993

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

18 SEGMENTAL INFORMATION

(a) Reportable segments

The Group manages its businesses by divisions, which are organised by products, services and customer types. In a manner consistent with the way in which information is reported internally to the executive management for the purposes of resource allocation and performance assessment, the Group has presented the following four reportable segments.

(i) Corporate and institutional banking

This segment mainly represents the provision of a range of financial products and services to corporations and financial institutions. The products and services mainly include commercial loans, syndicated loans, trade financing, foreign exchange and deposit-taking activities.

(ii) Consumer and commercial banking

This segment mainly represents the provision of a range of financial products and services to individual customers and small and medium sized enterprises. The products and services mainly comprise residential and commercial mortgages, personal loans, credit cards, auto-financing, commercial loans, trade financing, deposit-taking activities, foreign exchange, wealth management, insurance and securities agency services.

(iii) Treasury

This segment covers the Bank's treasury operations. The Treasury Division enters into inter-bank money market transactions and invests in debt instruments. It also trades in debt instruments, derivatives and foreign currency for its own account and carries out customer driven derivatives such as foreign currency transactions. Its function also includes the management of the Group's overall liquidity position, including the issuance of certificates of deposit.

(iv) Others

This segment mainly represents management of shareholders' funds and investments in premises, subsidiaries and others.

Segment assets and liabilities are mainly composed of placements with banks, advances to banks and customers, investment securities, derivatives financial instruments, deposits and certificates of deposit and other debt securities issued.

Revenue and expenses are allocated to the reportable segments with reference to interest and fees and commission income generated by these segments and the expenses incurred by these segments or which otherwise arise from the depreciation or amortisation of assets attributable to these segments.

The primary revenue stream of the Group is derived from net interest income and net fees and commission income. The executive management relies to a large extent on net interest income and net fees and commission income in managing its business. Hence, net interest income and net fees and commission income for all reportable segments are presented under segmental information.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

18 SEGMENTAL INFORMATION (continued)

(a) Reportable segments (continued)

	2018					
	Corporate and institutional banking	Consumer and commercial banking	Treasury	Others	Inter- segment elimination	Total
Net interest income	1,588,000	3,056,987	236,691	1,238,290	–	6,119,968
Net fees and commission income	361,839	656,018	(4,782)	574,392	–	1,587,467
Total operating income						
— External	5,217,696	(729,170)	3,355,214	378,497	–	8,222,237
— Inter-segment	(3,058,293)	4,599,491	(3,046,185)	1,504,987	–	–
Total operating income	2,159,403	3,870,321	309,029	1,883,484	–	8,222,237
Depreciation	(38,521)	(192,067)	(10,876)	(72,700)	–	(314,164)
Total operating expenses	(470,399)	(1,985,451)	(159,951)	(590,626)	–	(3,206,427)
Operating profit before change in expected credit losses and impairment loss	1,689,004	1,884,870	149,078	1,292,858	–	5,015,810
(Charge on)/release of expected credit losses	(383,050)	(214,881)	9,964	(13)	–	(587,980)
Charge on impairment allowances	–	–	–	(47,000)	–	(47,000)
Non-operating income	–	(1,554)	–	(23,023)	–	(24,577)
Profit before taxation	1,305,954	1,668,435	159,042	1,222,822	–	4,356,253
Total assets	177,704,564	89,557,070	206,646,632	7,609,711	(548,074)	480,969,903
Total liabilities	78,056,086	280,580,546	56,048,668	4,354,673	(548,074)	418,491,899

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

18 SEGMENTAL INFORMATION (continued)

(a) Reportable segments (continued)

	2017					
	Corporate and Institutional Banking	Consumer and Commercial Banking	Treasury	Others	Inter- segment elimination	Total
Net interest income	1,636,477	2,771,559	(18,089)	555,220	–	4,945,167
Net fees and commission income	162,993	710,973	6,306	564,344	–	1,444,616
Total operating income						
— External	2,998,355	585,483	3,435,575	388,818	–	7,408,231
— Inter-segment	(1,117,843)	3,069,360	(2,755,378)	803,861	–	–
Total operating income	1,880,512	3,654,843	680,197	1,192,679	–	7,408,231
Depreciation and amortization	(33,127)	(178,679)	(10,844)	(74,960)	–	(297,610)
Total operating expenses	(391,991)	(1,937,351)	(138,225)	(608,402)	–	(3,075,969)
Operating profit before impairment losses	1,488,521	1,717,492	541,972	584,277	–	4,332,262
(Charge on)/release of impairment losses	(257,694)	(109,971)	666	–	–	(366,999)
Non-operating losses	–	–	–	(28,120)	–	(28,120)
Profit before taxation	1,230,827	1,607,521	542,638	556,157	–	3,937,143
Total assets	205,216,356	97,109,961	211,615,947	7,797,733	(715,284)	521,024,713
Total liabilities	93,980,675	267,349,598	96,733,715	4,358,574	(715,284)	461,707,278

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

18 SEGMENTAL INFORMATION (continued)

(b) Geographical information

The following table sets out information about the geographical location of the Group's revenue from external customers, profit before taxation, total assets, total liabilities, specified non-current assets, contingent liabilities and commitments. The geographical location of customers is based on the location at which the services were provided. Segment assets or liabilities are based on the geographical location of the asset or liabilities. Specified non-current assets comprise fixed assets, interests in leasehold land, interest in a joint venture and interest in an associate and the geographical location is based on the physical location of the asset for fixed assets, and the location of the operation to which they are allocated for interest in a joint venture and interest in an associate.

	Revenue from external customers	Profit before taxation	Total assets	Total liabilities	Specified non-current assets	Contingent liabilities and commitments
As at December 31, 2018 Hong Kong (place of domicile)	8,222,237	4,356,253	480,969,903	418,491,899	5,225,897	88,609,788
	Revenue from external customers	Profit before taxation	Total assets	Total liabilities	Specified non-current assets	Contingent liabilities and commitments
As at December 31, 2017 Hong Kong (place of domicile)	7,408,231	3,937,143	521,024,713	461,707,278	5,570,003	84,823,295

19 CASH AND BALANCES WITH BANKS AND CENTRAL BANKS

	2018	2017
Cash in hand	256,638	263,098
Balances with banks	2,539,639	2,762,104
Balances with central banks	6,674,775	2,367,067
Placements with banks maturing within one month	68,769,107	76,280,972
Gross cash and balances with banks and central banks	78,240,159	81,673,241
Less: Expected credit loss allowances Stage 1: 12-month ECL	(1,462)	–
Net cash and balances with banks and central banks	78,238,697	81,673,241

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

20 PLACEMENTS WITH BANKS

	2018	2017
Gross placements with banks maturing between one and twelve months	31,758,244	17,997,303
Less: Expected credit loss allowances		
Stage 1: 12-month ECL	(4,403)	–
Net placements with banks	31,753,841	17,997,303

21 FINANCIAL ASSETS HELD UNDER RESALE AGREEMENTS

Financial assets held under resale agreements by underlying assets are shown as follows:

	2018	2017
Debt securities issued by policy banks	1,514,983	–
Less: Expected credit loss allowances		
Stage 1: 12-month ECL	–	–
Net financial assets held under resale agreements	1,514,983	–

22 FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

	2018
Other debt securities issued by corporate	276,354
Other debt instruments	3,539,873
	3,816,227
Analysed by place of listing	
Listed outside Hong Kong	27,611
Unlisted	3,788,616
	3,816,227

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

23 ADVANCES TO CUSTOMERS AND TRADE BILLS

(a) Net advances to customers and trade bills

	2018	2017
Net advances to customers		
Gross advances to customers	256,613,787	288,027,512
Dealers' commission and deferred fee income	(283,204)	(172,801)
	256,330,583	287,854,711
Less: Expected credit loss/Impairment allowances		
Collectively assessed	–	(925,424)
Individually assessed	–	(226,147)
Stage 1: 12-month ECL	(1,089,388)	–
Stage 2: Lifetime ECL but not credit-impaired	(780,326)	–
Stage 3: Lifetime ECL and credit-impaired	(197,179)	–
Net advances to customers	254,263,690	286,703,140
Net trade bills		
Trade bills	210,808	1,470,733
Less: Expected credit loss/Impairment allowances		
Collectively assessed	–	(23,867)
Individually assessed	–	(140,132)
Stage 1: 12-month ECL	(36)	–
Stage 2: Lifetime ECL but not credit-impaired	–	–
Stage 3: Lifetime ECL and credit-impaired	(3,052)	–
Net trade bills	207,720	1,306,734
Net advances to customers and trade bills	254,471,410	288,009,874

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

23 ADVANCES TO CUSTOMERS AND TRADE BILLS (continued)

(b) Movement in gross advances to customers and trade bills

The following table shows the reconciliation from the opening balance to the closing balance of gross advances to customers and trade bills.

	2018			
	Stage 1 12-month ECL	Stage 2 Lifetime ECL but not credit- impaired	Stage 3 Lifetime ECL and credit- impaired	Total
Balance as at January 1, 2018	275,535,158	7,447,652	832,209	283,815,019
Transfer to Stage 1: 12-month ECL	12,390	(12,390)	–	–
Transfer to Stage 2: lifetime ECL but not credit-impaired	(8,103,831)	8,103,831	–	–
Transfer to Stage 3: lifetime ECL and credit-impaired	(346,815)	(186,233)	533,048	–
New — added, originated or purchased*	100,654,309	4,187,237	92,417	104,933,963
Derecognised during the year	(126,980,970)	(4,560,722)	(543,331)	(132,085,023)
Write-off	–	–	(122,568)	(122,568)
Balance as at December 31, 2018	240,770,241	14,979,375	791,775	256,541,391

* During 2018, all advances to customers and trade bills were initially classified in Stage 1 and were not considered as credit-impaired at the time of origination or purchase. Some were subsequently transferred into Stage 2 or Stage 3 based on the result of credit assessments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

23 ADVANCES TO CUSTOMERS AND TRADE BILLS (continued)

(c) Movement in change in expected credit loss/impairment allowances on advances to customers and trade bills

The following tables show reconciliations from the opening balance to the closing balance of the expected credit loss allowances on advances to customers and trade bills. Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in Note 8(a)(xii).

	2018			
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL but not credit-impaired	Lifetime ECL and credit-impaired	Total
Balance as at January 1, 2018	803,570	339,949	379,784	1,523,303
Transfer to Stage 1: 12-month ECL	1,548	(1,548)	–	–
Transfer to Stage 2: lifetime ECL but not credit-impaired	(21,164)	21,164	–	–
Transfer to Stage 3: lifetime ECL and credit-impaired	(114,615)	(9,779)	124,394	–
Net remeasurement of loss allowances	70,596	(23,951)	6,282	52,927
New financial assets originated or purchased*	358,415	63,017	16,941	438,373
Financial assets that have been derecognised	(267,457)	(95,356)	(231,518)	(594,331)
Write-offs	–	–	(122,568)	(122,568)
Recoveries of amounts previously written-offs	–	–	42,935	42,935
Changes in risk parameters	262,380	489,148	(15,984)	735,544
Foreign exchange and other movements	(3,849)	(2,318)	(35)	(6,202)
Balance as at December 31, 2018	1,089,424	780,326	200,231	2,069,981

* During 2018, all advances to customers and trade bills were initially classified in Stage 1 and were not considered as credit-impaired at the time of origination or purchase. Some were subsequently transferred into Stage 2 or Stage 3 based on the result of credit assessments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

23 ADVANCES TO CUSTOMERS AND TRADE BILLS (continued)

(c) Movement in change in expected credit loss/impairment allowances on advances to customers and trade bills (continued)

As at 31 December 2018, the retail and wholesale portfolios represented \$513,213 and \$1,556,768 or 25% and 75% (January 1, 2018: \$427,673 and \$1,095,630 or 28% and 72%), respectively, of the total expected credit loss allowances on advances to customers and trade bills as at December 31, 2018. The measurement of expected credit loss allowances for retail and wholesale portfolios is under the same modelling framework by applying different risk parameters.

During the year the movement of the retail portfolio is mainly driven by the consideration of countercyclical measures in the economic environment. The movement of the wholesale portfolio is driven by the change in risk parameters from considering the countercyclical measures in the economic environment, the newly originated assets and the assets that have been derecognised during the year.

	Collectively assessed allowances	2017 Individually assessed allowances	Total
Advances to customers			
As at January 1, 2017	840,574	142,928	983,502
Loans written-off as uncollectible	(138,283)	(10,411)	(148,694)
Recoveries of advances written-off	32,478	4,763	37,241
Impairment losses charged to the statement of profit or loss (Note 15)	190,655	88,867	279,522
As at December 31, 2017	925,424	226,147	1,151,571

	Collectively assessed allowances	2017 Individually assessed allowances	Total
Trade bills			
As at January 1, 2017	1,271	73,934	75,205
Impairment losses charged to the statement of profit or loss (Note 15)	22,596	66,198	88,794
As at December 31, 2017	23,867	140,132	163,999

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

23 ADVANCES TO CUSTOMERS AND TRADE BILLS (continued)

(d) Advances to customers and trade bills less expected credit loss allowances by staging

	2018			
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL but not credit- impaired	Lifetime ECL and credit- impaired	Total
Gross advance to customers	240,562,485	14,979,375	788,723	256,330,583
Less: Expected credit loss allowances	(1,089,388)	(780,326)	(197,179)	(2,066,893)
Net advance to customers	239,473,097	14,199,049	591,544	254,263,690
Gross trade bills	207,756	–	3,052	210,808
Less: Expected credit loss allowances	(36)	–	(3,052)	(3,088)
Net trade bills	207,720	–	–	207,720

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

23 ADVANCES TO CUSTOMERS AND TRADE BILLS (continued)

(e) Impaired advances to customers and trade bills and impairment allowances

(i) Impaired advances to customers and allowances are analysed as follows:

	2018 % of gross advances	2017 % of gross advances
Gross impaired advances	788,330 0.31	635,678 0.22
Expected credit loss/Impairment allowances	(196,841)	(226,147)
	591,489	409,531
Gross individually assessed impaired advances	184,591 0.07	557,182 0.19
Expected credit loss/Impairment allowances	(166,634)	(226,147)
	17,957	331,035
Net realisable value of collateral held against the impaired advances	549,723	34,965

(ii) Impaired trade bills and allowances are analysed as follows:

	2018 % of gross trade bills	2017 % of gross trade bills
Gross impaired trade bills	3,052 1.45	140,132 9.53
Expected credit loss/Impairment allowances	(3,052)	(140,132)
	–	–
Gross individually assessed impaired trade bills	3,052 1.45	140,132 9.53
Expected credit loss/Impairment allowances	(3,052)	(140,132)
	–	–
Net realisable value of collateral held against the impaired trade bills	–	–

