2012

NCB 南洋商業銀行

NCB 南洋商業銀行

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Report of the Directors

The Directors are pleased to present their report together with the audited consolidated financial statements of Nanyang Commercial Bank, Limited (hereinafter as the "Bank") and its subsidiaries (together with the Bank hereinafter as the "Group") for the year ended 31 December 2012.

Principal Activities

The Bank is a licensed bank authorised under the Hong Kong Banking Ordinance. The principal activities of the Bank are provision of banking and related financial services. The principal activities of the Bank's subsidiaries are shown in Note 26 to the Financial Statements.

Results and Appropriations

The results of the Group for the year are set out in the consolidated income statement on page 5.

The directors declared an interim dividend of HK$56 per share totaling HK$392,000,000 on 12 June 2012 which was paid on 8 August 2012.

Reserves

Details of movements in the reserves of the Group are set out in the consolidated statement of changes in equity on page 10.

Donations

Charitable and other donations made by the Group during the year amounted to approximately HK$134,000.

Properties, Plant and Equipment

Details of movements in properties, plant and equipment of the Group and the Bank are set out in Note 28 to the Financial Statements.

Share Capital

Details of the share capital of the Bank are set out in Note 35 to the Financial Statements.

Directors

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

Board of Directors

Chairman:	Zhou Zaiqun#	
Vice Chairman:	Fang Hongguang	
	Zeng Xiaoping#	(resigned on 10 July 2012)
Directors:	Gao Yingxin#	
	Zhuo Chengwen#	
	Li Jiuzhong#	
	Zhu Yanlai#	
	Chan Sai Ming	(appointed on 22 May 2012)
	Chang Hsin Kang*	
	Lan Hong Tsung, David*	
	Lau Hon Chuen*	
	Yuen Wai Keung	(resigned on 1 May 2012)

Non-executive directors

* Independent non-executive directors

Report of the Directors (continued)

Directors (continued)

In accordance with Article 81 of the Articles of Association of the Bank, Mr. Zhou Zaiqun, Mr. Li Jiuzhong, Mr. Lau Hon Chuen and Mr. Chang Hsin Kang retire at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

Directors' Interests in Equity or Debt Securities

Saved as disclosed in Note 18, at no time during the year was the Bank or any of its holding companies, subsidiaries or fellow subsidiaries a party to any arrangements to enable the directors of the Bank to acquire benefits by means of the acquisition of shares in, or debentures of, the Bank or any other body corporate.

Directors' Interests in Contracts of Significance

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

Management Contracts

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

Compliance with the Banking (Disclosure) Rules

The financial statements for the year ended 31 December 2012 comply with the requirements set out in the Banking (Disclosure) Rules under the Hong Kong Banking Ordinance.

Auditor

The financial statements for the year 2012 have been audited by PricewaterhouseCoopers ("PwC").

PwC will retire as auditor of the Bank upon expiration of its current term of office at the close of the forthcoming annual general meeting of the Bank (the "2013 AGM").

On 18 March 2013, the Board resolved to propose the appointment of Messrs. Ernst & Young as the auditor of the Bank to fill the vacancy following the retirement of PwC and to hold office until the next annual general meeting of the Bank, subject to the approval of its shareholders at the 2013 AGM.

On behalf of the Board

Zhou Zaiqun

Chairman

Hong Kong, 18 March 2013

Independent Auditor's Report

To the shareholders of Nanyang Commercial Bank, Limited

(incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of Nanyang Commercial Bank, Limited (the "Bank") and its subsidiaries (together, the "Group") set out on pages 5 to 165, which comprise the consolidated and company balance sheets as at 31 December 2012, and the consolidated income statement, the consolidated and company statements of comprehensive income, the consolidated and company statements of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

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

Independent Auditor's Report (continued)

To the shareholders of Nanyang Commercial Bank, Limited (continued)
(incorporated in Hong Kong with limited liability)

Opinion

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

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 18 March 2013

Consolidated Income Statement

For the year ended 31 December	Notes	2012	2011
		HK$'000	HK$'000
Interest income		**7,710,456**	5,803,023
Interest expense		**(3,777,643)**	(2,518,282)
Net interest income	5	**3,932,813**	3,284,741
Fee and commission income		**822,777**	863,825
Fee and commission expense		**(67,598)**	(73,639)
Net fee and commission income	6	**755,179**	790,186
Net trading gain	7	**147,216**	80,349
Net gain/(loss) on financial instruments designated at fair value through profit or loss		**21,959**	(4,561)
Net gain on other financial assets	8	**16,601**	53,780
Other operating income	9	**57,109**	46,074
Net operating income before impairment allowances		**4,930,877**	4,250,569
Net charge of impairment allowances	10	**(396,948)**	(161,306)
Net operating income		**4,533,929**	4,089,263
Operating expenses	11	**(1,946,297)**	(1,284,837)
Operating profit		**2,587,632**	2,804,426
Net gain from disposal of/fair value adjustments on investment properties	12	**178,766**	136,237
Net loss from disposal/revaluation of properties, plant and equipment	13	**(6,627)**	(14,468)
Profit before taxation		**2,759,771**	2,926,195
Taxation	14	**(419,813)**	(477,237)
Profit for the year		**2,339,958**	2,448,958
Dividends	16	**392,000**	-

The notes on pages 13 to 165 are an integral part of these financial statements.

Consolidated Statement of Comprehensive Income

For the year ended 31 December	Notes	2012	2011
		HK$'000	HK$'000
Profit for the year		**2,339,958**	2,448,958
Premises:			
Revaluation of premises		**1,388,296**	1,213,719
Deferred tax	34	**(218,290)**	(172,968)
		1,170,006	1,040,751
Available-for-sale securities:			
Change in fair value of available-for-sale securities		**328,116**	3,249
Release upon disposal of available-for-sale securities		**(11,839)**	(53,559)
Net charge of impairment allowances on available-for-sale securities transferred to income statement	10	**-**	725
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities		**(715)**	(5,957)
Deferred tax	34	**(47,000)**	11,131
		268,562	(44,411)
Change in fair value of hedging instruments under net investment hedges		**(4,138)**	(91,759)
Currency translation difference		**94,637**	292,659
Other comprehensive income for the year, net of tax		**1,529,067**	1,197,240
Total comprehensive income for the year		**3,869,025**	3,646,198

The notes on pages 13 to 165 are an integral part of these financial statements.

Statement of Comprehensive Income

For the year ended 31 December	Notes	2012	2011
		HK$'000	HK$'000
Profit for the year		**2,072,764**	2,180,414
Premises:			
Revaluation of premises		**1,379,172**	1,195,288
Deferred tax	34	**(217,913)**	(169,034)
		1,161,259	1,026,254
Available-for-sale securities:			
Change in fair value of available-for-sale securities		**340,360**	(18,200)
Release upon disposal of available-for-sale securities		**(10,893)**	(53,559)
Net charge of impairment allowances on available-for-sale securities transferred to income statement	10	**-**	725
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities		**(715)**	(5,957)
Deferred tax	34	**(50,297)**	16,494
		278,455	(60,497)
Currency translation difference		**(35)**	175
Other comprehensive income for the year, net of tax		**1,439,679**	965,932
Total comprehensive income for the year		**3,512,443**	3,146,346

The notes on pages 13 to 165 are an integral part of these financial statements.

Consolidated Balance Sheet

As at 31 December	Notes	2012	2011
		HK$'000	HK$'000
ASSETS			
Cash and balances with banks and other financial institutions	20	**40,788,320**	43,994,333
Placements with banks and other financial institutions maturing between one and twelve months		**17,308,944**	23,169,580
Financial assets at fair value through profit or loss	21	**5,125,160**	2,245,761
Derivative financial instruments	22	**764,577**	816,403
Advances and other accounts	23	**138,032,685**	132,914,225
Investment in securities	25	**40,989,649**	30,182,604
Investment properties	27	**1,027,083**	847,948
Properties, plant and equipment	28	**6,224,995**	4,583,411
Deferred tax assets	34	**49,727**	57,714
Other assets	29	**1,442,298**	819,477
Total assets		**251,753,438**	239,631,456
LIABILITIES			
Deposits and balances from banks and other financial institutions		**20,262,071**	28,066,288
Financial liabilities at fair value through profit or loss	30	**4,975,073**	1,077,896
Derivative financial instruments	22	**459,607**	672,618
Deposits from customers	31	**185,533,717**	174,469,468
Other accounts and provisions	32	**9,998,985**	8,396,670
Current tax liabilities		**82,384**	229,927
Deferred tax liabilities	34	**828,380**	582,393
Total liabilities		**222,140,217**	213,495,260
EQUITY			
Share capital	35	**700,000**	700,000
Reserves	36	**28,913,221**	25,436,196
Total equity		**29,613,221**	26,136,196
Total liabilities and equity		**251,753,438**	239,631,456

The notes on pages 13 to 165 are an integral part of these financial statements.

Approved by the Board of Directors on 18 March 2013 and signed on behalf of the Board by:

Fang Hongguang

Director

Lau Hon Chuen

Director

Chan Sai Ming

Director

Leung Ka Chun

Secretary

Balance Sheet

As at 31 December	Notes	2012	2011
		HK$'000	HK$'000
ASSETS			
Cash and balances with banks and other financial institutions	20	**21,758,708**	26,941,578
Placements with banks and other financial institutions maturing between one and twelve months		**1,579,422**	2,260,456
Financial assets at fair value through profit or loss	21	**5,125,160**	2,245,761
Derivative financial instruments	22	**649,703**	749,148
Advances and other accounts	23	**89,917,821**	95,159,808
Investment in securities	25	**33,899,483**	26,016,031
Investment in subsidiaries	26	**8,171,067**	5,222,682
Investment properties	27	**979,670**	802,260
Properties, plant and equipment	28	**5,461,161**	4,120,250
Deferred tax assets	34	**662**	656
Other assets	29	**1,067,668**	652,284
Total assets		**168,610,525**	164,170,914
LIABILITIES			
Deposits and balances from banks and other financial institutions		**4,173,831**	9,476,635
Financial liabilities at fair value through profit or loss	30	**4,975,073**	1,077,896
Derivative financial instruments	22	**376,425**	614,632
Deposits from customers	31	**128,178,500**	124,747,402
Other accounts and provisions	32	**2,184,907**	2,767,476
Current tax liabilities		**67,322**	199,047
Deferred tax liabilities	34	**819,491**	573,293
Total liabilities		**140,775,549**	139,456,381
EQUITY			
Share capital	35	**700,000**	700,000
Reserves	36	**27,134,976**	24,014,533
Total equity		**27,834,976**	24,714,533
Total liabilities and equity		**168,610,525**	164,170,914

The notes on pages 13 to 165 are an integral part of these financial statements.