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

23 ADVANCES TO CUSTOMERS AND TRADE BILLS (continued)

(f) Net investment in finance leases and hire purchase contracts

Advances to customers include net investments in equipment leased to customers under finance leases and hire purchase contracts having the characteristics of finance leases. The contracts usually run for an initial period of 5 to 20 years. The total minimum lease payments receivable and their present value at the year end are as follows:

	2018	2017
Total minimum lease payments	6,052,748	6,612,396
Unearned future finance income on finance leases	(831,522)	(915,747)
Present value of the minimum lease payments	5,221,226	5,696,649
Expected credit loss/Impairment allowances		
Individually assessed	–	(385)
Collectively assessed	–	(17,928)
Stage 1: 12-month ECL	(12,668)	–
Stage 2: Lifetime ECL but not credit-impaired	(729)	–
Stage 3: Lifetime ECL and credit-impaired	(75)	–
Expected credit loss/Impairment allowances	(13,472)	(18,313)
Net investment	5,207,754	5,678,336

The residual maturity analysis of the minimum lease payments and present value of the minimum lease payments are analysed as follows:

	2018	2017
Total minimum lease payments		
Not later than one year	1,388,142	1,493,577
Later than one year and not later than five years	2,404,897	2,461,852
Later than five years	2,259,709	2,656,967
	6,052,748	6,612,396

	2018	2017
Present value of the minimum lease payments		
Not later than one year	1,290,665	1,391,472
Later than one year and not later than five years	2,147,286	2,200,532
Later than five years	1,783,275	2,104,645
	5,221,226	5,696,649

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

24 FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	2018
Treasury bills issued by central governments	23,999,212
Certificates of deposit issued by banks	3,148,734
Other debt securities issued by	
Banks	34,767,953
Corporate	24,780,791
	86,696,690
Equity shares issued by corporate	
Listed outside Hong Kong	30,627
Unlisted	17,242
	47,869
	86,744,559
Analysed by place of listing	
Listed in Hong Kong	46,918,046
Listed outside Hong Kong	15,350,725
Unlisted	24,475,788
	86,744,559

The unlisted equity investment is made by the Group for being members of the electronic payment system in Hong Kong. Management has no intention to dispose of this investment as at December 31, 2018.

During the year of 2018, there are no significant movements in the gross balances of financial assets measured at fair value through other comprehensive income that resulted in significant changes to the expected credit loss allowances.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

24 FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (continued)

(a) Movement in change in expected credit loss allowances on financial assets measured at fair value through other comprehensive income

The following table shows the reconciliation from the opening balance to the closing balance of the expected credit loss allowances on financial assets measured at fair value through other comprehensive income. Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in Note 8(a)(xii).

	2018			Total
	Stage 1 12-month ECL	Stage 2 Lifetime ECL but not credit- impaired	Stage 3 Lifetime ECL and credit- impaired	
Balance as at January 1, 2018	82,210	–	–	82,210
Transfer to stage 1: 12-month ECL	–	–	–	–
Transfer to stage 2: lifetime ECL but not credit-impaired	–	–	–	–
Transfer to stage 3: lifetime ECL and credit-impaired	–	–	–	–
Net remeasurement of loss allowances	(1,486)	–	–	(1,486)
New financial assets originated or purchased	9,829	–	–	9,829
Financial assets that have been derecognised	(16,582)	–	–	(16,582)
Write-offs	–	–	–	–
Recoveries of amounts previously written-offs	–	–	–	–
Changes in risk parameters	(6,836)	–	–	(6,836)
Foreign exchange and other movements	(435)	–	–	(435)
Balance as at December 31, 2018	66,700	–	–	66,700

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

25 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2017
Treasury bills issued by central governments	30,176,967
Certificates of deposit issued by banks	664,085
Other debt securities issued by	
Banks	42,132,809
Corporate	25,940,259
	98,914,120
Equity shares issued by corporate	
Listed outside Hong Kong	24,695
Unlisted	17,242
	41,937
	98,956,057
Analysed by place of listing	
Listed in Hong Kong	54,411,766
Listed outside Hong Kong	37,976,552
Unlisted	6,567,739
	98,956,057

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

26 FINANCIAL ASSETS MEASURED AT AMORTISED COST

	2018
Gross financial assets measured at amortised cost	12,090,571
Less: Expected credit loss allowances	(24,739)
Net financial assets measured at amortised cost	12,065,832
Represented by	
Debt securities issued by	
Banks	6,199,228
Corporate	5,891,343
	12,090,571
Analysed by place of listing	
Listed in Hong Kong	2,745,816
Listed outside Hong Kong	937,772
Unlisted	8,406,983
	12,090,571
Fair value	
Listed securities	3,574,792
Unlisted securities	8,397,308
	11,972,100

The fair value of financial assets measured at amortised cost is based on quoted market bid prices.

There were no overdue financial investments at 31 December 2018 for the Group. The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

During the year of 2018, there are no significant movements in the gross balances of financial assets measured at amortised cost that resulted in significant changes to the expected credit loss allowances

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

26 FINANCIAL ASSETS MEASURED AT AMORTISED COST (continued)

(a) Movement in change in expected credit loss allowances on financial assets measured at amortised cost

The following table shows the reconciliation from the opening balance to the closing balance of the expected credit loss allowances on financial assets measured at amortised cost. Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in Note 8(a)(xii).

	2018			
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL but not credit-impaired	Lifetime ECL and credit-impaired	Total
Balance as at January 1, 2018	11,045	–	–	11,045
Transfer to stage 1: 12-month ECL	–	–	–	–
Transfer to stage 2: lifetime ECL but not credit-impaired	–	–	–	–
Transfer to stage 3: lifetime ECL and credit-impaired	–	–	–	–
Net remeasurement of loss allowances	–	–	–	–
New financial assets originated or purchased	24,739	–	–	24,739
Financial assets that have been derecognised	(11,046)	–	–	(11,046)
Write-offs	–	–	–	–
Recoveries of amounts previously written-offs	–	–	–	–
Changes in risk parameters	–	–	–	–
Foreign exchange and other movements	1	–	–	1
Balance as at December 31, 2018	24,739	–	–	24,739

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

27 HELD-TO-MATURITY INVESTMENTS

	2017
Held-to-maturity investments	17,467,915
Less: Impairment allowances	
— collectively assessed	(9,058)
	17,458,857
Debt securities issued by	
Banks	14,921,587
Corporate	2,546,328
	17,467,915
Analysed by place of listing	
Listed in Hong Kong	1,172,861
Listed outside Hong Kong	659,300
Unlisted	15,635,754
	17,467,915
Fair value	
Listed securities	1,800,954
Unlisted securities	15,657,241
	17,458,195

The fair value of held-to-maturity financial assets was based on quoted market bid prices.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

28 DERIVATIVE FINANCIAL INSTRUMENTS

Derivatives include forward, swap and option transactions undertaken by the Group in the foreign exchange and interest rate markets. The Group uses derivatives for trading activities and sale to customers as risk management products. These positions are actively managed through entering into offsetting deals with external parties to ensure the Group's net exposures are within acceptable risk levels. No significant proprietary positions are maintained by the Group as at the reporting date. The Group also uses these derivatives in the management of its own asset and liability portfolios and structural positions.

(a) Notional amounts of derivatives

	2018				2017			
	Managed in conjunction with financial instruments designated at fair value through profit or loss	Held for trading	Used for accounting hedges	Total	Managed in conjunction with financial instruments designated at fair value through profit or loss	Held for trading	Used for accounting hedges	Total
Exchange rate contracts								
Forwards	12,378,124	270,200,698	-	282,578,822	87,586,464	401,440,678	-	489,027,142
Options purchased	-	975,701	-	975,701	-	44,459,430	-	44,459,430
Options written	-	975,701	-	975,701	-	44,459,430	-	44,459,430
Interest rate swaps	3,644,679	1,276,013	33,763,759	38,684,451	7,794,628	78,144	36,696,248	44,569,020
Currency swaps	7,754,708	-	-	7,754,708	5,685,605	-	-	5,685,605
Equity options purchased/issued	-	-	-	-	-	161,556	-	161,556
Equity swaps	-	-	-	-	-	161,556	-	161,556
	23,777,511	273,428,113	33,763,759	330,969,383	101,066,697	490,760,794	36,696,248	628,523,739

The principal derivatives instruments used by the Group are interest and foreign exchange rate related contracts, which are primarily over-the-counter derivatives. The Group also participates in exchange traded derivatives.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

28 DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(b) Notional amounts of derivatives by remaining maturity analysis

The following table provides an analysis of the notional amounts of derivatives of the Group by relevant maturity grouping based on the remaining periods to settlement at the reporting date.

	2018				2017			
	1 year or less	Over 1 year to 5 years	Over 5 years	Total	1 year or less	Over 1 year to 5 years	Over 5 years	Total
Exchange rate contracts								
Forwards	282,578,822	-	-	282,578,822	487,780,766	1,246,376	-	489,027,142
Options purchased	975,701	-	-	975,701	44,459,430	-	-	44,459,430
Options written	975,701	-	-	975,701	44,459,430	-	-	44,459,430
Interest rate swaps	14,009,265	21,110,803	3,564,383	38,684,451	7,923,754	33,988,370	2,656,896	44,569,020
Currency swaps	4,165,315	3,589,393	-	7,754,708	-	5,685,605	-	5,685,605
Equity options purchased/issued	-	-	-	-	161,556	-	-	161,556
Equity swaps	-	-	-	-	161,556	-	-	161,556
	302,704,804	24,700,196	3,564,383	330,969,383	584,946,492	40,920,351	2,656,896	628,523,739

(c) Fair values and credit risk weighted amounts of derivatives

	2018			2017		
	Fair value assets	Fair value liabilities	Credit risk weighted amount	Fair value assets	Fair value liabilities	Credit risk weighted amount
Exchange rate contracts						
Forwards	1,702,391	1,756,689	1,353,456	5,672,279	6,093,294	3,284,434
Options purchased	7,812	-	-	142,764	-	-
Options written	-	7,812	3,592	-	142,764	224,226
Interest rate swaps	394,072	86,832	152,239	333,325	85,382	168,573
Currency swaps	652,195	290,909	278,563	635,737	237,404	288,747
Equity options purchased/issued	-	-	-	4,137	95	-
Equity swaps	-	-	-	95	4,137	4,796
	2,756,470	2,142,242	1,787,850	6,788,337	6,563,076	3,970,776

As at December 31, 2018 and 2017, the credit risk weighted amount was calculated in accordance with the Capital Rules and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 20% to 100% (2017: 20% to 100%) for all derivatives.

Derivative financial instruments are presented in net when there is legally enforceable right to offset the recognised amounts, and there is an intention to settle them on a net basis or realise the asset and settle the liability simultaneously. As at December 31, 2018, no derivative financial instruments have fulfilled the above criteria, and therefore no derivative financial instruments were offset on the statement of financial position (2017: Nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

28 DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(d) Fair values of derivatives designated as hedging instruments

The fair values of derivatives designated as fair value hedges are as follows.

	2018		2017	
	Assets	Liabilities	Assets	Liabilities
Interest rate contracts	347,621	82,049	281,947	80,389

Fair value hedges

Fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of debt securities held, certificates of deposit, medium term notes and sub-ordinated debts issued due to movements in market interest rates. At December 31, 2018, the net fair value of interest rate swaps was assets of \$265,572 while at December 31, 2017, the net fair value of interest rate swaps was assets of \$201,558.

29 SUBSIDIARIES

Particulars of the subsidiaries as at December 31, 2018 are as follows:

Name of company	Place of incorporation and place of business	Particulars of issued shares held	Percentage held		Principal activities
			Directly	Indirectly	
CCB Nominees Limited ("CCBN")	Hong Kong	HKD6,000,000 of 600,000 ordinary shares	100%	–	Custodian and nominee services
CCB Securities Limited ("CCBS")	Hong Kong	HKD500,000,000 of 500,000,000 ordinary shares	100%	–	Securities brokerage business
CCB (Asia) Trustee Company Limited ("CCBT")	Hong Kong	HKD10,000,000 of 100,000 ordinary shares	100%	–	Trustee and custodian business
CCB (Asia) Insurance Broker Limited ("CCBIB")	Hong Kong	HKD10,000,000 of 10,000,000 ordinary shares	100%	–	Insurance broker business
CCB Hong Kong Property Management Company Limited	Hong Kong	HKD10,000 of 10,000 ordinary shares	100%	–	Management services and investment holding
CCB Properties (Hong Kong) Holdings Limited ("CCBPHK")	Hong Kong	HKD1 of 1 ordinary share	–	100%	Investment holding

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

29 SUBSIDIARIES (continued)

Name of company	Place of incorporation and place of business	Particulars of issued shares held	Percentage held		Principal activities
			Directly	Indirectly	
Better Chief Limited ("BCL")	Hong Kong	HKD100 of 100 ordinary shares	–	100%	Property investment
Hong Kong (SAR) Hotel Limited ("HKSAR Hotel")	Hong Kong	HKD10,000 of 10,000 ordinary shares	–	100%	Hotel operation and management

All subsidiary undertakings are included in the consolidation. The proportion of the voting rights in the subsidiary undertakings held directly by the Bank does not differ from the proportion of ordinary shares held. There is no non-controlling interest for both years for all of the subsidiaries.

30 INTEREST IN A JOINT VENTURE

	2018	2017
As at January 1	2,044,996	1,987,787
Share of profits	60,717	57,209
Dividend	(150,000)	–
As at December 31	1,955,713	2,044,996

The joint venture listed below has share capital consisting solely of ordinary shares, which is held indirectly by the Group.

Particulars of the joint venture as at December 31, 2018 are as follows:

Name of company	Place of business/ Place of incorporation	Particulars of issued and paid up capital	Percentage of ownership held by the Group	Principal activities	Nature of relationship	Measurement method
Diamond String Limited	Hong Kong	HKD10,000 of 10,000 ordinary shares	50%	Property investment	Note	Equity

Note: Diamond String Limited's principal activity is property investment and it is strategic to the Group's activities, viz., holding property for the Bank's operation. Diamond String Limited is a private company and there is no quoted market price available for its shares.

There was dividend of \$150,000 paid by Diamond String Limited to the Group during the year ended December 31, 2018 (2017: Nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

30 INTEREST IN A JOINT VENTURE (continued)

Contingent liabilities, guarantees and commitments in respect of joint venture

There are no contingent liabilities, guarantees and commitments relating to the Group's interest in Diamond String Limited as at December 31, 2018 and 2017.

Summarised financial information for a joint venture

Set out below is the summarised financial information for Diamond String Limited which is accounted for using the equity method.

	As at December 31	
	2018	2017
Current		
Other current assets	268,873	241,988
Total current assets	268,873	241,988
Financial liabilities	(18,982)	(9,546)
Other current liabilities	(1,537)	(67,122)
Total current liabilities	(20,519)	(76,668)
Non-current		
Financial assets	75,245	71,110
Other assets	1,684,750	1,751,199
Total non-current assets	1,759,995	1,822,309
Financial liabilities	(1,755,156)	(1,557,221)
Other liabilities	(29,602)	(28,251)
Total non-current liabilities	(1,784,758)	(1,585,472)
Net assets	223,591	402,157

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

30 INTEREST IN A JOINT VENTURE (continued)

Summarised financial information for a joint venture (continued)

Summarised statement of comprehensive income

	For the year ended December 31	
	2018	2017
Revenue	277,084	254,378
Depreciation and amortisation	(56,747)	(56,664)
Interest income	2,374	545
Interest expense	(37,656)	(19,066)
Profit before taxation	150,228	144,392
Income tax expense	(28,794)	(29,974)
Profit for the year & total comprehensive income	121,434	114,418
Dividends received from joint venture	300,000	–

Reconciliation of summarised financial information

Reconciliation of the summarised financial information presented to the carrying amount of its interest in a joint venture.

Summarised financial information	2018	2017
Net assets as at January 1	402,157	287,739
Profit for the year	121,434	114,418
Dividend	(300,000)	–
Net assets as at December 31	223,591	402,157
Interest in a joint venture @ 50%	111,795	201,078
Fair value adjustment of investment in property held by the joint venture at the acquisition date	1,843,918	1,843,918
Carrying value of interest in a joint venture as at December 31	1,955,713	2,044,996

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

31 INTEREST IN AN ASSOCIATE

Particulars of the associate as at December 31, 2018 are as follows:

Name of company	Place of business/ Place of incorporation	Particulars of issued and paid up capital	Percentage of ownership held by the Group	Principal activities	Nature of relationship	Measurement method
QBE Hongkong & Shanghai Insurance Limited ("QBE")	Hong Kong	HKD78,192,220 of 78,192,220 ordinary shares	25.50%	Insurance	Note	Equity

Note: QBE is the authorised insurance agents and brokers and it is a strategic partnership for the Group, providing insurance products to the Bank's customers. QBE is a private company and there is no quoted market price available for its shares.

There are no contingent liabilities, guarantees and commitments relating to the Group's interest in the associate as at December 31, 2018 and 2017.

There was no dividend paid by associate to the Group during the year ended December 31, 2018 and 2017.

Summarised financial information for an associate

Set out below is the summarised financial information for QBE which is accounted for using the equity method.

	As at November 30	
	2018	2017
Current		
Current assets	3,017,493	3,665,051
Current liabilities	(2,340,377)	(2,589,965)
Non-current		
Non-current assets	151,546	528,275
Non-current liabilities	(372,886)	(819,392)
Net assets	455,776	783,969

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

31 INTEREST IN AN ASSOCIATE (continued)

Summarised statement of comprehensive income

	For the 12 months ended November 30	
	2018	2017
Revenue	1,381,223	1,376,478
Depreciation and amortisation	18,060	23,181
Interest income	53,994	46,711
Interest expense	(22,378)	(68)
Loss before taxation	(420,753)	(374,224)
Income tax recovery	92,560	39,438
Loss for the year and total comprehensive loss	(328,193)	(334,786)
Dividends received from associate	–	–

Reconciliation of summarised financial information

As at December 31, 2018, the Group's share of net assets in an associate is \$116,223 (2017: \$199,912), and net interest is \$69,223 (2017: \$199,912) after impairment allowance, which amounted at \$47,000, is charged as described in Note 4(h).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

32 INCOME TAX IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(a) Current tax payable in the consolidated statement of financial position represents:

	2018	2017
Provision for Hong Kong Profits Tax for the year	853,229	687,799
Provisional Profits Tax paid	(673,819)	(587,956)
Balance of Profits Tax provision relating to prior years	70,822	63,598
	250,232	163,441
Provision for tax in the Mainland	2,037	3,767
Current tax payable	252,269	167,208

(b) Deferred tax assets and deferred tax liabilities

	2018	2017
Deferred tax assets recognised on the consolidated statement of financial position	396,042	234,912
	2018	2017
Deferred tax liabilities recognised on the consolidated statement of financial position	21,508	20,902

As at December 31, 2018 and 2017, majority of the deferred tax assets and deferred tax liabilities recognised will be recovered after twelve months.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

32 INCOME TAX IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION (continued)

(b) Deferred tax assets and deferred tax liabilities (continued)

The components of deferred tax assets recognised in the consolidated statement of financial position and the movements during the year are as follows:

	Impairment allowances	Accelerated tax depreciation	Investment revaluation reserve	Provision for staff bonus	Others	Total
As at January 1, 2017	127,392	(50,732)	62,749	473	(202)	139,680
Credited to the statement of comprehensive income	17,722	23,171	54,256	–	83	95,232
As at December 31, 2017	145,114	(27,561)	117,005	473	(119)	234,912
HKFRS 9 Financial instrument adjustments	95,651	–	(7,881)	–	–	87,770
As at January 1, 2018	240,765	(27,561)	109,124	473	(119)	322,682
Credited/(charged) to the statement of comprehensive income	118,045	3,271	(51,864)	3,837	71	73,360
As at December 31, 2018	358,810	(24,290)	57,260	4,310	(48)	396,042

The components of deferred tax liabilities recognised in the consolidated statement of financial position and the movements during the year are as follows:

	Accelerated tax depreciation	Tax losses	Others	Total
As at January 1, 2017	(2,583)	16,382	(33,198)	(19,399)
Credited/(Charged) to the statement of comprehensive income	537	(3,229)	1,189	(1,503)
As at December 31, 2017 & January 1, 2018	(2,046)	13,153	(32,009)	(20,902)
Credited/(charged) to the statement of comprehensive income	100	(2,543)	1,837	(606)
As at December 31, 2018	(1,946)	10,610	(30,172)	(21,508)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

33 FIXED ASSETS

	Leasehold land*	Buildings	Leasehold improvements	Furniture and equipment	Total
Cost:					
As at January 1, 2018	610,110	2,806,556	566,136	877,860	4,860,662
Additions	–	11,513	32,286	147,836	191,635
Written-off	–	–	(11,796)	(5,764)	(17,560)
As at December 31, 2018	610,110	2,818,069	586,626	1,019,932	5,034,737
Accumulated depreciation:					
As at January 1, 2018	76,514	445,953	354,254	658,846	1,535,567
Charge for the year	2,015	79,355	84,583	148,211	314,164
Written-off	–	–	(10,406)	(5,549)	(15,955)
As at December 31, 2018	78,529	525,308	428,431	801,508	1,833,776
Net book value:					
As at December 31, 2018	531,581	2,292,761	158,195	218,424	3,200,961

	Leasehold land*	Buildings	Leasehold improvements	Furniture and equipment	Total
Cost:					
As at January 1, 2017	87,110	3,365,943	496,988	777,403	4,727,444
Additions	–	–	47,007	108,363	155,370
Written-off	–	–	(14,246)	(7,906)	(22,152)
Reclassification	523,000	(559,387)	36,387	–	–
As at December 31, 2017	610,110	2,806,556	566,136	877,860	4,860,662
Accumulated depreciation:					
As at January 1, 2017	28,816	427,830	275,781	527,673	1,260,100
Charge for the year	2,015	77,468	79,057	139,070	297,610
Written-off	–	–	(14,246)	(7,897)	(22,143)
Reclassification	45,683	(59,345)	13,662	–	–
As at December 31, 2017	76,514	445,953	354,254	658,846	1,535,567
Net book value:					
As at December 31, 2017	533,596	2,360,603	211,882	219,014	3,325,095

* All leasehold land is held under finance leases.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

34 OTHER ASSETS

	2018	2017
Gross accrued interest receivable	1,771,735	1,739,427
Less: Expected credit loss allowances		
Stage 1: 12-month ECL	(4,783)	–
Stage 2: Lifetime ECL but not credit impaired	(1,483)	–
Stage 3: Lifetime ECL and credit impaired	(51)	–
Net accrued interest receivable	1,765,418	1,739,427
Settlement accounts	290,690	303,933
Customer liability under acceptances	566,454	457,767
Debt securities trade date receivable	166,513	–
Accounts receivable	668,223	1,025,337
Repossessioned assets	489	55,813
Refundable deposits	319,085	244,319
Prepaid expenses	112,915	102,956
Others	96,158	144,079
	3,985,945	4,073,631

The fair value of other assets approximately equals to their carrying amount.

During the year of 2018, there are no significant movements in the gross balances of other assets that resulted in significant changes to the expected credit loss allowances

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

34 OTHER ASSETS (continued)

(a) Movement in change in expected credit loss allowances on other assets

The following table shows the reconciliation from the opening balance to the closing balance of the expected credit loss allowances on other assets. Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in Note 8(a)(xii).

	2018			
	Stage 1 12-month ECL	Stage 2 Lifetime ECL but not credit- impaired	Stage 3 Lifetime ECL and credit- impaired	Total
Balance as at January 1, 2018	1,287	68	27,534	28,889
Transfer to stage 1: 12-month ECL	–	–	–	–
Transfer to stage 2: lifetime ECL but not credit-impaired	(1)	1	–	–
Transfer to stage 3: lifetime ECL and credit-impaired	–	–	–	–
Net remeasurement of loss allowances	(217)	10	(198)	(405)
New financial assets originated or purchased*	2,164	264	15	2,443
Financial assets that have been derecognised	(292)	(35)	(27,303)	(27,630)
Write-offs	–	–	–	–
Recoveries of amounts previously written-offs	–	–	–	–
Changes in risk parameters	1,819	1,176	3	2,998
Foreign exchange and other movements	23	(1)	–	22
Balance as at December 31, 2018	4,783	1,483	51	6,317

* During 2018, all other assets were initially classified in Stage 1 and were not considered as credit-impaired at the time of origination or purchase. Some were subsequently transferred into Stage 2 or Stage 3 based on the result of credit assessments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

35 DEPOSITS AND BALANCES OF BANKS

	2018	2017
Deposits from banks	1,729,630	2,623,700
Takings from banks	30,437,773	70,599,922
	32,167,403	73,223,622

36 FINANCIAL ASSETS SOLD UNDER REPURCHASE AGREEMENTS

	2018	2017
Government bonds	2,420,859	–

There were no financial assets sold under repurchase agreements on December 31, 2017.

37 DEPOSITS FROM CUSTOMERS

	2018	2017
Demand deposits and current accounts	31,115,147	23,666,420
Savings deposits	64,736,188	58,952,499
Time and call deposits	257,573,125	269,925,700
Structured notes	–	161,556
Other deposits	705,419	563,158
	354,129,879	353,269,333

38 OTHER DEBT SECURITIES ISSUED

	2018	2017
Other debt securities issued at amortised cost	9,770,535	10,127,917
Other debt securities issued at fair value	2,404,220	2,454,154
Other debt securities under fair value hedge	2,341,154	2,334,973
	14,515,909	14,917,044

As at December 31, 2018, the fair values of other debt securities issued at amortised cost were \$9,797,381 (2017: \$10,212,531). The fair values were measured using level 2 hierarchy method as disclosed in Note 8(e)(i).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

39 OTHER LIABILITIES

	2018	2017
Accrued interest payable	2,045,531	1,718,439
Settlement accounts	341,666	295,768
Accounts payable	211,190	488,660
Acceptances outstanding	566,454	457,767
Accrued salaries and welfare	340,358	279,410
Amounts due to intermediate holding companies	2,662,917	2,900,956
Debt securities trade date payable	166,494	—
Accrued expenses	72,220	93,129
Cash collateral received (Note 8(f)(i))	167,784	1,356,736
Expected credit loss allowances on loan commitments (Note 46)	201,896	—
Others	231,522	143,117
	7,008,032	7,733,982

The fair value of other liabilities, except for expected credit loss allowances on loan commitments, approximately equals to their carrying amount.

40 SUBORDINATED DEBT

	2018	2017
Subordinated debt		
— Under fair value hedge	5,833,798	5,812,111

On August 20, 2014, the Bank issued subordinated note with aggregate nominal amount of USD750 million, bearing a fixed interest rate of 4.25% per annum to institutional investors. The note was issued at discount with maturity due on August 20, 2024 (callable at the option of the Bank on August 20, 2019). The note was listed on the Stock Exchange of Hong Kong Limited.

Subordinated debt was raised by the Bank for the development and expansion of business. The subordinated debt will be written-off at the point of non-viability as determined by the HKMA. These notes have been qualified and included as the Bank's Tier 2 Capital in accordance with the Capital Rules.

The Bank has not had any default of principal or interest or other breaches with respect to the subordinated debt during the year.

The Bank designates the subordinated debt under fair value hedge. The fair value hedge principally consists of interest rate swaps that are used to protect against changes in the fair value of the subordinated debt due to movements in market interest rates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

41 SHARE CAPITAL

	2018	2017
Issued and fully paid		
162,776,068 (2017: 162,776,068) HKD ordinary shares	6,511,043	6,511,043
440,000,000 (2017: 440,000,000) RMB ordinary shares	22,316,800	22,316,800
	28,827,843	28,827,843

42 OTHER EQUITY INSTRUMENTS

		2018	2017
Nominal value	Description		
USD1 billion	Fixed rate perpetual capital instrument callable from December 29, 2022	7,811,732	7,812,200

The additional tier 1 capital instruments are perpetual and subordinated, and the coupon payments may be cancelled at the sole discretion of the Group. The capital instruments will be written down at the point of non-viability on the occurrence of a trigger event as defined in the Banking (Capital) Rules. They rank higher than ordinary shares in the event of a winding-up.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

43 RESERVES

(a) General reserve

General reserve is appropriated from the retained earnings for future use.

(b) Investment revaluation reserve

The investment revaluation reserve comprises the cumulative net change in the fair value of financial assets measured at fair value through other comprehensive income (formerly known as available-for-sale financial assets) until the financial assets are derecognised and is dealt with in accordance with the accounting policies adopted for the measurement of these financial assets at fair value.

(c) Regulatory reserve

Regulatory reserve comprises reserves maintained in accordance with Hong Kong regulations. At Group level, it includes a regulatory reserve of \$576,966 (December 31, 2017: \$2,307,924) to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purposes. Movement in this reserve is made directly through retained earnings and in consultation with HKMA.