Approved by the Board of Directors on 18 March 2013 and signed on behalf of the Board by:

Fang Hongguang

Director

Lau Hon Chuen

Director

Chan Sai Ming

Director

Leung Ka Chun

Secretary

Consolidated Statement of Changes in Equity

	Share capital	Share premium	Capital reserve	Premises revaluation reserve	Reserve for fair value changes of available-for-sale securities	Regulatory reserve*	Translation reserve	Retained earnings	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2011	700,000	2,444,517	605	2,695,267	143,483	1,141,136	421,355	14,943,635	22,489,998
Profit for the year	-	-	-	-	-	-	-	2,448,958	2,448,958
Other comprehensive income:									
Premises	-	-	-	1,040,751	-	-	-	-	1,040,751
Available-for-sale securities	-	-	-	-	(38,690)	-	-	(5,721)	(44,411)
Change in fair value of hedging instruments under net investment hedges	-	-	-	-	-	-	(91,759)	-	(91,759)
Currency translation difference	-	-	-	4,568	(362)	-	288,453	-	292,659
Total comprehensive income	-	-	-	1,045,319	(39,052)	-	196,694	2,443,237	3,646,198
Release upon disposal of premises	-	-	-	(67,095)	-	-	-	67,095	-
Transfer from retained earnings	-	-	-	-	-	217,491	-	(217,491)	-
At 31 December 2011	700,000	2,444,517	605	3,673,491	104,431	1,358,627	618,049	17,236,476	26,136,196

	Share capital	**Share premium**	**Capital reserve**	**Premises revaluation reserve**	**Reserve for fair value changes of available-for-sale securities**	**Regulatory reserve***	**Translation reserve**	**Retained earnings**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
At 1 January 2012	**700,000**	**2,444,517**	**605**	**3,673,491**	**104,431**	**1,358,627**	**618,049**	**17,236,476**	**26,136,196**
Profit for the year	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2,339,958**	**2,339,958**
Other comprehensive income:									
Premises	**-**	**-**	**-**	**1,170,006**	**-**	**-**	**-**	**-**	**1,170,006**
Available-for-sale securities	**-**	**-**	**-**	**-**	**269,101**	**-**	**-**	**(539)**	**268,562**
Change in fair value of hedging instruments under net investment hedges	**-**	**-**	**-**	**-**		**-**	**(4,138)**	**-**	**(4,138)**
Currency translation difference	**-**	**-**	**-**	**939**	**(368)**	**-**	**94,066**	**-**	**94,637**
Total comprehensive income	**-**	**-**	**-**	**1,170,945**	**268,733**	**-**	**89,928**	**2,339,419**	**3,869,025**
Release upon disposal of premises	**-**	**-**	**-**	**(7,208)**	**-**	**-**	**-**	**7,208**	**-**
Transfer from retained earnings	**-**	**-**	**-**	**-**	**-**	**188,384**	**-**	**(188,384)**	**-**
Dividends	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(392,000)**	**(392,000)**
At 31 December 2012	**700,000**	**2,444,517**	**605**	**4,837,228**	**373,164**	**1,547,011**	**707,977**	**19,002,719**	**29,613,221**

* In accordance with the requirements of the HKMA, the amounts are set aside for general banking risks, including future losses or other unforeseeable risks, in addition to the loan impairment allowances recognised under HKAS 39.

The notes on pages 13 to 165 are an integral part of these financial statements.

Statement of Changes in Equity

	Share capital	Share premium	Premises revaluation reserve	Reserve for fair value changes of available-for-sale securities	Regulatory reserve*	Translation reserve	Retained earnings	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2011	700,000	2,444,517	2,543,596	151,303	639,114	(6,104)	15,095,761	21,568,187
Profit for the year	-	-	-	-	-	-	2,180,414	2,180,414
Other comprehensive income:								
Premises	-	-	1,026,254	-	-	-	-	1,026,254
Available-for-sale securities	-	-	-	(54,776)	-	-	(5,721)	(60,497)
Currency translation difference	-	-	-	-	-	175	-	175
Total comprehensive income	-	-	1,026,254	(54,776)	-	175	2,174,693	3,146,346
Release upon disposal of premises	-	-	(65,938)	-	-	-	65,938	-
Transfer from retained earnings	-	-	-	-	69,396	-	(69,396)	-
At 31 December 2011	700,000	2,444,517	3,503,912	96,527	708,510	(5,929)	17,266,996	24,714,533

	Share capital	**Share premium**	**Premises revaluation reserve**	**Reserve for fair value changes of available-for-sale securities**	**Regulatory reserve***	**Translation reserve**	**Retained earnings**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
At 1 January 2012	**700,000**	**2,444,517**	**3,503,912**	**96,527**	**708,510**	**(5,929)**	**17,266,996**	**24,714,533**
Profit for the year	**-**	**-**	**-**	**-**	**-**	**-**	**2,072,764**	**2,072,764**
Other comprehensive income:								
Premises	**-**	**-**	**1,161,259**	**-**	**-**	**-**	**-**	**1,161,259**
Available-for-sale securities	**-**	**-**	**-**	**278,994**	**-**	**-**	**(539)**	**278,455**
Currency translation difference	**-**	**-**	**-**	**(432)**	**-**	**397**	**-**	**(35)**
Total comprehensive income	**-**	**-**	**1,161,259**	**278,562**	**-**	**397**	**2,072,225**	**3,512,443**
Release upon disposal of premises	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Transfer to retained earnings	**-**	**-**	**-**	**-**	**(216,526)**	**-**	**216,526**	**-**
Dividends	**-**	**-**	**-**	**-**	**-**	**-**	**(392,000)**	**(392,000)**
At 31 December 2012	**700,000**	**2,444,517**	**4,665,171**	**375,089**	**491,984**	**(5,532)**	**19,163,747**	**27,834,976**

* In accordance with the requirements of the HKMA, the amounts are set aside for general banking risks, including future losses or other unforeseeable risks, in addition to the loan impairment allowances recognised under HKAS 39.

The notes on pages 13 to 165 are an integral part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December	Notes	2012	2011
		HK$'000	HK$'000
Cash flows from operating activities			
Operating cash (outflow)/inflow before taxation	37(a)	**(6,710,114)**	17,510,176
Hong Kong profits tax paid		**(505,312)**	(366,311)
Overseas profits tax paid		**(73,560)**	(106,236)
Net cash (outflow)/inflow from operating activities		**(7,288,986)**	17,037,629
Cash flows from investing activities			
Purchase of properties, plant and equipment	28	**(429,519)**	(198,551)
Purchase of investment properties	27	**-**	(13,105)
Proceeds from disposal of properties, plant and equipment		**5,502**	67,734
Proceeds from disposal of investment properties		**-**	5,892
Net cash outflow from investing activities		**(424,017)**	(138,030)
Cash flows from financing activities			
Dividends paid		**(392,000)**	(483,000)
Net cash outflow from financing activities		**(392,000)**	(483,000)
(Decrease)/increase in cash and cash equivalents		**(8,105,003)**	16,416,599
Cash and cash equivalents at 1 January		**41,732,029**	24,585,347
Effect of exchange rate changes on cash and cash equivalents		**74,187**	730,083
Cash and cash equivalents at 31 December	37(b)	**33,701,213**	41,732,029

The notes on pages 13 to 165 are an integral part of these financial statements.

Notes to the Financial Statements

1. Principal activities

Nanyang Commercial Bank, Limited was incorporated in Hong Kong (hereinafter as the "Bank") and its subsidiaries were incorporated in Hong Kong or Shanghai (together with the Bank hereinafter as the "Group"). The Bank is a licensed bank authorised under the Hong Kong Banking Ordinance.

The principal activities of the Bank are the provision of banking and related financial services. The principal activities of the Bank's subsidiaries are shown in Note 26 to the Financial Statements. The address of the Bank's registered office is 151 Des Voeux Road Central, Hong Kong.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards (HKFRSs is a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, HKASs and Interpretations) issued by the HKICPA and the requirements of the Hong Kong Companies Ordinance.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale securities, financial assets and financial liabilities (including derivative financial instruments) at fair value through profit or loss, investment properties which are carried at fair value and premises which are carried at fair value or revalued amount less accumulated depreciation and accumulated impairment losses.

The preparation of financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires the Management to exercise judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards and amendments already mandatorily effective for accounting periods beginning on 1 January 2012

Standard	Content	Applicable for financial years beginning on/after	Currently relevant to the Group
HKAS 12 (Amendment)	Income taxes	1 January 2012	Yes
HKFRS 1 (Amendment)	First-time Adoption of Hong Kong Financial Reporting Standards: Hyperinflation and Fixed Dates	1 July 2011	No
HKFRS 7 (Amendment)	Financial instruments: Disclosures – Transfer of Financial Assets	1 July 2011	Yes

- HKAS 12 (Amendment), “Income taxes”. The standard which was revised in December 2010 is mandatorily effective for reporting periods beginning on or after 1 January 2012. Earlier application is permitted. The Group has considered that the required treatment under the revised standard better reflects the tax position of the investment properties of the Group, and has early adopted the amended standard retrospectively since the year ended 31 December 2010.

- HKFRS 7 (Amendment), ‘Financial Instruments: Disclosures – Transfer of Financial Assets’. The amendment introduces new quantitative disclosure requirements for transfers of financial assets that are either fully derecognised or derecognised not in their entirety. The Group will disclose relevant information in the financial statements when the Group undertakes transfers of financial assets that fall within its scope.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012

The following standards, amendments and interpretations have been issued and are mandatory for accounting periods beginning on or after 1 July 2012:

Standard/Interpretation	Content	Applicable for financial years beginning on/after	Currently relevant to the Group
HKAS 1 (Revised)	Presentation of Financial Statements	1 July 2012	Yes
HKAS 19 (2011)	Employee Benefits	1 January 2013	Yes
HKAS 27 (2011)	Separate Financial Statements	1 January 2013	Yes
HKAS 28 (2011)	Investments in Associates and Joint Ventures	1 January 2013	No
HKAS 32 (Amendment)	Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities	1 January 2014	Yes
HKFRS 1 (Amendment)	First Time Adoption of Hong Kong Financial Reporting Standards – Government Loans	1 January 2013	No
HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities	1 January 2013	Yes
HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Transition to HKFRS 9	1 January 2015	Yes
HKFRS 9	Financial Instruments	1 January 2015	Yes
HKFRS 10	Consolidated Financial Statements	1 January 2013	Yes
HKFRS 11	Joint Arrangements	1 January 2013	No
HKFRS 12	Disclosure of Interests in Other Entities	1 January 2013	Yes
HKFRS 10, 11 and 12 (Amendment)	Transition Guidance	1 January 2013	Yes
HKFRS 10, 12 and HKAS 27 (Amendments)	Investment Entities	1 January 2014	No
HKFRS 13	Fair Value Measurement	1 January 2013	Yes
HK(IFRIC) – Int 20	Stripping Costs in the Production Phase of a Surface Mine	1 January 2013	No

- HKAS 1 (Revised), 'Presentation of Financial Statements'. The amendments to HKAS 1 (Revised) require companies preparing financial statements in accordance with HKFRSs to group together items within other comprehensive income (OCI) that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The adoption of this revised standard will affect the presentation of the Group's statement of comprehensive income.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012 (continued)

- HKAS 19 (2011), 'Employee Benefits'. The revised standard mainly amends the part related to accounting for changes in defined benefit obligations and plan assets, and related presentation and disclosure. The amendments do not have impact on the Group's financial statements.