(d) Other reserve

Other reserve is used to record the corresponding amount of the share options and bonus rewards granted by the former parent company to the Bank's employees. The options and rewards granted are classified as equity-settled share-based payments and the amount recognised in other reserve represents capital contribution from its former parent company and is not distributable.

(e) Merger reserve

Merger reserve arises as a result of the acquisition of a majority of the corporate banking business ("Acquired Business") of CCB Hong Kong Branch ("HKBR"). This amount represented the difference between the net book value of the Acquired Business and the consideration paid.

(f) Retained earnings

The Bank and its financial subsidiaries are required to maintain minimum capital adequacy ratios under their respective regulatory jurisdictions. The minimum capital requirements could therefore potentially restrict the amount of retained earnings available for distribution to the shareholders.

All reserves, except for general reserve and retained earnings, are not available for distribution.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

44 STATEMENT OF FINANCIAL POSITION AND RESERVE MOVEMENT OF THE BANK

Statement of Financial Position of the Bank

	Note	2018	2017
ASSETS			
Cash and balances with banks and central banks		78,238,552	81,673,095
Placements with banks		31,753,841	17,997,303
Advances to banks		–	262,498
Advances to customers and trade bills		254,471,410	288,127,996
Financial assets held under resale agreements		1,514,983	–
Financial assets measured at fair value through profit or loss		3,539,873	–
Financial assets measured at fair value through other comprehensive income		86,744,559	–
Financial assets measured at amortised cost		12,065,832	–
Available-for-sale financial assets		–	98,956,057
Held-to-maturity investments		–	17,458,857
Derivative financial instruments		2,756,470	6,788,337
Investments in subsidiaries		526,010	526,010
Interest in an associate		10,411	10,411
Deferred tax assets		396,042	234,912
Fixed assets		2,472,366	2,587,011
Other assets		4,070,661	4,205,324
Total assets		478,561,010	518,827,811
LIABILITIES			
Deposits and balances of banks		32,167,403	73,223,622
Deposits from customers		354,675,588	353,824,669
Financial assets sold under repurchase agreements		2,420,859	–
Other debt securities issued		14,515,909	14,917,044
Derivative financial instruments		2,142,242	6,563,076
Current tax payable		250,140	162,804
Other liabilities		4,414,148	5,377,199
Subordinated debt		5,833,798	5,812,111
Total liabilities		416,420,087	459,880,525
EQUITY			
Share capital		28,827,843	28,827,843
Other equity instruments		7,811,732	7,812,200
Reserves	44(a)	25,501,348	22,307,243
Total equity		62,140,923	58,947,286
Total equity and liabilities		478,561,010	518,827,811

Approved and authorised for issue by the Board of Directors on March 22, 2019.

JIANG Xianzhou
Chairman and Executive Director

ZHANG Jun
Vice Chairman, Executive Director
and Chief Executive Officer

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

44 STATEMENT OF FINANCIAL POSITION AND RESERVE MOVEMENT OF THE BANK (continued)

(a) Reserve movement of the Bank

Details of the changes in the Bank's reserve between the beginning and the end of the year are set out below:

	General reserve	Investment revaluation reserve	Regulatory reserve	Other reserve	Merger reserve	Retained earnings	Total
Balance as at December 31, 2017	750,956	(562,295)	2,307,924	15,913	62,262	19,732,482	22,307,242
Impact on transition to HKFRS 9	–	118,890	–	–	–	(433,194)	(314,304)
Restated balance as at January 1, 2018	750,956	(443,405)	2,307,924	15,913	62,262	19,299,288	21,992,938
Profit for the year	–	–	–	–	–	3,607,365	3,607,365
Other comprehensive income, net of tax	–	269,475	–	–	–	–	269,475
Total comprehensive income for the year	–	269,475	–	–	–	3,607,365	3,876,840
Coupon paid for other equity instruments	–	–	–	–	–	(368,430)	(368,430)
Regulatory reserve	–	–	(1,730,958)	–	–	1,730,958	–
Balance as at December 31, 2018	750,956	(173,930)	576,966	15,913	62,262	24,269,181	25,501,348

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

44 STATEMENT OF FINANCIAL POSITION AND RESERVE MOVEMENT OF THE BANK (continued)

(a) Reserve movement of the Bank (continued)

Details of the changes in the Bank's reserve between the beginning and the end of the year are set out below:
(continued)

	General reserve	Investment revaluation reserve	Regulatory reserve	Other reserve	Merger reserve	Retained earnings	Total
Balance as at January 1, 2017	750,956	(300,618)	2,307,924	15,913	62,262	16,462,924	19,299,361
Profit for the year	–	–	–	–	–	3,269,558	3,269,558
Other comprehensive losses:							
change in fair value of available-for-sale financial assets	–	(261,677)	–	–	–	–	(261,677)
Total comprehensive income for the year	–	(261,677)	–	–	–	3,269,558	3,007,881
Balance as at December 31, 2017	750,956	(562,295)	2,307,924	15,913	62,262	19,732,482	22,307,242

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

45 MATERIAL RELATED PARTY TRANSACTIONS

During the year, the Group entered into transactions with related parties in the normal course of its banking business including lending, acceptance and placements of inter-bank deposits, correspondent banking transactions, securities brokerage and derivative transactions. The transactions were priced at the relevant market rates at the time of each transaction.

(a) The amount of material related party transactions during the year and outstanding balances at the reporting date are set out below:

	Intermediate holding company (Note 51)		Fellow subsidiaries		Associate	
	2018	2017	2018	2017	2018	2017
Interest income	933,164	899,696	172,093	129,105	–	–
Interest expense	420,661	462,390	32,357	6,980	11,973	8,482
Fees and commission income (Note 10)	555,673	557,042	–	–	–	–
Fees and commission expense (Note 10)	34,955	69,492	196	101	–	–
Other operating income	46,288	56,033	4,236	2,805	–	–
Operating expenses	4,144	4,704	–	–	–	–

Fees and commission income mainly represented the fees received from intermediate holding company for advisory and support services provided.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

45 MATERIAL RELATED PARTY TRANSACTIONS (continued)

(a) The amount of material related party transactions during the year and outstanding balances at the reporting date are set out below: (continued)

	Intermediate holding company (Note 51)		Fellow subsidiaries		Associate	
	2018	2017	2018	2017	2018	2017
Amounts due from:						
Cash and balances with banks and central banks	30,839,686	67,738,488	—	—	—	—
Placements with banks	13,807,830	8,266,633	—	—	—	—
Financial assets held under resale agreements	1,514,983	—	—	—	—	—
Advances to customers and trade bills	42,194	926,918	1,317,425	3,136,235	—	—
Financial assets measured at fair value through other comprehensive income	929,240	—	1,900,521	—	—	—
Available-for-sale financial assets	—	992,234	—	1,901,961	—	—
Derivative financial instruments	311,943	906,912	—	—	—	—
Other assets	656,074	851,128	26,458	18,951	—	—
Amounts due to:						
Deposits and balances of banks	29,379,049	69,248,616	6,475	177,551	—	—
Financial assets sold under repurchase agreements	2,420,859	—	—	—	—	—
Deposits from customers	2,849	2,847	5,902,536	7,201,863	614,342	602,549
Derivative financial instruments	317,562	3,613,958	—	—	—	—
Other liabilities	2,682,674	2,900,956	4,987	371	8,293	5,493
Contingencies and commitments:						
Direct credit substitutes	85,000	85,000	—	—	—	—
Transaction-related contingencies	19,299	5,974	—	—	—	—
Other commitments	—	—	2,210,770	52,992	—	—
Derivative financial instruments: (notional amount)						
Exchange rate contracts	67,325,878	220,207,045	—	—	—	—
Interest rate swaps	273,560	—	—	—	—	—

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

45 MATERIAL RELATED PARTY TRANSACTIONS (continued)

(a) The amount of material related party transactions during the year and outstanding balances at the reporting date are set out below: (continued)

The Group may enter into transactions with entities directly or indirectly owned by the Mainland government through its government authorities, agencies, affiliations and other organisations ("state-owned entities") in the normal course of business. These transactions are entered into on terms similar to those that would have been entered into with non-state-owned entities. These transactions include but are not limited to:

- lending and deposit taking;
- inter-bank balances taking and placing;
- insurance and securities agency;
- custody services;
- sale, purchase, underwriting and redemption of bonds;
- purchase, sale and leases of property and other assets; and
- rendering and receiving of utilities and other services.

The Group's pricing and approval processes for major products and services do not depend on whether the customers or counterparties are state-owned entities. Having due regard to the substance of the relationships, the Group is of the opinion that none of these transactions are material related party transactions that require separate disclosure.

(b) Directors and key management personnel

During the year, the Group provided credit facilities to and accepted deposits from the directors and key management personnel of the Group and its holding companies and their close family members and companies controlled or significantly influenced by them. The credit facilities and deposits were provided and taken in the ordinary course of business and on substantially the same terms as for comparable transactions with persons of a similar standing, or where applicable, with other employees. These transactions did not involve more than the normal risk of collectability or present other unfavourable features.

	2018	2017
Loans	1,175	6,538
Interest income earned	148	179
Deposits	94,253	50,963
Interest expense paid	1,062	596
Compensation — salaries and other short-term benefits	32,290	27,174

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

45 MATERIAL RELATED PARTY TRANSACTIONS (continued)

(c) Loans to Directors

Particulars of loans to directors disclosed pursuant to Section 17 of the Hong Kong Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G).

	2018	2017
Aggregate amount in respect of principal and interest as at December 31	652	6,469
The maximum aggregate amount outstanding in respect of principal and interest during the year	7,917	13,848

46 CONTINGENT LIABILITIES AND COMMITMENTS

The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments to extend credit:

	2018	2017
Direct credit substitutes	628,195	659,080
Transaction-related contingencies	8,365,482	2,454,818
Trade-related contingencies	1,040,083	1,074,184
Other commitments		
which are unconditionally cancellable or automatically cancellable due to the deterioration in the credit worthiness of the borrower	53,713,318	53,002,350
with an original maturity under one year	836,818	7,064,387
with an original maturity over one year	24,025,892	20,568,476
	88,609,788	84,823,295

Contingent liabilities and commitments are credit-related instruments which include letter of credits, guarantees and commitments to extend credit. The risk involved is essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are, therefore, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for the loans. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client defaults. As the facilities may expire without being drawn upon, the contract amounts do not represent expected future cash flows.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

46 CONTINGENT LIABILITIES AND COMMITMENTS (continued)

(a) Movement in change in expected credit loss allowances on loan commitments

The following table shows the reconciliation from the opening balance to the closing balance of the expected credit loss allowances on loan commitments. Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in Note 8(a)(xii).

	2018			
	Stage 1 12-month ECL	Stage 2 Lifetime ECL but not credit- impaired	Stage 3 Lifetime ECL and credit- impaired	Total
Balance as at January 1, 2018	169,747	48,807	–	218,554
Transfer to stage 1: 12-month ECL	–	–	–	–
Transfer to stage 2: lifetime ECL but not credit-impaired	–	–	–	–
Transfer to stage 3: lifetime ECL and credit-impaired	–	–	–	–
Net remeasurement of loss allowances	(67,297)	(14,719)	–	(82,016)
New commitments originated or purchased*	125,774	2,272	–	128,046
Commitments that have been derecognised	(17,928)	(18)	–	(17,946)
Write-offs	–	–	–	–
Recoveries of amounts previously written-offs	–	–	–	–
Changes in risk parameters	(44,075)	1,144	–	(42,931)
Foreign exchange and other movements	(1,830)	19	–	(1,811)
Balance as at December 31, 2018	164,391	37,505	–	201,896

* During 2018, all loan commitments were initially classified in Stage 1 and were not considered as credit-impaired at the time of origination or purchase. Some were subsequently transferred into Stage 2 or Stage 3 based on the result of credit assessments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

47 CAPITAL COMMITMENTS

Capital commitments outstanding as at December 31, not provided for in the consolidated financial statements are as follows:

	2018	2017
Expenditure contracted but not provided for	88,942	70,609
Expenditure authorised but not contracted for	51,421	64,785
	140,363	135,394

48 LEASE COMMITMENTS

At December 31, 2018, the Group had future aggregate minimum lease payments under non-cancellable operating leases as follows:

	2018	2017 (restated)
Not later than one year	323,797	291,986
Later than one year and not later than five years	1,010,720	746,364*
Later than five years	997,087	1,092,766*
	2,331,604	2,131,116

The Group leases a number of properties and equipment under operating leases. The remaining terms of the leases range from 1 to 14 years (2017: 1 to 15 years). These lease arrangements are typically subject to rent reviews every 3 years to reflect market rates. Aside from such potential increase in lease payments due to rent reviews, there are no other contingent rentals.

* The comparative figures for the year ended 31 December 2017 has been restated to include the minimum lease payments for the period from the next rent review date till the end of the lease term. This is to conform the current year presentation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

49 NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS

(a) Reconciliation of operating profit to net cash outflow from operations

	2018	2017
Operating activities		
Operating profit	4,427,830	3,965,263
Adjustments for:		
Dividend income	(5,903)	(3,782)
Depreciation	314,164	297,610
Charges on impairment allowances on loans and advances	–	368,316
Releases on impairment allowances on repossessed assets	–	(1,636)
Charges on impairment allowances on held-to-maturity investments	–	319
Charges on expected credit losses, total	587,980	–
Written-off of loans and advances, net of recoveries	(79,633)	(111,453)
Written-off of fixed assets	–	51
Interest income on financial assets measured at amortised cost (2017: held-to-maturity investments)	(429,856)	(421,076)
Interest expenses on subordinated debt	254,873	253,270
Fair value adjustment on financial assets measured at fair value through profit or loss	(149,242)	–
Fair value adjustment on subordinated debt under fair value hedge	5,448	(11,241)
Effect of foreign exchange rate changes	2,308,327	(5,604,625)
	7,233,988	(1,268,984)
Decrease/(increase) in operating assets		
Balances and placements with banks with original maturity beyond three months and remaining maturity beyond one month and balances with central banks	(2,230,567)	10,420,787
Financial assets held under resale agreements	(1,514,983)	–
Gross advances to banks	262,498	(262,498)
Gross advances to customers and trade bills	27,263,645	(54,970,658)
Financial assets measured at fair value through profit or loss with original maturity beyond three months	1,854,515	–
Derivative financial instruments	4,031,867	946,214
Other assets	521,575	6,108,771
	30,188,550	(37,757,384)
Decrease in operating liabilities		
Deposits and balances of banks	(41,056,219)	(13,097,163)
Financial liabilities sold under repurchase agreements	2,420,859	–
Deposits from customers	860,546	31,046,764
Derivative financial instruments	(4,420,834)	(1,070,639)
Other debt securities issued	(401,135)	(16,905,931)
Other liabilities	(927,879)	(1,674,269)
	(43,524,662)	(1,701,238)
Net cash outflow from operations	(6,102,124)	(40,727,606)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

49 NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

(b) Cash and cash equivalents in the consolidated statement of cash flows

	2018	2017
Gross cash and balances with banks and central banks	78,240,159	81,673,241
Placements with banks with original maturity within three months	19,996,804	8,466,430
	98,236,963	90,139,671

(c) Reconciliation with the consolidated statement of financial position

	2018	2017
Cash and balances with banks and central banks (Note 19)	78,238,697	81,673,241
Placements with banks (Note 20)	31,753,841	17,997,303
Financial assets measured at fair value through other comprehensive income (2017: available-for-sale financial assets) (Note 24)	86,744,559	98,956,057
Amounts shown in consolidated statement of financial position	196,737,097	198,626,601
Less: Amounts with an original maturity of beyond three months and remaining maturity beyond one month		
Placements with banks	(11,761,440)	(9,530,873)
Available-for-sale financial assets	–	(98,956,057)
Financial assets measured at fair value through other comprehensive income	(86,744,559)	–
Expected credit loss allowances on balances with banks and central banks and placements with banks	5,865	–
Cash and cash equivalent in the consolidated statement of cash flows	98,236,963	90,139,671

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

49 NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

(d) Analysis of changes in financing activities during the year

	Subordinated debt	Other equity instruments
Balance as at January 1, 2017	5,773,574	–
Cash inflow from financing activities	–	7,812,200
Cash outflow from financing activities	(248,400)	–
Interest expenses on subordinated debt	253,271	–
Fair value adjustment on subordinated debt under fair value hedge	(11,242)	–
Exchange differences	44,908	–
Balance as at December 31, 2017	5,812,111	7,812,200
Cash outflow from financing activities	(249,788)	(468)
Interest expenses on subordinated debt	254,873	–
Fair value adjustment on subordinated debt under fair value hedge	5,448	–
Exchange differences	11,154	–
Balance as at December 31, 2018	5,833,798	7,811,732

(e) Non-cash investing and financing activities

The Group's non-cash investing and financing activities include (losses)/gains on disposal of fixed assets, share of profit/(losses) of associate/joint venture, and impairment charges on associate/joint venture.

50 ASSETS TRANSFERRED AND COLLATERAL ACCEPTED AS SECURITY FOR ASSETS

(a) Transferred financial assets not qualifying for full derecognition and their associated financial liabilities

	2018	
	Carrying amount of transferred assets	Carrying amount of associated liabilities
Repurchase agreements	2,406,835	2,420,859

The financial assets shown above include amounts transferred to third parties that do not qualify for derecognition are mainly debt securities held by counterparties as collateral under repurchase agreements. As the substance of these transactions is secured borrowings, the collateral assets continue to be recognised in full and the related liabilities, reflecting the Group's obligation to repurchase the transferred assets for a fixed price at a future date, are also recognised on the statement of financial position. As a result of these transactions, the Group is unable to use, sell or repledge the transferred assets for the duration of the transactions. The Group remains exposed to interest rate risk, credit risk and market risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

50 ASSETS TRANSFERRED AND COLLATERAL ACCEPTED AS SECURITY FOR ASSETS (continued)

(b) Collateral accepted as securities for assets

The Group conducts resale agreements under usual and customary terms of placements, and holds collateral for these transactions. As at December 31, 2018, for resale agreements, the Group was not permitted to sell or repledge the collateral held, unless there is a default.

51 IMMEDIATE PARENT AND ULTIMATE CONTROLLING PARTY

At December 31, 2018, the Bank's immediate parent is CCB Overseas Holdings Limited ("CCBOHL"), a company incorporated in Hong Kong. CCBOHL is controlled by CCB. Central Huijin Investment Ltd. is the controlling party of CCB, and is a wholly-owned subsidiary of China Investment Corporation which is a wholly state-owned investment and management company. The Group's intermediate parent, CCB, which is a listed bank incorporated in the Mainland, produces financial statements available for public use.

52 EVENTS AFTER THE REPORTING PERIOD

There are no significant events after the reporting period.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

The notes to the consolidated financial statements and the following unaudited supplementary information are prepared to comply with the Banking (Disclosure) Rules.

1 OVERDUE AND RESCHEDULED ASSETS

(a) Gross advances to customers overdue for more than three months:

	2018		2017	
		% on total advances to customers		% on total advances to customers
Six months or less but over three months	78,691	0.03	23,793	0.01
One year or less but over six months	16,323	0.01	2,987	–
Over one year	111,048	0.04	123,582	0.04
Total gross amount of advances overdue for more than three months	206,062	0.08	150,362	0.05
Expected credit loss/impairment allowances made in respect of the above overdue advances	142,613		127,180	
Net realisable value of collateral held against the overdue advances	132,400		29,648	
Covered portion of overdue advances	132,400		8,536	
Uncovered portion of overdue advances	73,662		141,826	
	206,062		150,362	

As at December 31, 2018, collaterals held with respect of overdue advances to customers are mainly residential properties (2017: automobiles and residential properties).

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

1 OVERDUE AND RESCHEDULED ASSETS (continued)

(b) Gross trade bills overdue for more than three months:

	2018		2017	
		% on total trade bills		% on total trade bills
Six months or less but over three months	–	–	–	–
One year or less but over six months	–	–	–	–
Over one year	3,052	1.45	140,132	9.53
Total gross amount of trade bills overdue for more than three months	3,052	1.45	140,132	9.53
Expected credit loss/impairment allowances made in respect of the above overdue trade bills	3,052		140,132	
Net realisable value of collateral held against the overdue trade bills	–		–	
Covered portion of overdue trade bills	–		–	
Uncovered portion of overdue trade bills	3,052		140,132	
	3,052		140,132	

As at December 31, 2018 and 2017, there were no overdue advances to banks.

(c) Rescheduled advances to customers:

	2018		2017	
		% on total advances to customers		% on total advances to customers
Rescheduled advances to customers	56,346	0.02	59,153	0.02

Rescheduled advances are those advances which have been restructured or renegotiated because of deterioration in the financial position of the borrower, or the inability of the borrower to meet the original repayment schedule and for which the revised payment terms are non-commercial to the Bank. The rescheduled advances are stated net of any advances that have subsequently become overdue for over three months and reported as overdue advances as above.

As at December 31, 2018 and 2017, there were no rescheduled advances to banks and trade bills.

(d) Other overdue and rescheduled assets

As at December 31, 2018 and 2017, there were no other overdue and rescheduled assets.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

2 LIQUIDITY INFORMATION

(a) Average liquidity coverage ratio ("LCR")

		2018 %	2017 %
Average liquidity coverage ratio	— First quarter	156.4	116.8
	— Second quarter	160.2	122.8
	— Third quarter	236.3	138.3
	— Fourth quarter	270.9	187.5

The average LCR for each quarter is based on the arithmetic mean of its LCR as at the end of each working day for each quarter for the Bank as required by the Hong Kong Monetary Authority ("HKMA") for its regulatory purposes.

The LCR of the Bank was maintained at a stable level in the year of 2018.

The Bank manages its liquidity independently of other members of the CCB Group and has not granted any liquidity facility to any group member. However, CCB Head Office provides strong liquidity support to the Bank which forms an important part of the Bank's funding sources.

Other LCR disclosure requirements under the Banking (Disclosure) Rules are published on the Bank's website: <http://www.asia.ccb.com/hongkong>.

The Bank's High Quality Liquidity Assets ("HQLA") consists of cash, balances at central banks and high quality marketable securities issued or guaranteed by sovereigns, central banks, mainland policy banks and non-financial corporate debt securities. The Bank continues to purchase securities issued by other sovereign or central bank entities so as to diversify the composition of its HQLA and to enhance the LCRs of individual currencies.

The currency mismatch between the HQLA and the net cash outflow in the calculation of LCR is controlled and monitored via individual currency LCR limits. The HQLA mix is further governed by concentration caps and limits in accordance with statutory requirements and internal policy requirements for risk management purposes.

The Bank's primary sources of funds are retail and corporate customer deposits, supplemented by wholesale funding such as issuance of certificates of deposit, debts instruments and short-term interbank money market borrowings.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

2 LIQUIDITY INFORMATION (continued)

(a) Average liquidity coverage ratio ("LCR") (continued)

The Bank's customer deposits are mainly denominated in HKD. To meet customers' loan demand, the Bank swaps surplus HKD funding into USD and other foreign currencies. This results in some currency mismatch in the LCR.

The Bank closely monitors all its exchange traded and over-the-counter derivative exposures arising from customer transactions and the corresponding hedging activities with counterparties. Collateral may be required to be posted to counterparties depending on the marked-to-market position of the derivative contracts. Nonetheless, such exposures are not material and hence the impact of the relevant cash outflows was minimal to the LCR levels.

(b) Quarter-end net stable funding ratio ("NSFR")

		2018 %
Quarter-end NSFR	— First quarter	126.55
	— Second quarter	128.04
	— Third quarter	136.78
	— Fourth quarter	139.42

The NSFR of the Bank was maintained at a stable level in the year of 2018.

Net stable funding ratio means the ratio of the amount of the Bank's available stable funding ("ASF") to the amount of the Bank's required stable funding ("RSF").

ASF is sum of weighted amounts of the Bank's capital and on-balance sheet liabilities. Retail and corporate customer deposits are the Bank's primary sources of liabilities. Other liabilities include certificates of deposit and term debts issued by the Bank and interbank money market borrowing.

RSF is sum of weighted amounts of the Bank's on-balance sheet assets and off-balance sheet obligations. Loans and funds provided to retail customers and wholesale customers are major components of RSF. Other RSF items include debt securities held by the Bank and interbank money market lending. The Bank's off-balance sheet obligations mainly involve potential drawdown of undrawn committed facilities.

Other NSFR disclosure requirements under the Banking (Disclosure) Rules are published on the Bank's website: <http://www.asia.ccb.com/hongkong>.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

2 LIQUIDITY INFORMATION (continued)

(c) Liquidity cushion

The size and composition of the Bank's liquidity cushion as of December 31, 2018 and 2017 was:

	2018	2017
Cash & Central Bank reserves	6,935,303	2,630,025
Hong Kong Government Exchange Fund	13,045,422	14,393,765
Other securities which fulfil the High Quality Liquidity Assets definition	44,436,681	57,925,412

This is an additional information disclosed in relation to the requirement of HKMA Supervisory Policy Manual "Sound Systems and Controls for Liquidity Risk Management".

3 CAPITAL ADEQUACY RATIO AND CAPITAL MANAGEMENT

Capital adequacy ratio

	Group	
	2018	2017
	%	%
Common Equity Tier 1 capital ratio	15.1	13.2
Tier 1 capital ratio	17.3	15.4
Total capital ratio	19.7	17.8

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

4 SEGMENTAL INFORMATION

(a) Gross advances to customers

(i) Gross advances to customers by industry sectors

Analysis of gross advances to customers covered by collateral is as follows:

	Group			
	2018 Outstanding balance	% of advances covered by collateral	2017 Outstanding balance	% of advances covered by collateral
Advances for use in Hong Kong				
Industrial, commercial and financial				
Property development	18,744,581	94.75	16,993,073	11.31
Property investment	32,567,682	83.04	34,511,542	81.09
Financial concerns	33,809,319	72.73	44,486,011	50.78
Stockbrokers	1,070,347	93.46	405,719	92.61
Wholesale and retail trade	5,549,307	67.52	8,283,535	65.81
Manufacturing	4,767,472	43.62	4,317,801	34.47
Transport and transport equipment	8,326,221	76.18	11,153,593	62.11
Recreational activities	354,518	8.84	351,368	7.80
Information technology	3,190,770	98.41	3,114,372	25.26
Others	13,545,491	51.81	11,921,817	55.58
	121,925,708		135,538,831	
Individuals				
Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	3,699	100.00	4,420	100.00
Loans for the purchase of other residential properties	16,633,839	99.58	15,087,680	99.29
Credit card advances	4,324,556	0.00	4,878,873	0.00
Others	17,982,997	33.27	20,619,908	26.64
	38,945,091		40,590,881	
Trade finance	3,722,133	51.57	4,354,428	46.77
Advances for use outside Hong Kong	92,020,855	74.25	107,543,372	47.53
Gross advances to customers	256,613,787	72.31	288,027,512	51.32

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE

The Bank has complied with the requirements set out on the Supervisory Policy Manual Module, CG-1 “Corporate Governance of Locally Incorporated Authorised Institutions” issued by the HKMA.

There are five special committees and one sub-committee under the Board of Directors, namely Executive Committee, Strategy and Corporate Governance Committee, Audit Committee, Nomination and Remuneration Committee, Risk Committee and Compliance Sub-Committee under the Risk Committee. There are seven key functional committees, of which Asset and Liability Committee and Information Technology Committee directly report to Executive Committee, while Risk Management Committee, Credit Committee, Product Innovation and Approval Committee, Internal Control, Compliance and Operations Committee and New Capital Accord Steering Committee jointly report to Executive Committee and Risk Committee.

(a) Board of Directors

The Board of Directors has the ultimate responsibilities to the shareholders, depositors, creditors, employees, other stakeholders, and banking supervisors of the Group in ensuring that the business and operational functions of the Group are managed in a prudent, professional and competent manner and in conformity with relevant laws and regulations. Key specialised committees are established to be responsible to and report to the Board of Directors, and assist the Board of Directors in performing its duties according to the authorisation of the Board of Directors. The functional committees are established to ensure that such operational functions, as well as efficient management of the main types of risk arising out of the business, are effectively carried out. The Board of Directors held four meetings in 2018.