- HKAS 27 (2011), 'Separate Financial Statements'. Please refer to the below on HKFRS 10, 'Consolidated Financial Statements'.

- HKAS 28 (2011), 'Investments in Associates and Joint Ventures'. Please refer to the below on HKFRS 11, 'Joint Arrangements'.

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

- HKFRS 7 (Amendment), 'Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities'. The amendments require new disclosures to include information that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position. The adoption of this amended standard will affect the disclosure of the Group's financial statements.

- HKFRS 7 (Amendment), 'Financial Instruments: Disclosures – Transition to HKFRS 9'. The amendments provide relief from the requirement to restate comparative financial statements which was originally available only to entities that chose to apply HKFRS 9 prior to 2012. Instead, additional transition disclosures will be required to help users to better understand the effect of initial application of the standard.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012 (continued)

- HKFRS 9, 'Financial Instruments'. The first part of HKFRS 9 was issued in November 2009 and will replace those parts of HKAS 39 relating to the classification and measurement of financial assets. In November 2010, a further pronouncement was published to address financial liabilities and derecognition. Key features are as follows:

(i) Classification and Measurement

Financial assets are required to be classified into one of the following measurement categories: (1) those to be measured subsequently at fair value or (2) those to be measured subsequently at amortised cost. Classification is to be made on transition, and subsequently on initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

A financial instrument is subsequently measured at amortised cost only if it is a debt instrument, and the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only unleveraged payments of principal and interest. All other debt instruments are to be measured at fair value through profit or loss.

All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than income statement. Once elected to be recognised through other comprehensive income, there will be no reclassification of fair value gains and losses to income statement. Dividends are to be presented in income statement as long as they represent a return on investment.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012 (continued)

(ii) Financial Liabilities and Derecognition

Except for the two substantial changes described below, the classification and measurement requirements of financial liabilities have been basically carried forward with minimal amendments from HKAS 39. For the derecognition principles, they are consistent with that of HKAS 39.

The requirements related to the fair value option for financial liabilities were changed to address own credit risk. It requires the amount of change in fair value attributable to changes in the credit risk of the financial liabilities be presented in other comprehensive income. The remaining amount of the total gain or loss is included in income statement. If this requirement creates or enlarges an accounting mismatch in profit or loss, then the whole fair value change is presented in income statement. The determination of whether there will be a mismatch will need to be made at initial recognition of individual liabilities and will not be re-assessed. Amounts presented in other comprehensive income are not subsequently reclassified to income statement but may be transferred within equity.

The standard eliminates the exception from fair value measurement contained in HKAS 39 for derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument.

The mandatory effective date of HKFRS 9 is 1 January 2015 with earlier adoption permitted. New transitional disclosures are required instead of comparative restatement. The Group is considering the financial impact of the standard and the timing of its application.

- HKFRS 10, 'Consolidated Financial Statements'. HKFRS 10 builds on existing principles by identifying the concept of control as the determining factor when considering whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. It also replaces all of the guidance on control and consolidation stipulated in HKAS 27 (Revised), 'Consolidated and Separate Financial Statements' and HK(SIC)-Int 12, 'Consolidation — Special Purpose Entities'. The remainder of HKAS 27 (Revised) is renamed HKAS 27 (2011), 'Separate Financial Statements' as a standard dealing solely with separate financial statements without changing the existing guidance for separate financial statements.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012 (continued)

- HKFRS 11, 'Joint Arrangements'. Changes in the definitions stipulated in HKFRS 11 have reduced the types of joint arrangements to two: joint operations and joint ventures. A joint operation is a joint arrangement that gives parties to the arrangement direct rights to the assets and obligations for the liabilities. The 'jointly controlled assets' classification in HKAS 31, 'Interests in Joint Ventures', has been merged into joint operations, as both types of arrangements generally result in the same accounting outcome. A joint venture, in contrast, gives the parties rights to the net assets or outcome of the arrangement. Joint ventures are accounted for using the equity method in accordance with HKAS 28, 'Investments in Associates' which is renamed as HKAS 28 (2011), 'Investments in Associates and Joint Ventures'. The standard is amended to include the requirements of joint ventures accounting and to merge with the requirements of HK(SIC)-Int 13, 'Jointly Controlled Entities – Non-Monetary Contributions by Venturers'. After the application of HKAS 28 (2011), entities can no longer account for an interest in a joint venture using the proportionate consolidation method.

- HKFRS 12, 'Disclosure of Interests in Other Entities'. The standard sets out the required disclosures for entities reporting under the two new standards, HKFRS 10 and HKFRS 11, and the revised standard HKAS 28 (2011). The existing guidance and disclosure requirements for separate financial statements stipulated in HKAS 27 (Revised) are unchanged. HKFRS 12, requires entities to disclose information that helps financial statements readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities.

The above HKFRS 10, HKFRS 11, HKFRS 12, HKAS 27 (2011) and HKAS 28 (2011) issued in June 2011 are a group of five new standards that address the scope of reporting entity and will supersede HKAS 27 (Revised), HKAS 28, HKAS 31, HK(SIC)-Int 12 and HK(SIC)-Int 13. Earlier application of these standards are permitted but only when they are applied at the same time. The adoption of these standards does not have a material impact on the Group's financial statements.

- HKFRS 10, 11 and 12 (Amendment), on transition guidance. The amendments provide additional transition relief to HKFRSs 10, 11 and 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. The adoption of this amendment will not materially affect the disclosure of the Group's financial statements.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012 (continued)

- HKFRS 13, 'Fair Value Measurement'. The new standard which was issued in June 2011 replaces the fair value measurement guidance contained in individual HKFRSs by providing a revised definition of fair value and a single source of fair value measurement and disclosure requirements for use across HKFRSs. The requirements do not extend the use of fair value accounting, but provide guidance on how it should be applied when its use is already required or permitted by other standards within HKFRSs. The Group will apply HKFRS 13 prospectively from 1 January 2013.

(c) Improvements to HKFRS

'Improvements to HKFRS' contains numerous amendments to HKFRS which the HKICPA considers not urgent but necessary. It comprises amendments that result in accounting changes for presentation, recognition or measurement purpose as well as terminology or editorial amendments related to a variety of individual HKFRS. The amendments are effective for annual periods beginning on or after 1 January 2013. No material changes to accounting policies are expected as a result of these amendments.

2.2 Consolidation

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

Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group controls the composition of the Board of Directors, controls more than half of the voting power, holds more than half of the issued capital or by any other means that entitle the Group to govern the financial and operating policies of the entities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

Subsidiaries (continued)

For combination with a company under common control, the merger accounting method will be applied. The principle of merger accounting is a way to combine companies under common control as though the business of the acquiree had always been carried out by the acquirer. The Group's consolidated financial statements represent the consolidated results, consolidated cash flows and consolidated financial position of the Group as if any such combination had occurred from the date when the Bank and the acquiree first came under common control (i.e. no fair value adjustment on the date of combination is required). The difference between the consideration and carrying amount at the time of combination is recognised in equity. The effects of all transactions between the Group and the acquiree, whether occurring before or after the combination, are eliminated in preparing the consolidated financial statements of the Group. Comparative amounts are presented as if the acquiree had been combined at the end of the previous reporting period. The transaction costs for the combination will be expensed in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of impairment of the assets transferred. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

In the Bank's balance sheet, the investments in subsidiaries are stated at cost less allowance for impairment losses. The results of subsidiaries are accounted for by the Bank on the basis of dividends received and receivable. Dividend income from subsidiaries is recognised in the income statement when the right to receive payment is established.

2.3 Segmental reporting

The operating result of segments are reported in a manner consistent with the internal reporting provided to the Management, which is the chief operating decision maker of the Group, that allocates resources and assesses the performance of operating segments. Income and expenses directly associated with each segment are included in determining operating segment performance.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.4 Foreign currency translation

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

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or exchange rates at the end of the reporting period for items that are re-measured. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions using the exchange rates prevailing at the dates of the transactions and monetary assets and liabilities denominated in foreign currencies translated at the exchange rate at the end of the reporting period are recognised directly in the income statement, except when deferred in other comprehensive income as qualifying net investment hedges.

Translation differences on monetary securities held at fair value through profit or loss are reported as part of the fair value gain or loss. Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the securities and other changes in the carrying amount of the securities. Translation differences related to changes in the amortised cost are recognised in the income statement, and other changes in the carrying amount are recognised in other comprehensive income.

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

The results and financial position of all the Group entities that have a functional currency different from Hong Kong dollars are translated into Hong Kong dollars as follows:

- assets and liabilities are translated at the closing rate at the end of the reporting period;
- income and expenses are translated at average exchange rates; and
- all resulting exchange differences are recognised in the currency translation reserve in equity through other comprehensive income.

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

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.5 Derivative financial instruments

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

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e., the fair value of the consideration given or received).

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

Derivatives are categorised as held for trading and changes in their fair value are recognised immediately in the income statement unless they are designated as hedges and are effective hedging instruments, then they are subject to measurement under the hedge accounting requirements.

2.6 Hedge accounting

The Group documents at inception the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at the 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.

Net investment hedge

A gain or loss on the effective portion of the hedging instrument is recognised in other comprehensive income and accumulated in equity; a gain or loss on the ineffective portion is recognised immediately in the income statement. Accumulated gains and losses previously recognised in other comprehensive income are reclassified to income statement upon disposal of the foreign operation as part of the gain or loss on disposal.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.7 Offsetting financial instruments

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

2.8 Interest income and expense and fee and commission income and expense

Interest income and expense are recognised in the income statement for all financial assets and financial liabilities using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates future cash flows considering all contractual terms of the financial instrument (e.g. prepayment options or incentives relating to residential mortgage loans) but does not consider future credit losses. The calculation includes fees, premiums or discounts and basis points paid or received between parties to the contract, and directly attributable origination fees and costs which represent an integral part of the effective yield.

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

Fee and commission income and expenses that are not an integral part of the effective yield are recognised on an accrual basis ratably over the period when the related service is provided, such as administrative fee, asset management fee and custody services fee. Loan syndication fees are recognised as revenue when the related syndication arrangement has been completed and the Group has retained no part of the loan package for itself or has retained a part at the same effective interest rate as that of other participants.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.9 Financial assets

The Group classifies its financial assets into the following four categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity securities and available-for-sale financial assets. The Management determines the classification of investments at initial recognition. The classification depends on the purpose for which the financial assets are held. All financial assets are recognised initially at fair value. Except for financial assets carried at fair value through profit or loss, all transaction costs of financial assets are included in their amortised costs.

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

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

A financial asset which has been acquired or incurred principally for the purpose of selling in the short term or is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking is classified as held-for-trading. Derivatives are also classified as held for trading unless they are designated as effective hedges.

A financial asset, other than one held for trading, will be designated as a financial asset at fair value through profit or loss, if it meets one of the criteria set out below, and is so designated by the Management:

- eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would otherwise arise from measuring the financial assets or recognising the gains and losses on them on different bases; or

- applies to a group of financial assets, financial liabilities or both that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the key Management; or

- relates to financial assets containing one or more embedded derivative that significantly modifies the cash flow resulting from those financial assets.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.9 Financial assets (continued)

(1) Financial assets at fair value through profit or loss (continued)

These assets are recognised initially at fair value, with transaction costs taken directly to the income statement, and are subsequently re-measured at fair value.

Gains and losses from changes in the fair value of such assets (excluding the interest component) are reported in net trading gain/loss or net gain/loss on financial instruments designated at fair value through profit or loss. The interest component is reported as part of interest income.

(2) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, including placements with and advances to banks and other financial institutions, investment debt securities without an active market and loans and advances to customers. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method less allowances for impairment losses.

(3) Held-to-maturity

Financial assets classified as held-to-maturity are those traded in active markets, with fixed or determinable payments and fixed maturities that the Group's Management has both the positive intention and the ability to hold to maturity. Where the Group sold held-to-maturity assets (i) other than due to an isolated event beyond the Group's control, non-recurring and could not have been reasonably anticipated by the Group, such as a significant deterioration in the issuer's creditworthiness, significant change in statutory or regulatory requirement or (ii) other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale. They are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method less allowances for impairment losses.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.9 Financial assets (continued)

(4) Available-for-sale

Financial assets classified as available-for-sale are those that are either designated as such or are not classified in any of the other categories. They are intended to be held for an indefinite period of time but may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Available-for-sale financial assets are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at fair value. Unrealised gains and losses arising from changes in the fair value of investments are recognised directly in other comprehensive income, until the financial asset is derecognised or impaired at which time the accumulated gain or loss previously recognised in equity should be transferred to the income statement. However, interest income which includes the amortisation of premium and discount is calculated using the effective interest method and is recognised in the income statement. Dividends on equity instruments classified as available-for-sale are recognised in other operating income when the Group's right to receive payment is established.

The treatment of translation differences on available-for-sale securities is dealt with in Note 2.4.

2.10 Financial liabilities

The Group classifies its financial liabilities under the following categories: trading liabilities, financial liabilities designated at fair value through profit or loss, deposits and other liabilities. All financial liabilities are classified at inception and recognised initially at fair value.

(1) Trading liabilities

A financial liability is classified as held for trading if it is incurred principally for the purpose of repurchasing in the short term. Derivatives are also classified as held for trading unless they are designated as effective hedges. It is measured at fair value and any gains and losses from changes in fair value are recognised in the income statement.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.10 Financial liabilities (continued)

(2) Financial liabilities designated at fair value through profit or loss

A financial liability can be designated at fair value through profit or loss if it is so designated at inception. A financial liability is so designated if it meets one of the following criteria:

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

- applies to a group of financial assets, financial liabilities or both that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the key Management; or

- relates to financial liabilities containing one or more embedded derivative that significantly modifies the cash flow resulting from those financial liabilities.

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

(3) Deposits and other liabilities

Deposits and other liabilities, other than those classified as trading liabilities or designated at fair value through profit or loss are carried at amortised cost. Any difference (if available) between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period using the effective interest method.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.11 Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a contract between the holder and the debtor.

Financial guarantees are initially recognised as financial liabilities and reported under “Other accounts and provisions” in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the Group’s liabilities under such guarantees are measured at the higher of (i) the amount determined in accordance with HKAS 37 “Provisions, Contingent Liabilities and Contingent Assets” and (ii) the amount initially recognised less, where appropriate, accumulated amortisation recognised over the life of the guarantee on a straight-line basis. Any changes in the liability relating to financial guarantees are taken to the income statement.

2.12 Recognition and derecognition of financial instruments

Purchases and sales of financial assets at fair value through profit or loss, available-for-sale and held-to-maturity securities are recognised on the trade date, the date on which the Group purchases or sells the assets. Loans and receivables (except investment securities without an active market) are recognised when cash is advanced to the borrowers. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. When the Group neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the Group either continues to recognise the transferred financial asset to the extent of its continuing involvement if control remains or derecognise it if there is no retained control.

Trading liabilities and financial liabilities designated at fair value through profit or loss are recognised on the trade date. Deposits that are not trading liabilities are recognised when money is received from customers, other liabilities are recognised when such obligations arise. Financial liabilities are derecognised from the balance sheet when and only when the obligation specified in the contract is discharged, cancelled or expired.

Securities and bills sold to a counterparty with an obligation to repurchase at a pre-determined price on a specified future date under a repurchase agreement are referred to as Repos. Securities and bills purchased from a counterparty with an obligation to re-sell to the counterparty at a pre-determined price on a specified future date under a resale agreement are referred to as Reverse repos.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.12 Recognition and derecognition of financial instruments (continued)

Repos or securities lending are initially recorded as due to banks, placements from banks and other financial institutions, as appropriate, at the actual amount of cash received from the counterparty. Financial assets given as collateral for repurchase agreements are not derecognised and are recorded as investment securities or financial assets at fair value through profit or loss. Reverse repos or securities borrowing are initially recorded in the balance sheet as cash and due from banks or placements with banks and other financial institutions, as appropriate, at the actual amount of cash paid to the counterparty. Financial assets received as collateral under reverse repurchase agreements are not recognised on the balance sheet. The difference between sale and repurchase price is recognised as interest income or interest expense over the life of the agreements using the effective interest method.

2.13 Determination of fair value of financial instruments

The fair values of financial assets and financial liabilities that are quoted in active markets are based on current bid prices and current ask prices respectively. If the market for financial assets and financial liabilities is not active (such as unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.14 Impairment of financial assets

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

(i) significant financial difficulty of the issuer or obligor;

(ii) a breach of contract, such as a default or delinquency in interest or principal payment;

(iii) the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;

(iv) it becoming probable that the borrower will enter into bankruptcy or other financial reorganisation;

(v) the disappearance of an active market or downgrading below investment grade level for that financial asset because of financial difficulties; or

(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

- adverse changes in the payment status of borrowers in the group; or
- national or local economic conditions that correlate with defaults on the assets in the group.

(1) Assets carried at amortised cost

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

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

(1) Assets carried at amortised cost (continued)

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

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

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

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

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

If, in a subsequent period, the amount of allowance for impairment losses decreases and the decrease can be related objectively to an event occurring after the impairment loss was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss to the extent of its decrease is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Loans whose terms have been renegotiated with substantial difference in the terms are no longer considered to be past due but are treated as new loans.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

(2) Assets classified as available-for-sale

If evidence of impairment exists for available-for-sale financial assets, the accumulated losses, measured as the difference between the acquisition cost or amortised cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement, is removed from equity and recognised in the income statement. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss to the extent of its decrease is reversed through the income statement. With respect to equity instruments, further fair value changes are recognised in the reserve for fair value change of available-for-sale securities through other comprehensive income, impairment losses are not reversed through the income statement.

2.15 Impairment of investment in subsidiaries, associates and non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Potential indications of impairment may include significant adverse changes in the technological, market, economic or legal environment in which the assets operate or whether there has been a significant or prolonged decline in value below their cost.

An impairment loss is recognised for the amount by which the asset’s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset’s fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

In the Bank’s financial statements, impairment testing of the investment in a subsidiary is also required upon receiving dividend from that entity if the dividend exceeds the total comprehensive income of that entity concerned in the period the dividend is declared or if the carrying amount of that entity in the Bank's balance sheet exceeds the carrying amount of that entity's net assets including goodwill in its consolidated balance sheet.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.16 Investment properties

Properties that are held for long-term rental yields or for capital appreciation or both, and that are not occupied by the companies in the Group, are classified as investment properties. Properties leased out within Group companies are classified as investment properties in individual companies' financial statements and as premises in consolidated financial statements. Land held under operating lease is classified and accounted for as investment property when the rest of the definition of investment property is met. The operating lease is accounted for as if it is a finance lease.

Investment properties are recognised initially at cost, including related transaction costs. After initial recognition, investment properties are measured at fair value assessed by professional valuers on the basis of open market value. If information of open market value is not available, alternative valuation methods are used such as recent prices on less active markets or discounted cash flow projections. These valuations are performed in accordance with valuation standards on properties published by The Hong Kong Institute of Surveyors.

Subsequent expenditure is charged to the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The item is stated at cost less impairment and is included in the carrying amount of investment properties. Once the item begins to generate economic benefits, it is then measured at fair value. All other repairs and maintenance costs are expensed in the income statement during the financial period in which they are incurred.

Any changes in fair value are recognised directly in the income statement.

If an investment property becomes owner-occupied, it is reclassified as premises, and its fair value at the date of reclassification becomes its cost for accounting purposes. If an item of premises becomes an investment property because its use has changed, any difference resulting between the carrying amount and the fair value of this item at the date of transfer is recognised in other comprehensive income as a revaluation of premises under HKAS 16 "Property, Plant and Equipment". However, if a fair value gain reverses a previous revaluation loss or impairment loss, the gain is recognised in the income statement up to the amount previously debited.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.17 Properties, plant and equipment

Properties are mainly branches and office premises. Premises are shown at fair value based on periodic, at least annual, valuations by external independent valuers less subsequent accumulated depreciation. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. In the intervening periods, the directors review the carrying amount of premises, by reference to the open market value of similar properties, and adjustments are made when there has been a material change.

All plant and equipment are stated at historical cost less accumulated depreciation and impairment. Historical cost includes expenditures that are directly attributable to the acquisition and installation of the items.