The key functions and powers of the Board of Directors are set out below:

- Determining the Bank’s development strategy, and supervising its implementation;
- Deciding on the business plan, investment plan and risk capital distribution plan of the Bank;
- Preparing annual financial budget and final accounts of the Bank;
- Preparing profit distribution plan and planning for making up losses of the Bank;
- Preparing plans for the increase or reduction of the Bank’s share capital, issuance of the Bank’s convertible bonds, subordinated bonds, corporate bonds or other negotiable securities and listing;
- Preparing plans for the Bank’s major acquisitions;
- Preparing plans for merger, division, dissolution and liquidation of the Bank;
- Deciding on the Bank’s equity investment, bond investment, asset acquisition, asset disposal, asset written-off, asset mortgage, other non-commercial banking business guarantees and external donations;
- Deciding on the setting up of the Bank’s internal management divisions;
- Deciding on the setting up of subsidiaries;

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(a) Board of Directors (continued)

- According to the shareholder's requirements, appointing or removing the chief executive officer of the Bank, senior executive vice president, executive vice president and other senior management members and determining their remuneration, reward and penalty;
- Formulating the Bank's basic management systems, and supervising the implementation of these systems;
- Deciding on risk management policies and internal control policies of the Bank, formulating risk management system and internal control system of the Bank, and supervising the implementation of such systems;
- Making proposal for the engagement, dismissal or retention of auditors to the Shareholders' General Meeting;
- Receiving and reviewing work reports of the Bank's senior management, and supervising, checking and assessing his/her work and adopting accountability system;
- Assessing and evaluating the duty performance of directors and senior management members;
- Regularly evaluating and continuously improving corporate governance of the Bank, and conducting a regular evaluation of the performance of the Board of Directors;
- Formulating the amendments to the Articles of Association of the Bank and the Procedural Rules for Board of Directors of the Bank, and formulating other systems, rules and measures of the Board of Directors;
- Formulating the capital planning and relevant systems on capital adequacy ratio assessment and management of the Bank, and supervising the implementation of such systems;
- Formulating systems for the management of accounting consolidation of the Bank and its subsidiaries, and supervising the implementation of such systems;
- Delegating all or any part of the authorities given by the shareholder to the chairman or chief executive officer of the Bank and allowing the chairman or chief executive officer to further delegate all or part of his/her authority to other personnel of the Bank provided that the aforesaid delegation should be made by way of authorisation document; and
- Exercising other functions and powers vested by laws, regulations, rules, and relevant provisions of the relevant regulatory authorities, and the Articles of Association as well as those authorised by the Bank's ultimate sole shareholder, China Construction Bank Corporation ("CCBC"), and/or the Shareholders' General Meeting.

Members of the Board of Directors, who come from a variety of different backgrounds, have a diverse range of business, banking and professional expertise. Currently, the Board of Directors comprises three executive directors and five non-executive directors. Of the five non-executive directors, three are independent non-executive directors ("independent directors").

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(a) Board of Directors (continued)

In order to promote sustainable development and to diversify the composition of the Board of Directors, the Bank has in place a policy on the selection and appointment of directors. For nomination of directors, the Board of Directors shall consider both capabilities and professional ethics of the candidates, and at the same time, take into account the requirement of board diversity. The candidates are complementary including but not limited to gender, age, cultural and educational background, ethnicity, professional experience, skills, knowledge and length of service of persons with diversify backgrounds. The final decision shall be based on the candidates' overall competence and possible contributions to the Board. The Nomination and Remuneration Committee is responsible for reviewing and supervising the implementation of the selection and appointment policy for directors which is approved by the Board of Directors.

(b) Executive Committee

The Executive Committee is responsible to the Board of Directors and the main duties and powers of the Committee are:

- Matters assigned by the Board of Directors:
 - Research and formulate the Bank's specific measures to better implement the relevant policies and guidelines of shareholder and the Board of Directors;
 - Prepare and propose matters which are required to be submitted to the Board of Directors for approval or discussion, including:
 - Significant investment or asset disposal
 - Capital arrangement proposals
 - Any subsidiaries established in any countries
 - Any programs of medium term bonds or listed warrants
 - Report the potential impacts of significant changes in internal rating policies and rating override cases
 - Report on the scope and performance of internal control systems yearly
 - Other matters requiring approval by the Board of Directors

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(b) Executive Committee (continued)

- Matters assigned by the Board of Directors: (continued)
 - Review and approve the composition and terms of reference of functional committees directly reporting to Executive Committee, including:
 - Asset and Liability Committee
 - Information Technology Committee
 - Risk Management Committee
 - Credit Committee
 - Product Innovation and Approval Committee
 - Internal Control, Compliance and Operations Committee
 - New Capital Accord Steering Committee
 - Review reports of functional committees and working committees/working units directly reporting to Executive Committee ; review and approve matters that exceed the authority of functional committees and working committees/working units but within the authority delegated by the Board of Directors to Executive Committee; and
 - Other matters assigned by the Board of Directors for review or handling.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(b) Executive Committee (continued)

— Matters of Business Management:

- Analyse the macroeconomic situations and policy environment, conduct thematic research on strategic topics and formulate strategic plans;
- Direct asset and liability management;
- Direct system development of internal management and control;
- Review and approve Capital Planning and Allocation Guidelines;
- Review the Bank's major management systems and regulations, including but not limited to the systems of the committees directly reporting to Executive Committee;
- Study and review the Bank's schemes of organizational structure and functional committees' setup, as well as allocation of divisional functions;
- Review the annual financial budgeting, financial reports, significant expenditures, and asset acquisition projects;
- Supervise the implementation of internal rating systems;
- Decide on matters related to external donations made by the Bank;
- Other management matters of importance.

— Matters of Authorization and Human Resources Management:

- Determine and revise senior management's and division heads' authority and delegation of authority;
- Study and review the employments of General Manager, Deputy General Manager, and ad-hoc staff, and the adjustments of division of responsibilities among members of senior management;
- Investigate and review the assessments and corresponding rewards and punishments for representatives of each line of business and division;
- Decide to use the title of the Bank to report, compliment, and grant honors to group(s) or individual(s); and
- Other matters assigned by the Board of Directors for review or handling.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(b) Executive Committee (continued)

According to the terms of reference of the Committee, the Committee shall be executive directors and all executive vice presidents of the Bank. The Chairman of the Committee shall be taken by the Chairman of the Board of Directors ("executive director"). The chief executive officer, senior executive vice president and executive vice presidents serve as the member of the Committee. The term of office of the members of the Committee shall be the same as that of employment with the Bank. The Committee held twenty meetings in 2018.

(c) Strategy and Corporate Governance Committee

The Strategy and Corporate Governance Committee is responsible to the Board of Directors and the main duties and powers of the Committee are:

- Preparing the Bank's strategy and development plan, supervising and evaluating the implementation of plan, and providing suggestions to the Board of Directors;
- Examining the Bank's annual operation plan and fixed asset investment budget, and submitting them to the Board of Directors for consideration;
- Examining the report on implementation of annual operation plan and fixed asset investment budget;
- Evaluating coordinative development of various businesses, and providing suggestions to the Board of Directors;
- Examining significant organisational adjustment and institutional scheme of the Bank, and providing suggestions to the Board of Directors;
- Examining major investment and financing plan of the Bank, and providing suggestions to the Board of Directors;
- Supervising the implementation of the relevant resolutions of the Shareholders' General Meetings and board meetings;
- Regularly receiving and reviewing the reports of senior management and making suggestions on operation management, as well as formulating rules for implementation to facilitate execution;

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(c) Strategy and Corporate Governance Committee (continued)

- Ensuring that the Bank has committed adequate efforts, time and resources according to compliance requirements;
- Formulating and regularly reviewing whether the Bank is in compliance with the laws, regulations and codes on corporate governance, and making suggestions to the Board of Directors; and
- Other matters authorised by the Board of Directors.

According to the terms of reference of the Committee, the Committee shall be composed of at least three directors. The Chairman of the Committee shall be taken by the Chairman of the Board of Directors. Members other than the Chairman of the Committee shall be appointed by the Board of Directors. The Committee held four meetings in 2018.

(d) Audit Committee

The Audit Committee serves as the “eyes and ears” to the Board of Directors in monitoring compliance with the Group’s policies and other internal and statutory regulations. It provides oversight of the Group’s internal and external auditors and thereby assists the Board of Directors in providing independent review of the effectiveness of the financial reporting process and internal control system of the Group.

The main duties and powers of the Audit Committee are:

- Supervising financial reports of the Bank, and examining the Bank’s accounting information and disclosure of its major events;
- Supervising and evaluating internal control of the Bank, including internal rating systems related issues of the Bank;
- Supervising and evaluating external audit work of the Bank, proposing to the Board of Directors on engagement or replacement of independent audit firm, and responsible for the communication and co-ordination between external auditors and internal auditors;
- Approving the appointment or dismissal of the head of internal audit division;
- Approving the internal audit charter prepared by the internal audit division and its regular updates;
- Receiving and reviewing the work report of the person in charge of the internal audit division; inspecting, monitoring and assessing the internal audit function;

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(d) Audit Committee (continued)

- Reporting to the Board of Directors its work, and maintaining communication and co-operation with other special committees;
- Discussing the problems faced in the financial audit and suggestions, and any matters proposed by the auditor for discussion (without the presence of the management at the meeting);
- Reviewing and approving the scope of audit and its frequency;
- Reviewing the audit report and ensuring that the senior management (together with the monitoring division) take actions as necessary to tackle the internal control weaknesses, areas that do not comply with the laws, regulations and policies, or issues identified by other auditors/internal auditor in a timely manner;
- Reporting to the Board of Directors significant audit findings, and making relevant suggestions;
- Approving the internal audit plan and the needs for human and financial resources after identifying the coverage of business risks; and
- Other matters authorised by the Board of Directors.

According to the terms of reference of the Committee, the Committee shall consist of at least three directors, shall only be composed of non-executive directors, the majority of whom shall be independent directors, and as a whole shall have adequate experience in audit practices, financial reporting and accounting and shall possess a collective balance of skills and expertise. Members of the Committee shall be appointed by the Board of Directors. The Chairman shall be appointed for the Committee to take charge of the work of the Committee. The Chairman shall be an independent director with a background in accounting, banking, or other relevant financial industry. To ensure independence, the Chairman shall not be the Chairman of the Board of Directors or of any other committee. The Chairman shall be elected by more than half of the members of the Committee. The Committee held four meetings in 2018.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(e) Nomination and Remuneration Committee

The Nomination and Remuneration Committee is responsible to the Board of Directors and the main duties and powers of the Committee are:

- Organising the formulation of standards and procedures for the election of directors and senior management members of the Bank, and submitting the proposed procedures and standards to the Board of Directors for approval;
- Proposing to the Board of Directors on candidates for directors and chief executive officer of the Bank;
- Proposing to the Board of Directors on candidates for members of special committees of the Board of Directors;
- Examining the candidates for senior management members of the Bank in accordance with the shareholders' requirements and making suggestions to the Board of Directors;
- Formulating development plans for the senior management members of the Bank and fostering plans key backup talents;
- Making recommendations in respect of the Bank's remuneration policy and practices to the Board of Directors to ensure the remuneration policy is consistent with the legal and regulatory requirements;
- Organising the preparation of performance evaluation methods and remuneration plan for directors of the Bank, and submitting them to the Board of Directors for review;
- Organising the preparation of performance evaluation methods and remuneration plan for senior management members and submitting them to the Board of Directors for approval;
- Organising performance evaluation on directors, proposing the distribution of remuneration for directors, and submitting it to the Board of Directors for review;
- Organising performance evaluation on the senior management members, proposing the plan for distribution of remuneration for senior management members, key personnel and heads of control functions, and submitting it to the Board of Directors for approval;
- Supervising the implementation of the Bank's performance evaluation system;
- Ensuring a regular (at least annual) review of the Bank's remuneration system and its operation is conducted independently of management and the result is submitted to the Hong Kong Monetary Authority as required;
- Reporting to the Board of Directors any material issues in relation to the remuneration system on a regular basis;

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(e) Nomination and Remuneration Committee (continued)

- Reviewing corporate level's remuneration adjustments and performance-based bonus with reference to the corporate goals and objectives resolved by the Board of Directors from time to time, assessing whether such bonus involves any unidentified business interests, and submitting it to the Board of Directors for approval;
- Proposing to the Board of Directors on the appointment or re-appointment of directors and the succession plan of directors;
- Examining and approving relevant compensation to the executive directors and senior management members for loss or termination of office or appointment to ensure such compensation is consistent with provisions of relevant contracts; if it fails to abide by the relevant agreements, relevant compensation shall be proper and reasonable;
- Examining and approving compensation for dismissing or removing relevant directors due to their misconduct to ensure such arrangement is consistent with provisions of relevant agreement; if it fails to comply with the relevant agreements, relevant compensation shall be reasonable and proper;
- Reporting its decisions or suggestions to the Board of Directors unless such report is not allowed by laws or supervisory regulations;
- Reviewing the structure, size and composition of the Board of Directors (including skills, knowledge and experience), and putting forth recommendations on proposed adjustment of the Board of Directors to implement corporate strategy of the Bank;
- Regularly reviewing the contribution required from a director to perform his/her duties and powers to the Bank, and whether he/she is spending sufficient time performing them;
- Advising and assisting the Board of Directors in establishing the Bank's culture and behavioural standards that promote prudent risk-taking and fair treatment of customers; and
- Other matters authorised by the Board of Directors.

According to the terms of reference of the Committee, the Committee shall be composed of at least three directors, majority of whom shall be independent directors. Members of the Committee shall be appointed by the Board of Directors. The Chairman of the Committee shall be taken by an independent director, and shall be elected by all members of the Committee and reported to the Board of Directors for approval. The Committee held four meetings in 2018.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(f) Risk Committee

The Risk Committee is responsible to advise the Board of Directors in carrying out its risk management responsibilities, in order to ensure an adequate oversight of the Bank's overall risk management framework and to promote regular and transparent communications within the organisation in respect of bank-wide risk management issues.