Subsequent costs are included in an asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The item is stated at cost until it begins to generate economic benefits, then the item is subsequently measured according to the measurement basis of its respective assets class. All other repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation of premises are credited to the premises revaluation reserve through other comprehensive income. Decreases that offset previous increases of the same individual asset are charged against premises revaluation reserve through other comprehensive income; all other decreases are expensed in the income statement. Any subsequent increases are credited to the income statement up to the amount previously debited, and then to the premises revaluation reserve. Upon disposal of premises, the relevant portion of the premises revaluation reserve realised in respect of previous valuations is released and transferred from the premises revaluation reserve to retained earnings.

Depreciation is calculated on the straight-line method to write down the cost or revalued amount of such assets over their estimated useful lives as follows:

• Properties	Over the life of government land leases
• Plant and equipment	2-15 years

The useful lives of assets are reviewed, and adjusted if appropriate, as at the end of each reporting period.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.17 Properties, plant and equipment (continued)

At the end of each reporting period, both internal and external sources of information are considered to determine whether there is any indication that properties, plant and equipment, are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment loss is recognised in the income statement except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case it is treated as a revaluation decrease. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. Impairment loss is reversed through the premises revaluation reserve or income statement as appropriate.

Gains and losses on disposals are determined by comparing proceeds with carrying amount, relevant taxes and expenses. These are recognised in the income statement.

2.18 Leases

(1) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. The total payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place. Rental income from operating leases is recognised on a straight-line basis over the lease term.

(2) Finance leases

Leases of assets where lessee have obtained substantially all the risks and rewards of ownership are classified as finance leases. Government land leases in Hong Kong are classified as finance leases as the present value of the minimum lease payments (ie, transaction price) of the land amounted to substantially all of the fair value of the land as if it were freehold.

Finance leases are capitalised at the lease's commencement at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other liabilities. Investment properties acquired under finance leases are carried at their fair value.

When assets are leased out under a finance lease, the present value of the lease payments is recognised as a receivable. Lease income is recognised over the term of the lease using net investment method, which reflects a constant periodic rate of return.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.19 Cash and cash equivalents

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise balances with original maturity less than three months from the date of acquisition, including cash, balances with banks and other financial institutions, short-term bills and notes classified as investment securities.

2.20 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

2.21 Employee benefits

(1) Retirement benefit costs

The Group contributes to defined contribution retirement schemes under either recognised ORSO schemes or MPF schemes that are available to the Group's employees. Contributions to the schemes by the Group and employees are calculated as a percentage of employees' basic salaries for the ORSO schemes and in accordance with the MPF rules for MPF schemes. The retirement benefit scheme costs are charged to the income statement as incurred and represent contributions payable by the Group to the schemes. Contributions made by the Group that are forfeited by those employees who leave the ORSO scheme prior to the full vesting of their entitlement to the contributions are used by the Group to reduce the existing level of contributions or to meet its expenses under the trust deed of the ORSO schemes.

The assets of the schemes are held in independently-administered funds separate from those of the Group.

(2) Leave entitlements

Employee entitlements to annual leave and sick leave are recognised when they accrue to employees. A provision is made for the estimated liability for unused annual leave and the amount of sick leave expected to be paid as a result of services rendered by employees up to the end of the reporting period.

Compensated absences other than sick leave and special approved annual leaves are non-accumulating; they lapse if the current period's entitlement is not used in full. Except for unexpired annual leaves, they do not entitle employees to a cash payment for unused entitlement on leaving the Group.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.21 Employee benefits (continued)

(3) Bonus plans

The expected cost of bonus payments are recognised as a liability when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made. Liabilities for bonus plans that are expected to be settled longer than twelve months will be recognised using discounted cash flow method if the amounts are significant.

2.22 Current and deferred income taxes

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

Income tax payable on profits, based on the applicable tax law enacted or substantially enacted at the end of the reporting period in each jurisdiction where the Bank and the subsidiaries operate and generate taxable income, is recognised as a current income tax expense in the period in which profits arise.

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

The principal temporary differences arise from asset impairment provisions, depreciation of premises and equipment, revaluation of certain assets including available-for-sale securities and premises, and tax losses carried forward. However, the deferred income tax is not recognised if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred income tax liabilities are provided in full on all taxable temporary differences and deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.22 Current and deferred income taxes (continued)

Deferred income tax is charged or credited in the income statement except for deferred income tax relating to fair value re-measurement of available-for-sale securities and revaluation of premises which are charged or credited to other comprehensive income, in which case the deferred income tax is also credited or charged to other comprehensive income and is subsequently recognised in the income statement together with the realisation of the deferred gain and loss.

Deferred tax liability or deferred tax asset arising from investment property is determined based on the presumption that the revaluation amount of such investment property will be recovered through sale with the relevant tax rate applied.

2.23 Repossessed assets

Repossessed assets are initially recognised at the lower of their fair value less costs to sell and the amortised cost of the related outstanding loans on the date of repossession, and the related loans and advances together with the related impairment allowances are derecognised from the balance sheet. Subsequently, repossessed assets are measured at the lower of their cost and fair values less costs to sell and are reported as 'non-current assets held for sale' included in 'Other assets'.

2.24 Fiduciary activities

The Group commonly acts as a trustee, or in other fiduciary capacities, that result in its holding or managing assets on behalf of individuals, trusts and other institutions. These assets and any gains or losses arising thereon are excluded from these financial statements, as they are not assets of the Group.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.25 Contingent liabilities and contingent assets

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

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

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

Contingent assets are not recognised but are disclosed in the notes to the financial statements when an inflow of economic benefits is probable. When the inflow is virtually certain, it will be recognised as an asset.

2.26 Related parties

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

Notes to the Financial Statements (continued)

3. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Areas susceptible to changes in essential estimates and judgements, which affect the carrying amount of assets and liabilities, are set out below. The effect of changes to either the key assumptions or other estimation uncertainties will be presented below if it is practicable to determine. It is possible that actual results may require material adjustments to the estimates referred to below.

3.1 Impairment allowances on loans and advances

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

Carrying amounts of loans and advances as at 31 December 2012 are shown in Note 23 to the Financial Statements.

3.2 Impairment of held-to-maturity and available-for-sale securities

The Group reviews its held-to-maturity and available-for-sale investment portfolios to assess impairment at least on a quarterly basis. In determining whether any of these investments is impaired, risk characteristics and performance such as external credit rating, market price etc will be assessed. The Group makes estimates on the default rate and loss severity of each investment with reference to market performance of the portfolios, current payment status of the issuers or performance of the underlying assets, or economic conditions that correlate with defaults on the collateralised assets. The methodology and assumptions used for impairment assessments are reviewed regularly.

Carrying amounts of investment in securities as at 31 December 2012 are shown in Note 25 to the Financial Statements.

Notes to the Financial Statements (continued)

3. Critical accounting estimates and judgements in applying accounting policies (continued)

3.3 Fair values of derivative financial instruments

The fair values of derivative financial instruments that are not quoted in active markets are determined by using valuation techniques. Valuation techniques used include discounted cash flows analysis and models with built-in functions available in externally acquired financial analysis or risk management systems widely used by the industry. To the extent practical, the models only use observable data.

Carrying amounts of derivative financial instruments as at 31 December 2012 are shown in Note 22 to the Financial Statements.

3.4 Held-to-maturity securities

The Group follows the guidance of HKAS 39 in classifying certain non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity securities. This classification requires significant Management judgement to evaluate the Group's intention and ability to hold such investments to maturity. If the Group fails to hold these investments to maturity other than for specific circumstances defined in HKAS 39, such as selling an insignificant amount, selling close to maturity or due to significant credit deterioration of such investments, it will be required to reclassify the entire portfolio of financial assets as available-for-sale securities. The investments would then be measured at fair value and not amortised cost.

Carrying amounts of held-to-maturity securities as at 31 December 2012 are shown in Note 25 to the Financial Statements.

Notes to the Financial Statements (continued)

4. Financial risk management

The Group is exposed to financial risks as a result of engaging in a variety of business activities. The principal financial risks are credit risk, market risk (including currency risk and interest rate risk) and liquidity risk. This note summarises the Group's exposures to these risks, as well as its objectives, risk management governance structure, policies and procedures for managing and the methods used to measure these risks.

Financial risk management framework

The Group's risk management governance structure is designed to cover all businesses and ensure various risks are properly managed and controlled in the course of conducting business. The Group has a sound risk management organisational structure with a comprehensive set of policies and procedures to identify, measure, monitor and control various risks that may arise. These risk management policies and procedures are regularly reviewed and modified to reflect changes in markets and business strategies.

The Board of Directors, representing the interests of shareholders, is the highest decision-making authority of the Group and has the ultimate responsibility for risk management. The Board, with the assistance of the Risk Management Committee ("RMC"), has the primary responsibility for formulating risk management strategies and ensuring that the Group has an effective risk management system to implement these strategies.

The RMC, a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, reviewing and approving high-level risk-related policies and overseeing their implementation, reviewing and approving significant or high risk exposures or transactions. The RMC would refer any specific transaction to the Board if it is deemed so significant that Board approval is desirable. The Audit Committee assists the Board in fulfilling its role in overseeing the internal control system.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

Financial risk management framework (continued)

Various units of the Group have their respective risk management responsibilities. Business units act as the first line of defence while risk management units, which are independent from the business units, are responsible for the day-to-day management of different kinds of risks. Risk management units have the primary responsibilities for drafting, reviewing and updating various risk management policies and procedures.

The Group has put in place appropriate internal control systems, including establishment of an organisation structure that sets clear lines of authority and responsibility for monitoring compliance with policies, procedures and limits. Proper reporting lines also provide sufficient independence of the control functions from the business areas, as well as adequate segregation of duties throughout the organisation which helps to promote an appropriate internal control environment.

Pursuant to a risk-based approach, the Auditing Department conducts independent reviews on areas including principal risks, regulatory compliance, adequacy and effectiveness of risk policies and internal control systems.

Product development

To ensure effective risk assessment and monitoring, the Group developed a comprehensive product development and management framework which clearly defines the roles and responsibilities of all related units, and the proper risk assessment procedures for the product development process.

In accordance with the strategic objectives set by the Board and the Management, the respective product management units are responsible for formulating business and product development plans, and the division of strategic development shall ensure the plans are aligned with the Group’s overall strategies. Divisions that are responsible for risk management, legal, compliance and finance etc. are accountable for risk assessment and review.

Apart from product development, the respective business units shall work closely with relevant risk evaluating division to identify and assess all the related risks. Risk evaluating divsion shall conduct independent review on risk management procedures and assessment results. Products can only be launched after the risk management procedures are fulfilled and endorsed by all risk evaluating divisions.

In order to be prudent in offering treasury products to our clients, all treasury products, regardless brand new or modified, require approval from the Management or the special committee before launching.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk

Credit risk is the risk of loss that a customer or counterparty will be unable to or unwilling to meet its contractual obligations. Credit risk exists in the trading book and banking book, on- and off-balance sheet exposures of a bank. It arises principally from lending, trade finance, treasury businesses and covers inter-bank transactions, foreign exchange and derivative transactions as well as investments in bonds and securities.

Credit risk management framework

The Group has formulated a comprehensive set of credit risk management policies and procedures, and appropriate credit risk limits to manage and control credit risk that may arise. These policies, procedures and credit risk limits are regularly reviewed and modified to cope with changes in risk, market conditions and business strategies.

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

The Credit and Loans Management Committee ("CLMC"), a management committee authorized by the Chief Executive ("CE"), is responsible for the implementation of the credit risk management strategies as well as the approval of credit policies. It also monitors various aspects of the Group's loan portfolio such as asset quality, risk concentration etc. Various units of the Group have their respective credit risk management responsibilities. Business units act as the first line of defense. They are obliged to make thorough assessment on every credit application and are fully responsible for monitoring credit performance and punctual repayments. The business activities conducted should also comply with the credit policies and procedures. The risk management units, which are independent from the business units, are responsible for the day-to-day management of credit risks and have the primary responsibilities for providing an independent due diligence through identifying, measuring, monitoring and controlling credit risk, as well as drafting, reviewing and updating credit risk management policies and procedures. They report directly to the CLMC, CE and RMC. The subsidiary sets up independent risk monitoring teams to monitor credit risk, and submit management information and reports to the Bank on a regular basis.

The Board of Directors is the ultimate source of credit authority. The Board of Directors delegates credit approval authority to the CE. Based on management needs, the CE can further delegate to the subordinates within the limit authorized by the Board of Directors. The Group sets the limits of credit approval authority according to business nature, internal rating, the level of transaction risk and the extent of the credit exposure.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Credit risk measurement and control

In view of the rapidly changing market conditions, the Group has been continuously revisiting its credit strategies and conducting rigorous reviews on the concerned portfolios.

Loans and advances

Different credit approval and control procedures are adopted according to level of risk associated with the customer, counterparty or transaction. All credit applications are subject to thorough risk assessment and proper approval. In general, most of the credit applications will be reviewed and assessed by independent officer(s) of risk management unit(s) before approval, with exceptions given to certain designated products which satisfy certain conditions. These designated loans will be (randomly) reviewed by designated unit(s) which is(are) independent from the front line business units after funding being drawn. Obligor ratings (in terms of PD) and facility ratings (in terms of LGD) are assigned to credit applications for non-retail exposure to support credit approval.. Retail internal rating systems are deployed in risk assessment of retail credit transactions, including small business retail exposures, residential mortgage loans , personal loans. Loan grades, obligor and facility ratings as well as loss estimates (if applicable) are used to support credit approval.

The Group also uses loan grades, obligor ratings and loss estimates (if applicable) to support credit monitoring, analysis and reporting. For non-retail exposures, more frequent rating review and closer monitoring are required for riskier customers. For retail exposures, monthly updated internal ratings and loss estimates are used for credit monitoring on a portfolio basis. More comprehensive review is required for obligors being identified under high-risk pools.

The Group has established credit master scale for internal rating purpose, which is in compliance with the Banking (Capital) Rules under the Hong Kong Banking Ordinance on internal rating structure, and can be mapped to Standard & Poor’s external ratings.

Regular credit management information reports and ad hoc reports are provided to the Management, RMC and Board of Directors to facilitate their continuous monitoring of credit risk.

The Group identifies credit concentration risk by industry, geography, customer and counterparty risk. The Group monitors changes to counterparties credit risk, quality of the credit portfolio and risk concentrations, and reports regularly to the Management.

The Group continues to adopt loan grading criteria which divide credit assets into 5 categories with reference to HKMA's guidelines.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Credit risk measurement and control (continued)

Loans and advances (continued)

"Pass" represents loans where the borrower is current in meeting its repayment obligations and full repayment of interest and principal is not in doubt.

"Special Mention" represents loans where the borrower is experiencing difficulties which may threaten the Group's position. Ultimate loss is not expected at this stage but could occur if adverse conditions persist.

"Substandard" represents loans where the borrower displays a definable weakness that is likely to jeopardise repayment.

"Doubtful" represents loans where collection in full is improbable and the Group expects to sustain a loss of principal and/or interest, taking into account the net realisable value of the collateral.

"Loss" represents loans which are considered uncollectible after all collection options (such as the realisation of collateral or the institution of legal proceedings) have been exhausted.

Debt securities and derivatives

For investments in debt securities and securitisation assets, the obligor ratings or external credit ratings, assessment of the underlying assets and credit limits setting on customer/security issuer basis are used for managing credit risk associated with the investment. For derivatives, the Group sets customer limits to manage the credit risk involved and follows the same approval and control processes as loans and advances. On-going monitoring and stop-loss procedures are established.

Settlement risk arises mainly from foreign exchange transactions with counterparties and also from derivatives in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty to cover all settlement risk arising from the Group's transactions on any single day.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Collateral held as security and other credit enhancements

The valuation and management of collateral have been documented in the credit risk management and policies and procedures which cover acceptance criteria, validity of collateral, loan-to-value ratio, haircut ratio, valuation and insurance, etc. The collateral is revalued on a regular basis, though the frequency and the method used varies with the type of collateral involved and the nature and the risk of the underlying credit. The Group has established a mechanism to update the value of its main type of collateral, real estate properties, with the use of public indices on a portfolio basis. Collateral is insured with the Group as the beneficiary.

For loans guaranteed by a third party, the Group will assess the guarantor's financial condition, credit history and ability to meet obligations.

As at 31 December 2012 and 2011, the Group did not hold any collateral permitted to sell or re-pledge in the absence of default by the borrower.

(A) Credit exposures

The maximum exposure is a worst case scenario of credit risk exposure to the Group without taking into account any collateral held or other credit enhancements. For on-balance sheet assets, the maximum exposure to credit risk equals their carrying amount. 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 commitment and other credit related liabilities, the maximum exposure to credit risk is the full amount of the committed facilities.

The nature of the collateral held and other credit enhancements and their financial effect to the different classes of the Group's financial assets are as follows.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(A) Credit exposures (continued)

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 assets.

Financial assets at fair value through profit or loss and investment in securities

Collateral is generally not sought on debt securities.

Derivative financial instruments

The International Swaps and Derivatives Association Master Agreement is the preferred agreement for documenting derivatives activities of the Group. It provides the contractual framework within which dealing activities across a full range of OTC products are conducted, and contractually bind 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.

Advances and other accounts, contingent liabilities and commitments

The general types of collateral are disclosed on page 48. Advances and other accounts, contingent liabilities and commitments are collateralised to the extent considered appropriate by the Group taking account of the risk assessment of individual exposures. The collateral coverage of advances to customers is analysed on pages 61 to 64. The components and nature of contingent liabilities and commitments are disclosed in Note 38. Regarding the commitments that are unconditionally cancellable without prior notice, the Group would assess the necessity to withdraw the credit line in case where the credit quality of a borrower deteriorates. For contingent liabilities and commitments, 15.79% (2011: 25.11%) is covered by collateral as at 31 December 2012.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts

Gross advances and other accounts before loan impairment allowances are summarised by product type as follows:

	The Group	
	2012	2011
	HK$'000	HK$'000
Advances to customers		
Personal		
- Mortgages	**17,143,632**	17,151,357
- Others	**4,858,417**	3,711,930
Corporate		
- Commercial loans	**103,158,279**	93,541,765
- Trade finance	**5,992,781**	5,439,177
	131,153,109	119,844,229
Trade bills	**8,069,618**	13,318,487
Advances to banks and other financial institutions	**-**	544,256
Total	**139,222,727**	133,706,972

	The Bank	
	2012	2011
	HK$'000	HK$'000
Advances to customers		
Personal		
- Mortgages	**11,326,989**	12,790,281
- Others	**4,324,775**	3,527,842
Corporate		
- Commercial loans	**64,479,702**	62,983,938
- Trade finance	**4,931,864**	4,933,880
	85,063,330	84,235,941
Trade bills	**5,504,118**	10,819,714
Advances to banks and other financial institutions	**-**	544,256
Total	**90,567,448**	95,599,911

Advances with a specific repayment date are classified as overdue when the principal or interest is past due and remains unpaid. Advances repayable by regular instalments are classified as overdue when an instalment payment is past due and remains unpaid. Advances repayable on demand are classified as overdue either when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction or when the advances have remained continuously outside the approved limit that was advised to the borrower.

Advances are impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred and that loss event(s) has an impact on the estimated future cash flows of the advances that can be reliably estimated.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

If there is objective evidence that an impairment loss on advances has been incurred, the amount of loss is measured as the difference between the carrying amount and the present value of estimated future cash flows generated by the advances. Objective evidence that advances are impaired includes observable data that comes to the attention of the Group about the loss events.

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

- Significant financial difficulty incurred by the borrower;
- A breach of contract, such as a default or delinquency in interest or principal payment;
- For economic or legal reasons related to the borrower's financial difficulty, the Group has granted to the borrower a concession that it would not otherwise consider;
- Probable that the borrower will become bankrupt or undergo other financial reorganisation; or
- Other observable data indicating that there is a measurable decrease in the estimated future cash flows from such advances.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(a) Advances neither overdue nor impaired

Advances that were neither overdue nor impaired are analysed by internal credit grades as follows:

	The Group			
	2012			
	Pass	**Special mention**	**Substandard or below**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Advances to customers				
Personal				
- Mortgages	**16,895,662**	**23,523**	**2,066**	**16,921,251**
- Others	**4,792,158**	**8,453**	**1,607**	**4,802,218**
Corporate				
- Commercial loans	**100,427,042**	**2,145,488**	**72**	**102,572,602**
- Trade finance	**5,686,815**	**240,980**	**-**	**5,927,795**
	127,801,677	**2,418,444**	**3,745**	**130,223,866**
Trade bills	**8,069,618**	**-**	**-**	**8,069,618**
Advances to banks and other financial institutions	**-**	**-**	**-**	**-**
Total	**135,871,295**	**2,418,444**	**3,745**	**138,293,484**

	The Group			
	2011			
	Pass	Special mention	Substandard or below	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers				
Personal				
- Mortgages	16,930,079	2,668	4,213	16,936,960
- Others	3,690,063	879	655	3,691,597
Corporate				
- Commercial loans	92,528,432	780,456	21,801	93,330,689
- Trade finance	5,375,545	20,585	-	5,396,130
	118,524,119	804,588	26,669	119,355,376
Trade bills	13,231,930	86,557	-	13,318,487
Advances to banks and other financial institutions	544,256	-	-	544,256
Total	132,300,305	891,145	26,669	133,218,119

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(a) Advances neither overdue nor impaired (continued)