The main duties and powers of the Committee are:

- Examining the Bank's key risk management policies according to the overall strategy of the Bank, and supervising and evaluating implementation and effect of these policies;
- Reviewing and recommending the risk appetite framework, the narrative, risk appetite thresholds of the Bank's risk appetite statement to the Board of Directors for approval; reviewing the performance of the Bank relative to the established thresholds on a quarterly basis;
- Reviewing and recommending the recovery plan to the Board of Directors for approval;
- Approving the key policies of internal rating systems, ensuring compliance with regulatory requirements on the design and procedures of internal rating systems, quantification of risk parameters, IT system and data management, validation and application of internal rating; and exercising the oversight in implementation of these policies;
- Approving the implementation plan of internal rating systems with full understanding of the relevant policies and procedures, and ensuring sufficient allocation of resources to the development of internal rating systems;
- Reviewing the effectiveness of internal rating systems on an annual basis;
- Approving other key matters in relation to internal rating systems;
- Providing guideline to the formulation of risk management system of the Bank;
- Supervising and evaluating the setting, organisation and effect of risk management division, and making recommendations for improvement;
- Reviewing the Bank's risk report including strict compliance with any related prudential, statutory and regulatory limits and relevant requirements, as well as material risk exposures approved by the senior management members/Committee members; carrying out regular evaluation on the Bank's risk position; and giving opinions on the improvement of the Bank's risk management;
- Evaluating relevant work of senior management of the Bank in charge of risk management;

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(f) Risk Committee (continued)

- Supervising the compliance of core businesses, management systems and major operation activities of the Bank;
- Discussing the risk management strategies of the Bank based on the existing laws/regulations/regulatory requirements with due regard to its own business scale, nature and complexity etc., and making suggestions to the Board of Directors;
- Ensuring that comprehensive and integrated management is adopted with respect to the definition, identification and management of major risks:
 - Formulating a set of definitions applicable to the whole entity with respect to different types of risks faced by the Bank;
 - Comprehensively monitoring existing risks across the entity where the entity covers all branches under the Group where the Bank has management rights; and
 - Ensuring that potential risks involved in the Bank's existing and new businesses are effectively identified, understood and assessed.
- Approving the risk management framework that is in line with the Bank's business objectives, risk appetite and profile, and ensuring that the framework is duly implemented and maintained by the senior management members;
 - Monitoring and reviewing the risk governance structure of the Bank and approving the key risk management policies; ensuring the sound operation of risk management and various internal control functions; whether in terms of decision-making or reporting structure, maintaining effective independence from the business divisions that involve risks; possessing adequate power, resources, professional knowledge and expertise to perform its duties;
 - Approving the policy level limits; and
 - Ensuring that the Bank has a sound stress-testing system and reviewing the results of stress-testing program.
- Regularly reviewing the risk management framework to ensure the Bank has a suitable structural system to manage its risks arising in the course of business development and arising from the changes in external market environments;
- Ensuring that the information system and its infrastructure are provided with adequate resources to cope with the Bank's risk management and reporting needs;

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(f) Risk Committee (continued)

- Receiving and reviewing the report on the implementation of compliance policies to ensure that compliance risks are effectively managed; and
- Other matters authorised by the Board of Directors.

According to the terms of reference of the Committee, members of the Committee shall be appointed by the Board of Directors. The Committee shall be composed of at least three directors and collectively possess relevant technical expertise and experience in risk disciplines, the majority of whom shall be independent directors. The Chairman shall be an independent director with a background in accounting, banking or other relevant financial industry or expertise in risk management. The Chairman shall not be the same person as the Chairman of the Board of Directors or of any other committee. The Chairman shall be elected by all members of the Committee and reported to the Board of Directors for approval. Other than members of the Committee, the executive vice president overseeing risk management, chief financial officer, chief compliance officer, head of risk management, head of legal and compliance, and head of internal audit of the Bank shall sit in on meetings of the Committee as ex officio members. The Committee held four meetings in 2018.

(g) Compliance Sub-Committee under Risk Committee

The Compliance Sub-Committee under Risk Committee ("Sub-Committee") is responsible to the Risk Committee and the main duties and powers of the Sub-Committee are:

- Reviewing and approving the compliance policy of the Bank;
- Receiving and reviewing the report on the implementation of compliance policies to ensure that compliance risks are effectively managed;
- Providing guideline to the formulation of the compliance risk framework of the Bank;
- Supervising and evaluating the setting, organisation and effect of Legal and Compliance Division, and making recommendations for improvement;
- Approving the appointment of the Head of Compliance;
- Reviewing the on-site examination report of the HKMA and reporting the significant findings to the Risk Committee;
- Reviewing the Bank's legal and compliance report including, but not limited to, reporting of (a) regulatory incidents, (b) regulatory developments, (c) regulatory examinations, (d) progress of compliance reviews, (e) progress of the HKMA driven control self-assessments, (f) anti-money laundering activities and related controls, and (g) progress of litigation cases affecting the Bank;
- Ensuring that the compliance function is provided with adequate resources; and
- Other matters authorised by the Risk Committee.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(g) Compliance Sub-Committee under Risk Committee (continued)

According to the terms of reference of the Sub-Committee, the Sub-Committee shall be composed of three directors, all or majority of whom shall be non-executive directors. Members of the Sub-Committee shall be nominated and appointed by the Risk Committee. The adjustment and replacement of members of the Sub-Committee shall be decided by the Risk Committee. The Chairman of the Sub-Committee shall be appointed by the Risk Committee to take charge of the work of the Sub-Committee. The Committee held four meetings in 2018.

(h) Asset and Liability Committee

The Asset and Liability Committee ("ALCO") is a functional committee under the Executive Committee. Its main function is to base on the annual business plan, financial budgets, strategic development targets and risk appetite approved by the Board to formulate strategies over the Bank's asset and liability structure and capital allocation, and to ensure the Bank's business is operated within the acceptable risk tolerance level, so as to achieve the annual and strategic development goals approved by the Board.

ALCO members include Deputy Chief Executive overseeing Finance Division as the Chairperson, Vice Chairman and Chief Executive Officer, President & Executive Director, Deputy Chief Executives, Chief Executive of CCB Hong Kong Financial Markets Centre, the Head of Risk Management Division, Credit Division, Finance Division, Treasury Division, Corporate Banking Division, Institutional Banking Division, Commercial Banking Division and Consumer Banking Division.

(i) Information Technology Committee

The Information Technology Committee is set up to act as a functional committee under the Executive Committee with the following scope and responsibilities:

- Overseeing the development of the Bank's long-term and near-term information technology strategic plans, including strategy formulation, risk management and resource planning;
- Ensuring the IT strategy is co-operating and synchronised with Head Office;
- Formulating and approving major information technology policies and processes;
- Prioritising and monitoring major information technology projects and allocation of resources, assessing the effectiveness of information technology budgeting, planning and resourcing processes;

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(i) Information Technology Committee (continued)

- Major information technology activities project monitoring and resource allocations:
 - Overseeing the IT project portfolio management in terms of project initiation approval and prioritization as well as project delivery performance metrics;
 - Formulating and approving IT project governance framework and processes;
 - Reviewing and approving Project Requests, which may be submitted by business and supporting units as well as other IT function of Head Office;
 - Providing complementary approval on project initiatives approved by the Senior Management/Executive Committee or Head Office;
 - Formulating Project Request approving process for minor projects;
 - Prioritizing approved Project Requests and live projects;
 - Appraising project delivery performance result;
 - Monitoring project progress status, budget of commitment & actual P/L booking as well as in-house manday utilisation;
 - Providing a platform to assess project delivery capacity and capability in relation to respective business needs;
 - Assessing the project post-implementation review result (including the stated benefits) for the projects as requested by the Committee; and
 - Assessing the effectiveness of IT project planning, budgeting of investment & P/L booking, project cost allocation and project resources allocation processes.
- Appraising major accomplishments in the application of technology and the overall IT service performance;
- Ensuring an adequate information technology control environment in place, which is in compliance with regulations, guidelines, and governance set by regulatory bodies and Head Office; and
- Providing a platform to disseminate information technology related policies and processes to business units, as well as to solicit their inputs and support.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(i) Information Technology Committee (continued)

Membership of the Information Technology Committee is appointed by the Senior Management. Currently, the Committee consists of seventeen members with the Deputy Chief Executive overseeing Information Systems Division as the Chairperson. Other members are Head of Information Systems Division, Head of Corporate Banking Division, Head of Commercial Banking Division, Head of Consumer Banking Division, Head of Credit Card and Consumer Finance Division, Head of Treasury Division, Head of Finance Division, Head of Risk Management Division, Head of Operations Division, Head of Legal & Compliance Division, Head of Products Division, Head of Cross-Border Financial Services Division, Head of Institutional Banking Division, Head of eBanking Division, Head of Private Banking Division, Head of Marketing Division, and Credit Card and Consumer Finance Division — Head of Operations & Services. Representative from Audit function and IT related functions of CCB and Information Systems Division — Head of Technology Risk Management are invited as advisor in the Committee while Information Systems Representative is the secretary to the Committee.

(j) Risk Management Committee

The Risk Management Committee is set up as a functional committee to assist both the Executive Committee and the Risk Committee in the oversight of risk management matters. The Risk Management Committee acts as a central forum for overseeing the Bank's overall asset quality as well as resolving all important risk related or governance issues on credit risk, operational risk, market risk, liquidity risk, interest rate risk, strategic risk and reputation risk. In addition, a working committee and two working units namely Special Assets Management Committee, Stress Testing Unit and Operational Risk Unit are established under the Risk Management Committee. The major responsibilities of the Risk Management Committee include:

- Ensure a comprehensive and integrated management approach is adopted within the Bank with respect to the definition, identification and management of major risks;
- Ensure the Bank's risk profile is in line with the risk appetite and strategies set under the direction of the Executive Committee and the Risk Committee;
- Ensure the risk management framework is properly established and maintained and is adequate considering the scale and complexity of the Bank's business operation;
- Approve or review new or major changes in risk policies and processes to ensure they adequately accommodate the updated market conditions and economic trends, as well as due compliance of any relevant laws and regulations;
- Approve or review various risk limits, parameters and thresholds, as well as risk assessment tools to ensure pertinent risks are addressed/mitigated;
- Act as a central forum to review, discuss and resolve matters across different risk areas;
- Approve or review major risk assessment/monitoring reports;
- Approve credit programs with legal and compliance considerations;

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(j) Risk Management Committee (continued)

- Approve or review the results of the stress-testing programme and contemplate on any necessary mitigating actions;
- Approve the Annual Business Continuity Report;
- Approve or review operational risk issues including operational risk management tools, results of monitoring of key operational risk controls and other critical operational risk management related matters as reported by the Operational Risk Unit and respective operational management functions; and
- Review material issues relating to impairment allowances as reported by the Special Asset Management Committee.

The Risk Management Committee is chaired by the Deputy Chief Executive overseeing Risk Management or Chief Risk Officer (also Head of Risk Management Division), and members include the Bank's President and Executive Director, Head of Legal and Compliance Division, Deputy Head of Risk Management Division supervising Operational Risk and Head of Market Risk.

(k) Credit Committee

The Credit Committee acts as a functional committee to assist both the Executive Committee and the Risk Committee on loan quality maintenance, authority delegation, credit related policy-making and maintenance, credit approval and credit risk management issues. The major responsibilities of the Credit Committee include:

- Oversee overall credit quality of the Bank;
- Ensure that the Bank's credit risk profile is in line with the risk appetite and strategies set under the direction of the Risk Management Committee, the Executive Committee and the Risk Committee;
- Approve or review new or major changes in credit related policies and processes to ensure that they adequately accommodate the updated market conditions, economic trends as well as due compliance of any relevant laws and regulations;
- Approve or review various credit related risk limits, parameters and thresholds, as well as credit programs, products, risk assessment tools to ensure pertinent risks are addressed/mitigated;
- Approve new and changes in delegation of approval authorities; and
- Review and approve credit actions or applications.

The Credit Committee is chaired by the Deputy Chief Executive overseeing Risk Management or the Chief Risk Officer (also Head of Risk Management Division), and members include the Head of Credit Division, the Deputy Head of Risk Management Division and designated individual credit approver(s).

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(l) Product Innovation and Approval Committee

The Product Innovation and Approval Committee is established to oversee product development and management. The Committee provides an independent risk and compliance forum in the form of the Product Risk and Compliance Approval Meeting to conduct the review and approval of products and services as defined in the New Product Approval Policy. This committee is charged with the responsibility for:

- Reviewing and approving new product development and the requests regarding the engagement in new products as well as modified products that fall into the definitions as stated in the New Product Approval Policy;
- Ensuring that the major risk dimensions of new products are properly identified and analysed by the product owners in accordance with the New Product Approval Policy and relevant law, regulations and supervisory guidance, and effective control measures are properly proposed to address the risks;
- Reviewing and approving the New Product Approval Policy;
- Reviewing and approving investment and insurance products and third party product providers; and
- Facilitating the regular reporting of respective risk areas to the Risk Committee.

According to the terms of reference of the Product Innovation and Approval Committee, the members of the Product Risk and Compliance Approval Meeting include the Chief Executive Officer as the Chairperson, the Deputy Chief Executive overseeing Risk Management and the Chief Risk Officer (also the Head of Risk Management Division) as Co-chairpersons. Members include heads of the Legal and Compliance Division, Finance Division, Operations Division, Credit Division as well as Information Systems Division.

(m) Internal Control, Compliance and Operations Committee

The Internal Control, Compliance and Operations Committee is the functional committee under the Executive Committee and the Risk Committee to assist both the Executive Committee and the Risk Committee to identify and assess the risk of compliance, internal control function and adequacy of operations of the Bank. This committee is charged with the responsibility for:

- Providing advice and proposal to the Management regarding major compliance and internal control issues;
- Identifying and evaluating the Bank's overall compliance risks or significant internal control defects so as to monitor and control the identified risks and defects;
- Reviewing and approving the annual compliance plan, annual reports concerning the implementation of the plans, main rules and regulations that affect the Bank, and significant non-compliance matters and/or suspicious transactions or activities;
- Reviewing the adequacy and efficiency of the internal control system and ensuring fit and proper rectification measures;

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(m) Internal Control, Compliance and Operations Committee (continued)

- Approving membership and Terms of Reference for the AML Committee and Investment and Insurance Working Unit;
- Approving Annual Plan for Investment and Insurance Quality of Assurance of Consumer Banking and Investment Products Risk Rating Model submitted from the AML Committee or the Investment and Insurance Working Unit;
- Define responsible parties to set up operational policies, procedures and guidelines pertaining to all business activities of the Bank to ensure on-going operational efficiency, cost-effectiveness and adequate controls, as well as compliance with all applicable regulatory and operational risk management requirements and standards;
- Review delegation of operational authorities to staff of different levels so as to ensure responsible staff will discharge daily duties and responsibilities in a legitimate and adequately controlled manner;
- Reviewing and approving standard service charges and fees in relation to payments, products and services offered by the Bank to ensure fairness and market competitiveness;
- Formulating and approving management policy and guidelines to ensure the effective operation and sufficient monitoring of outsourced activities to ensure due compliance with all relevant regulatory and corporate guidelines and standards;
- Approving the account opening at the third party financial institutions and the highest trading limit of all the Bank's channels; and
- Facilitating regular reporting of important matters monitored and discussed to the Risk Committee.