	The Bank			
	2012			
	Pass	Special mention	Substandard or below	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers				
Personal				
- Mortgages	11,230,412	2,421	1,300	11,234,133
- Others	4,282,075	8,453	1,607	4,292,135
Corporate				
- Commercial loans	62,857,999	1,321,210	72	64,179,281
- Trade finance	4,693,834	198,501	-	4,892,335
	83,064,320	1,530,585	2,979	84,597,884
Trade bills	5,504,118	-	-	5,504,118
Advances to banks and other financial institutions	-	-	-	-
Total	88,568,438	1,530,585	2,979	90,102,002

	The Bank			
	2011			
	Pass	Special mention	Substandard or below	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers				
Personal				
- Mortgages	12,651,801	1,703	2,973	12,656,477
- Others	3,506,020	879	655	3,507,554
Corporate				
- Commercial loans	62,686,906	133,993	21,801	62,842,700
- Trade finance	4,900,016	18,035	-	4,918,051
	83,744,743	154,610	25,429	83,924,782
Trade bills	10,733,157	86,557	-	10,819,714
Advances to banks and other financial institutions	544,256	-	-	544,256
Total	95,022,156	241,167	25,429	95,288,752

The occurrence of loss event(s) may not necessarily result in impairment loss where the advances are fully collateralised. While such advances are of “substandard” or lower grades, they are regarded as not being impaired and have been included in the above tables.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(b) Advances overdue but not impaired

The gross amount of advances overdue but not impaired is analysed as follows:

	The Group				
	2012				
	Overdue for three months or less	Overdue for six months or less but over three months	Overdue for one year or less but over six months	Overdue for over one year	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers					
Personal					
- Mortgages	**199,852**	**4,227**	**-**	**191**	**204,270**
- Others	**51,452**	**-**	**-**	**-**	**51,452**
Corporate					
- Commercial loans	**199,491**	**6,371**	**2**	**1**	**205,865**
- Trade finance	**3,404**	**-**	**-**	**-**	**3,404**
Total	**454,199**	**10,598**	**2**	**192**	**464,991**

	The Group				
	2011				
	Overdue for three months or less	Overdue for six months or less but over three months	Overdue for one year or less but over six months	Overdue for over one year	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers					
Personal					
- Mortgages	203,980	1,452	-	210	205,642
- Others	12,565	1,305	-	-	13,870
Corporate					
- Commercial loans	124,832	-	64	1	124,897
- Trade finance	11,581	10	-	-	11,591
Total	352,958	2,767	64	211	356,000

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(b) Advances overdue but not impaired (continued)

	The Bank 2012				
	Overdue for three months or less HK$'000	Overdue for six months or less but over three months HK$'000	Overdue for one year or less but over six months HK$'000	Overdue for over one year HK$'000	Total HK$'000
Advances to customers					
Personal					
- Mortgages	**92,624**	**232**	**-**	**-**	**92,856**
- Others	**31,863**	**-**	**-**	**-**	**31,863**
Corporate					
- Commercial loans	**197,791**	**5,408**	**2**	**-**	**203,201**
- Trade finance	**3,404**	**-**	**-**	**-**	**3,404**
Total	**325,682**	**5,640**	**2**	**-**	**331,324**

	The Bank 2011				
	Overdue for three months or less HK$'000	Overdue for six months or less but over three months HK$'000	Overdue for one year or less but over six months HK$'000	Overdue for over one year HK$'000	Total HK$'000
Advances to customers					
Personal					
- Mortgages	133,301	503	-	-	133,804
- Others	12,565	1,305	-	-	13,870
Corporate					
- Commercial loans	124,833	-	64	-	124,897
- Trade finance	11,422	10	-	-	11,432
Total	282,121	1,818	64	-	284,003

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(c) Impaired advances

Advances individually identified to be impaired are analysed by product type as follows:

	The Group			
	2012		2011	
	Gross advances	Market value of collateral	Gross advances	Market value of collateral
	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers				
Personal				
- Mortgages	18,111	19,217	8,755	4,564
- Others	4,747	5,586	6,463	5,350
Corporate				
- Commercial loans	379,812	157,993	86,179	-
- Trade finance	61,582	83,399	31,456	65,851
Total	464,252	266,195	132,853	75,765
Loan impairment allowances made in respect of such advances	220,593		87,615	

	The Bank			
	2012		2011	
	Gross advances	Market value of collateral	Gross advances	Market value of collateral
	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers				
Personal				
- Mortgages	-	-	-	-
- Others	777	-	6,418	4,972
Corporate				
- Commercial loans	97,220	76,219	16,341	-
- Trade finance	36,125	17,017	4,397	-
Total	134,122	93,236	27,156	4,972
Loan impairment allowances made in respect of such advances	58,444		11,652	

The loan impairment allowances were made after taking into account the value of collateral in respect of impaired advances.

As at 31 December 2012 and 2011, there were no impaired trade bills and advances to banks and other financial institutions.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(c) Impaired advances (continued)

	The Group	
	2012	2011
	HK$'000	HK$'000
Current market value of collateral held against the covered portion of such advances to customers	**266,195**	75,765
Covered portion of such advances to customers	**177,725**	35,646
Uncovered portion of such advances to customers	**286,527**	97,207

	The Bank	
	2012	2011
	HK$'000	HK$'000
Current market value of collateral held against the covered portion of such advances to customers	**93,236**	4,972
Covered portion of such advances to customers	**51,233**	3,977
Uncovered portion of such advances to customers	**82,889**	23,179

Classified or impaired advances to customers are analysed as follows:

	The Group	
	2012	2011
	HK$'000	HK$'000
Gross classified or impaired advances to customers	**483,659**	165,966
Gross classified or impaired advances to customers as a percentage of gross advances to customers	**0.37%**	0.14%
Individually assessed loan impairment allowances made in respect of such advances	**220,593**	87,615

	The Bank	
	2012	2011
	HK$'000	HK$'000
Gross classified or impaired advances to customers	**147,240**	57,870
Gross classified or impaired advances to customers as a percentage of gross advances to customers	**0.17%**	0.07%
Individually assessed loan impairment allowances made in respect of such advances	**58,444**	11,652

Classified or impaired advances to customers follow the definitions set out in the Banking (Disclosure) Rules under the Banking Ordinance and represent advances which are either classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(d) Advances overdue for more than three months

The gross amount of advances overdue for more than three months is analysed as follows:

	The Group			
	2012		2011	
	Amount	% of gross advances to customers	Amount	% of gross advances to customers
	HK$'000		HK$'000	
Gross advances to customers which have been overdue for:				
- six months or less but over three months	**37,443**	**0.03%**	11,900	0.01%
- one year or less but over six months	**101,388**	**0.08%**	5,490	0.00%
- over one year	**125,587**	**0.09%**	88,155	0.08%
Advances overdue for over three months	**264,418**	**0.20%**	105,545	0.09%
Individually assessed loan impairment allowances made in respect of such advances	**121,444**		84,606	

	The Bank			
	2012		2011	
	Amount	% of gross advances to customers	Amount	% of gross advances to customers
	HK$'000		HK$'000	
Gross advances to customers which have been overdue for:				
- six months or less but over three months	**23,086**	**0.03%**	7,048	0.01%
- one year or less but over six months	**9,707**	**0.01%**	5,490	0.01%
- over one year	**25,591**	**0.03%**	9,308	0.01%
Advances overdue for over three months	**58,384**	**0.07%**	21,846	0.03%
Individually assessed loan impairment allowances made in respect of such advances	**21,359**		8,643	

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(d) Advances overdue for more than three months (continued)

	The Group	
	2012	2011
	HK$'000	HK$'000
Current market value of collateral held against the covered portion of such advances to customers	**611,086**	23,582
Covered portion of such advances to customers	**150,371**	11,416
Uncovered portion of such advances to customers	**114,047**	94,129

	The Bank	
	2012	2011
	HK$'000	HK$'000
Current market value of collateral held against the covered portion of such advances to customers	**430,151**	3,722
Covered portion of such advances to customers	**20,753**	1,818
Uncovered portion of such advances to customers	**37,631**	20,028

Collateral held against overdue or impaired loans is principally represented by charges over business assets such as commercial and residential premises for corporate loans and mortgages over residential properties for personal loans.

As at 31 December 2012 and 2011, there were no trade bills and advances to banks and other financial institutions overdue for more than three months for the Group and the Bank.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(e) Rescheduled advances

	The Group			
	2012		2011	
	Amount	**% of gross advances to customers**	Amount	% of gross advances to customers
	HK$'000		HK$'000	
Rescheduled advances to customers net of amounts included in "Advances overdue for more than three months"	**11,039**	**0.01%**	20,514	0.02%

	The Bank			
	2012		2011	
	Amount	**% of gross advances to customers**	Amount	% of gross advances to customers
	HK$'000		HK$'000	
Rescheduled advances to customers net of amounts included in "Advances overdue for more than three months"	**11,039**	**0.01%**	20,514	0.02%

As at 31 December 2012 and 2011, there were no rescheduled advances to banks and other financial institutions for the Group and the Bank.

Rescheduled advances are those advances that have been restructured or renegotiated because of deterioration in the financial position of the borrower or of the inability of the borrower to meet the original repayment schedule. Rescheduled advances, which have been overdue for more than three months under the revised repayment terms, are included in "Advances overdue for more than three months".