According to the terms of reference of the Internal Control, Compliance and Operations Committee, the Deputy Chief Executive in charge of Compliance and Operations shall be appointed as the Chairman of the Committee. Other members of the Committee shall be comprised of Head of Corporate Banking Divisions, Head of Institutional Banking Division, Head of Treasury Division, Head of Consumer Banking Division, Head of Commercial Banking Division, Head of Private Banking Division, Head of Cross-Border Financial Services Division, Head of Operations Division, Head of Information Systems Division, Head of Finance Division, Head of Risk Management Division, Head of Legal and Compliance Division, Head of Credit Card and Consumer Finance Division, and Head of Marketing Division.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

5 CORPORATE GOVERNANCE (continued)

(n) New Capital Accord Steering Committee

New Capital Accord Steering Committee is set up as a functional committee under the Executive Committee and the Risk Committee. The New Capital Accord Steering Committee is mainly responsible for the management, approval of resolutions, decision making and supervision of the project related duties for the implementation of Internal Ratings-based Approach in the Bank. In addition, New Capital Accord Implementation Committee is set up as a working committee under the New Capital Accord Steering Committee, mainly responsible for the implementation, guidance and execution of project related duties. Upon the implementation of the Internal Ratings-based Approach, both the New Capital Accord Steering Committee and the New Capital Accord Implementation Committee shall be dissolved and, the residual oversight tasks shall be exercised by the Executive Committee and the Risk Management Committee respectively. The major responsibilities of the New Capital Accord Steering Committee include:

- Allocate resources for the development, promotion, operation and maintenance of the Bank's internal rating systems according to the implementation plan approved by the Board or the special committee under the Board;
- Organise the development and operation of internal rating systems, define the respective requirements on quantification of risk parameters, performance and monitoring measures;
- Provide guidance on the design, operation, enhancement, reporting, and the setting of policies and procedures for internal rating systems, and ensure effectiveness and continuity of the operation of internal rating systems;
- Supervise the project implementation carried out by the New Capital Accord Implementation Committee;
- Approve the Terms of Reference of the working committee under the Steering Committee, namely New Capital Accord Implementation Committee;
- Review the implementation progress on a regular basis; receive and review reports on the performance and enhancement of internal rating systems;
- Review the results of validation of internal rating systems on a regular basis;
- Supervise and manage the functioning and performance of internal rating systems which are to be supported by the Bank's people, policies and processes. Ensure the proper integration of internal rating systems into the daily credit risk management processes; and
- Facilitate the regular reporting to the Executive Committees and/or the Risk Committee.

The New Capital Accord Steering Committee is chaired by the Chief Executive, and the other members are senior management of the Bank.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

6 RISK MANAGEMENT

(a) Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Group recognises the risk as a distinct risk which is inherent in every aspect of the Group's businesses and activities which should be managed in a structured and systematic manner.

The Group implements a centralised risk management framework and formulates operational risk management policy to provide a bank-wide definition of operational risks and set out the requirements on the identification, assessment, reporting, monitoring and mitigation of operational risk. The Board level Risk Committee is responsible for the oversight of risk matters including operational risk. The Risk Management Committee is the executive body to assist the Risk Committee in the daily management of operational risk related issues including the review and approval of operational risk management policies, discussion and resolution of operational risk matters as well as the supervision of the Bank's business continuity process.

The Group implements the "Three Lines of Defence" in its operational risk management framework. Every unit, business and supporting units alike, are functioning as the first line of defence responsible for its own operational risk management in carrying out their daily activities. Operational Risk under Risk Management Division, Legal and Compliance Division together with certain units involved in management of internal process, people and system are the second line of defence responsible for the design and implementation of the operational risk management policies, mechanism, tools and methodologies in their responsible areas. Internal Audit is the third line of defence which conducts periodic reviews and independent audits of the Group's operational risk management process. The purpose is to ensure due compliance with established operational risk management policies and procedures, and to evaluate the effectiveness of the operational risk management process and control mechanism. The results of these reviews and audits are regularly reported to the Board level Audit Committee for effective oversight and monitoring.

The Group regularly reviews and enhances the Business Continuity Plan of all critical banking services. It also maintains data processing back-up sites and facilities to support business operations during disastrous events. To ensure practicality of the plan, drills on contingency plans for certain critical business functions are performed annually with satisfactory results.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018

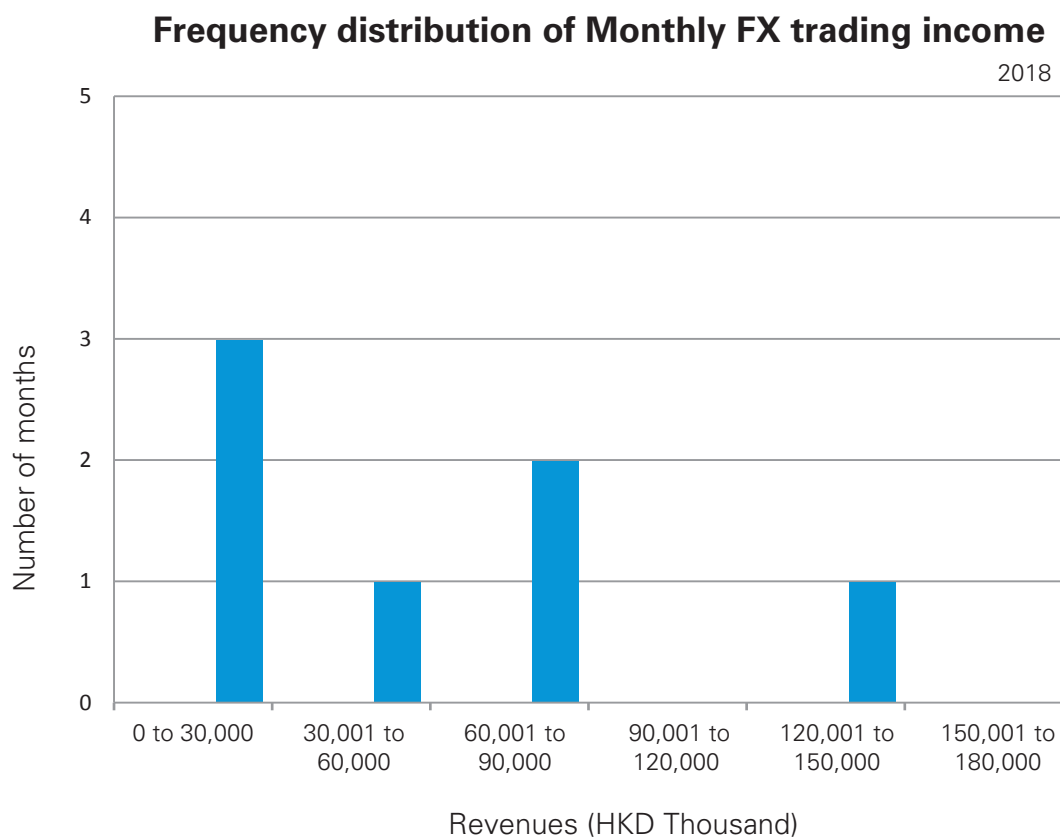
(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

6 RISK MANAGEMENT (continued)

(b) Market risk management

The Group's market risk management is detailed in Note 8(c) to the consolidated financial statements.

The Group's foreign exchange risk exposure arises from its foreign exchange trading activities. For the year ended December 31, 2018, the average monthly revenue of the foreign exchange trading activities was \$23,324 (2017: \$76,147) and the standard deviation of this monthly revenue was \$51,527 (2017: \$36,938). An analysis of the frequency distribution of the monthly foreign exchange trading revenue is presented by the following charts.



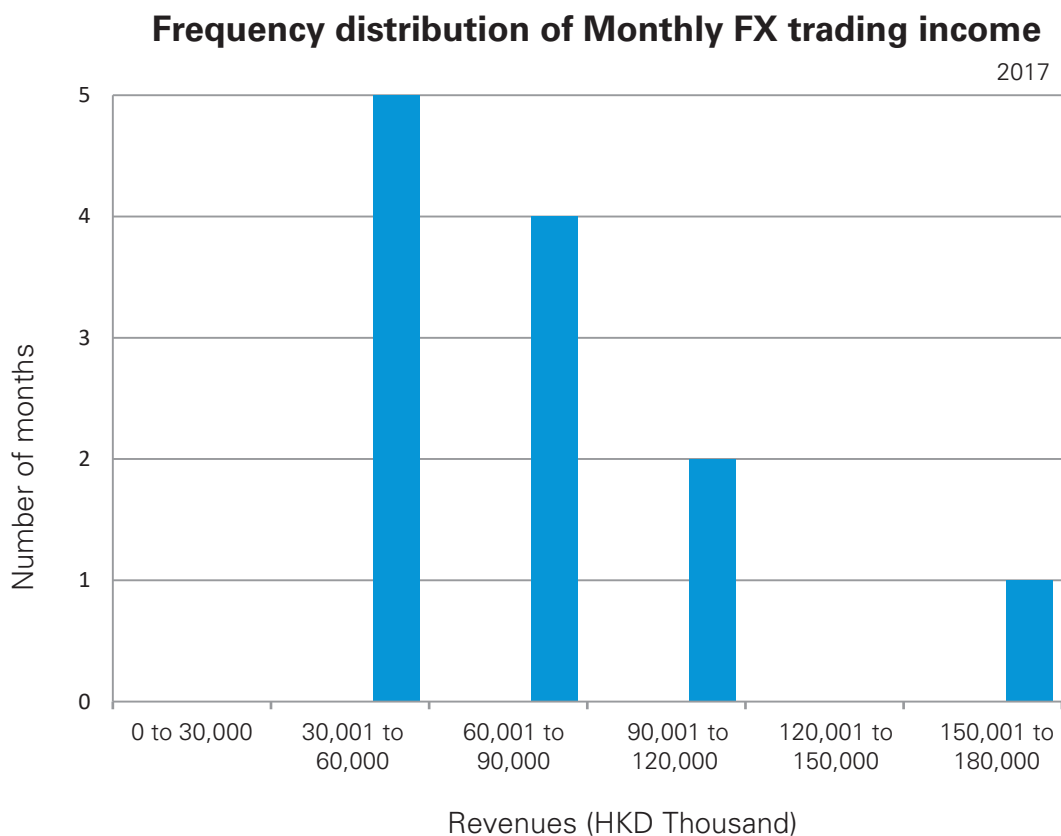
UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

For the year ended December 31, 2018

(Expressed in thousands of Hong Kong dollars, unless otherwise stated)

6 RISK MANAGEMENT (continued)

(b) Market risk management (continued)



SERVICE NETWORK

As of March 22, 2019

COMMERCIAL BANKING OFFICES

Telephone

Wanchai	Unit C, 20/F, China Overseas Building, 139 Hennessy Road	3918 6708
Tsimshatsui	25/F & 33/F, Tower 6, The Gateway, 9 Canton Road	2903 8366
Kowloon Bay	26/F, CCB Centre	2903 8366

SMALL ENTERPRISE AND PERSONAL LOAN CENTERS

Telephone

Causeway Bay	25/F, Causeway Bay Plaza 1, 489 Hennessy Road	3718 7928
Tsimshatsui	Unit 1603, 16/F, Carnarvon Plaza, No. 20 Carnarvon Road	3918 6388
Mongkok	Room 1017-18, 10/F, Park-in Commercial Centre, 56 Dundas Street	3918 6766
Kowloon Bay	G/F, CCB Centre	3718 3422
Tsuen Wan	Room 945, 9/F, Nan Fung Centre	3718 3940

PRIVATE BANKING

Telephone

Central	10/F, CCB Tower, 3 Connaught Road Central	3718 3779
----------------	---	-----------

CONSUMER BRANCHES

Telephone

Central	6 Des Voeux Road Central	3918 6666
Central CCB Tower	1/F CCB Tower	3918 6800
Central Des Voeux Road	99 Des Voeux Road Central	3718 7690
Sheung Wan Des Voeux Road	237 Des Voeux Road Central	3718 7040
Sai Wan	Shop 1, G/F, 489 Queen's Road West	3718 3640
Wanchai Hennessy Road	139 Hennessy Road	3718 7233
Wanchai Great Eagle Centre	Shop 121, 1/F, Great Eagle Centre	3718 3900
Wanchai Johnston Road	150 Johnston Road	3718 7300
Causeway Bay Plaza	G/F, Causeway Bay Plaza 1	3718 7680
Causeway Bay Jardine's Bazaar	51 Jardine's Bazaar	3718 3520
Happy Valley	37 Sing Woo Road	3918 6600
North Point	382 King's Road	3718 3500
Taikoo Shing	Shop 001, G/F, Cityplaza II	3718 7380
Shau Kei Wan	2 Po Man Street	3718 7000
Aberdeen	Shop 7, G/F, Site 4, Aberdeen Centre	3918 6836
Tsimshatsui Hankow Road	17 Hankow Road	3718 3680
Tsimshatsui Humphreys Avenue	3 Humphreys Avenue	3718 7166
Jordan	316 Nathan Road	3718 3999
Yaumati	556 Nathan Road	3718 7200
Mongkok Chun Yee Building	G/F, Chun Yee Building, No. 733 Nathan Road, Mongkok	3918 6620
Mongkok Nathan Road	788 Nathan Road	3718 7128
Tai Kok Tsui Olympian City	Shop 109, 1/F, Olympian City 2	3718 3920
Cheung Sha Wan	Unit G02, G/F Cheung Sha Wan Plaza, 833 Cheung Sha Wan Road	3718 3600

SERVICE NETWORK

As of March 22, 2019

CONSUMER BRANCHES (continued)

		Telephone
Mei Foo	Shop N46, G/F, Mei Foo Sun Chuen, Stage 6	3918 6630
Hunghom Whampoa	Shop A3, G/F, Yuen Wah Building, Whampoa Estates	3718 3180
Hunghom Ma Tau Wai Road	G/F, 100 Ma Tau Wai Road	3718 3580
Kwun Tong Hoi Yuen Road	56 Hoi Yuen Road	3718 7082
Kwun Tong Hip Wo Street	191 Hip Wo Street	3718 7333
Kowloon Bay Amoy Gardens	Shop 181, G/F, Phase IIA, Amoy Gardens	3718 7366
Kowloon Bay CCB Centre	G/F, CCB Centre	3718 7900
Tsuen Wan	282 Sha Tsui Road	3718 7199
Kwai Chung	Shop A23, G/F, Kwai Chung Plaza	3918 6575
Shatin Plaza	Shop 5, Level 1, Shatin Plaza	3718 3160
Ma On Shan	Shop 297, Level 2, Ma On Shan Plaza	3718 3560
Tai Wai	42 Tai Wai Road	3918 6599
Tai Po	Shop 9B, G/F, 1 On Chee Road	3718 7022
Sheung Shui	67 San Fung Avenue	3718 3620
Yuen Long	68 Castle Peak Road	3718 3543
Tin Shui Wai	Shop 1110, 1/F, One Sky Mall	3918 6618
Tuen Mun	Shop 9, G/F, Tuen Mun Town Plaza 2	3718 3118
Tuen Mun Yan Ching Street	Shop 6, G/F, 7 Yan Ching Street	3918 6565
Tseung Kwan O	Shop 190, Level 1, Metro City 3	3718 3120

CROSS BORDER WEALTH MANAGEMENT CENTER

		Telephone
Sheung Shui	Units 1103A–06, 11/F, Landmark North, 39 Lung Sum Avenue	3918 6790