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers

(i) Sectoral analysis of gross advances to customers

The information concerning gross advances to customers has been analysed into loans used inside or outside Hong Kong by industry sectors of the borrowers as follows:

	The Group					
	2012					
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK$'000		HK$'000	HK$'000	HK$'000	HK$'000
Loans for use in Hong Kong						
Industrial, commercial and financial						
- Property development	1,779,675	43.52%	-	-	-	7,646
- Property investment	12,173,523	83.05%	6,534	152,920	-	142,096
- Financial concerns	1,626,879	62.05%	-	-	-	19,981
- Stockbrokers	17,427	13.88%	-	-	-	274
- Wholesale and retail trade	12,832,343	47.65%	48,097	60,639	19,815	103,771
- Manufacturing	3,735,230	40.35%	20,906	41,113	8,983	42,651
- Transport and transport equipment	5,271,838	14.44%	1,027	312	217	59,638
- Recreational activities	66,779	-	-	-	-	690
- Information technology	2,290,103	1.45%	2,164	2,164	599	6,225
- Others	8,408,000	50.38%	19,713	43,616	2,319	44,934
Individuals						
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	703,350	100.00%	3,015	17,512	-	378
- Loans for purchase of other residential properties	10,623,638	99.97%	1,725	75,344	-	4,263
- Others	3,006,246	70.51%	2,526	9,517	788	1,572
Total loans for use in Hong Kong	62,535,031	60.75%	105,707	403,137	32,721	434,119
Trade finance	5,992,781	34.60%	61,582	62,454	42,165	54,299
Loans for use outside Hong Kong	62,625,297	35.95%	316,370	443,749	145,707	481,031
Gross advances to customers	131,153,109	47.72%	483,659	909,340	220,593	969,449

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(i) Sectoral analysis of gross advances to customers (continued)

	The Group					
	2011					
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK$'000		HK$'000	HK$'000	HK$'000	HK$'000
Loans for use in Hong Kong						
Industrial, commercial and financial						
- Property development	2,738,332	58.71%	-	-	-	8,510
- Property investment	10,942,261	79.38%	-	45,685	-	110,811
- Financial concerns	3,005,772	35.70%	-	-	-	8,392
- Stockbrokers	3,241	100.00%	-	-	-	12
- Wholesale and retail trade	18,064,963	61.52%	8,032	48,960	2,492	109,024
- Manufacturing	4,412,357	38.10%	9,409	14,854	2,214	39,747
- Transport and transport equipment	3,542,563	10.55%	-	2,466	-	18,360
- Recreational activities	70,162	-	-	-	-	194
- Information technology	1,091,930	2.48%	2,173	2,173	552	3,215
- Others	5,427,639	62.95%	977	30,140	725	39,451
Individuals						
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	861,024	100.00%	4,618	29,248	-	577
- Loans for purchase of other residential properties	11,929,257	99.99%	2,422	104,556	-	4,932
- Others	2,477,768	83.41%	2,625	10,544	825	2,084
Total loans for use in Hong Kong	64,567,269	66.35%	30,256	288,626	6,808	345,309
Trade finance	5,439,177	33.02%	31,456	39,972	2,971	44,663
Loans for use outside Hong Kong	49,837,783	35.50%	104,254	150,518	77,836	315,160
Gross advances to customers	119,844,229	52.01%	165,966	479,116	87,615	705,132

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(i) Sectoral analysis of gross advances to customers (continued)

	The Bank					
	2012					
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK$'000		HK$'000	HK$'000	HK$'000	HK$'000
Loans for use in Hong Kong						
Industrial, commercial and financial						
- Property development	1,779,675	43.52%	-	-	-	7,646
- Property investment	12,173,523	83.05%	6,534	152,920	-	142,096
- Financial concerns	1,626,879	62.05%	-	-	-	19,981
- Stockbrokers	17,427	13.88%	-	-	-	274
- Wholesale and retail trade	12,832,343	47.65%	48,097	60,639	19,815	103,771
- Manufacturing	3,735,230	40.35%	20,906	41,113	8,983	42,651
- Transport and transport equipment	5,233,212	14.55%	1,027	312	217	59,319
- Recreational activities	66,779	-	-	-	-	690
- Information technology	2,290,103	1.45%	2,164	2,164	599	6,225
- Others	8,408,000	50.38%	19,713	43,616	2,319	44,934
Individuals						
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	703,350	100.00%	3,015	17,512	-	378
- Loans for purchase of other residential properties	10,623,638	99.97%	1,725	75,344	-	4,263
- Others	3,006,246	70.51%	2,526	9,517	788	1,572
Total loans for use in Hong Kong	62,496,405	60.79%	105,707	403,137	32,721	433,800
Trade finance	4,931,864	35.22%	36,125	36,997	25,723	45,616
Loans for use outside Hong Kong	17,635,061	17.38%	5,408	5,408	-	111,767
Gross advances to customers	85,063,330	50.31%	147,240	445,542	58,444	591,183

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(i) Sectoral analysis of gross advances to customers (continued)

	The Bank					
	2011					
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK$'000		HK$'000	HK$'000	HK$'000	HK$'000
Loans for use in Hong Kong						
Industrial, commercial and financial						
- Property development	2,738,332	58.71%	-	-	-	8,510
- Property investment	10,942,261	79.38%	-	45,685	-	110,811
- Financial concerns	3,005,772	35.70%	-	-	-	8,392
- Stockbrokers	3,241	100.00%	-	-	-	12
- Wholesale and retail trade	18,064,963	61.52%	8,032	48,960	2,492	109,024
- Manufacturing	4,412,357	38.10%	9,409	14,854	2,214	39,747
- Transport and transport equipment	3,500,262	10.68%	-	2,466	-	17,653
- Recreational activities	70,162	-	-	-	-	194
- Information technology	1,091,930	2.48%	2,173	2,173	552	3,215
- Others	5,193,609	61.28%	977	30,140	725	35,544
Individuals						
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	861,024	100.00%	4,618	29,248	-	577
- Loans for purchase of other residential properties	11,929,257	99.99%	2,422	104,556	-	4,932
- Others	2,477,768	83.41%	2,625	10,544	825	2,084
Total loans for use in Hong Kong	64,290,938	66.27%	30,256	288,626	6,808	340,695
Trade finance	4,933,880	34.58%	4,397	15,829	2,971	36,250
Loans for use outside Hong Kong	15,011,123	20.17%	23,217	43	1,873	51,506
Gross advances to customers	84,235,941	56.20%	57,870	304,498	11,652	428,451

* Advances with a specific repayment date are classified as overdue when the principal or interest is past due and remains unpaid.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(i) Sectoral analysis of gross advances to customers (continued)

The amount of new impairment allowances charged to the income statement, and classified or impaired loans written off during the year are shown below:

	The Group			
	2012		2011	
	New impairment allowances	**Classified or impaired loans written off**	New impairment allowances	Classified or impaired loans written off
	HK$'000	**HK$'000**	HK$'000	HK$'000
Loans for use in Hong Kong				
Industrial, commercial and financial				
- Property development	**-**	**-**	-	-
- Property investment	**29,103**	**99**	10,625	118
- Financial concerns	**11,267**	**-**	766	-
- Stockbrokers	**257**	**-**	6	-
- Wholesale and retail trade	**22,910**	**4,337**	42,298	877
- Manufacturing	**11,775**	**1,766**	13,487	4,979
- Transport and transport equipment	**41,032**	**-**	7,098	-
- Recreational activities	**485**	**-**	42	-
- Information technology	**3,045**	**-**	233	-
- Others	**11,112**	**605**	8,763	13
Individuals				
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**-**	**-**	-	-
- Loans for purchase of other residential properties	**-**	**-**	673	-
- Others	**-**	**-**	885	-
Total loans for use in Hong Kong	**130,986**	**6,807**	84,876	5,987
Trade finance	**53,548**	**2,649**	12,896	4,819
Loans for use outside Hong Kong	**231,122**	**378**	87,728	22,891
Gross advances to customers	**415,656**	**9,834**	185,500	33,697

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(i) Sectoral analysis of gross advances to customers (continued)

	The Bank			
	2012		2011	
	New impairment allowances	Classified or impaired loans written off	New impairment allowances	Classified or impaired loans written off
	HK$'000	HK$'000	HK$'000	HK$'000
Loans for use in Hong Kong				
Industrial, commercial and financial				
- Property development	-	-	-	-
- Property investment	29,103	99	10,625	118
- Financial concerns	11,267	-	766	-
- Stockbrokers	257	-	6	-
- Wholesale and retail trade	22,910	4,337	42,298	877
- Manufacturing	11,775	1,766	13,487	4,979
- Transport and transport equipment	40,950	-	6,999	-
- Recreational activities	485	-	42	-
- Information technology	3,045	-	233	-
- Others	11,112	605	8,215	13
Individuals				
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	-	-	-	-
- Loans for purchase of other residential properties	-	-	673	-
- Others	-	-	885	-
Total loans for use in Hong Kong	130,904	6,807	84,229	5,987
Trade finance	35,630	2,649	11,716	4,819
Loans for use outside Hong Kong	58,653	-	1,940	-
Gross advances to customers	225,187	9,456	97,885	10,806

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers

The following geographical analysis of advances to customers is based on the location of the counterparties, after taking into account the transfer of risk. In general, such transfer of risk takes place if the advances to customers are guaranteed by a party in a country which is different from that of the customer.

Gross advances to customers

	The Group	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**67,584,057**	65,296,349
Mainland China	**58,393,561**	48,409,389
Others	**5,175,491**	6,138,491
	131,153,109	119,844,229

	The Bank	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**63,543,928**	60,491,684
Mainland China	**17,048,232**	18,394,496
Others	**4,471,170**	5,349,761
	85,063,330	84,235,941

Collectively assessed loan impairment allowances in respect of the gross advances to customers

	The Group	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**480,016**	374,974
Mainland China	**430,812**	283,920
Others	**58,621**	46,238
	969,449	705,132

	The Bank	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**429,488**	323,930
Mainland China	**130,398**	83,186
Others	**31,297**	21,335
	591,183	428,451

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers (continued)

Overdue advances

	The Group	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**472,042**	365,467
Mainland China	**433,690**	102,176
Others	**3,608**	11,473
	909,340	479,116

	The Bank	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**405,112**	291,507
Mainland China	**40,430**	12,387
Others	**-**	604
	445,542	304,498

Individually assessed loan impairment allowances in respect of the overdue advances

	The Group	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**93,005**	60,027
Mainland China	**123,297**	24,757
Others	**-**	89
	216,302	84,873

	The Bank	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**35,992**	6,682
Mainland China	**18,161**	2,139
Others	**-**	89
	54,153	8,910

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers (continued)

Overdue advances (continued)

Collectively assessed loan impairment allowances in respect of the overdue advances

	The Group	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**3,916**	5,343
Mainland China	**1,690**	542
Others	**11**	48
	5,617	5,933

	The Bank	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**3,713**	5,025
Mainland China	**496**	156
Others	**-**	2
	4,209	5,183

Classified or impaired advances

	The Group	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**180,495**	107,560
Mainland China	**303,164**	52,448
Others	**-**	5,958
	483,659	165,966

	The Bank	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**120,531**	46,292
Mainland China	**26,709**	5,621
Others	**-**	5,957
	147,240	57,870

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers (continued)

Classified or impaired advances (continued)

Individually assessed loan impairment allowances in respect of the classified or impaired advances

	The Group	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**95,512**	60,896
Mainland China	**125,081**	24,757
Others	**-**	1,962
	220,593	87,615

	The Bank	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**38,498**	7,552
Mainland China	**19,946**	2,138
Others	**-**	1,962
	58,444	11,652

Collectively assessed loan impairment allowances in respect of the classified or impaired advances

	The Group	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**193**	362
Mainland China	**392**	214
	585	576

	The Bank	
	2012	2011
	HK$'000	HK$'000
Hong Kong	**108**	81
	108	81

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(C) Repossessed assets

During the year, the Group and the Bank obtained assets by taking possession of collateral held as security. The nature and carrying value of such assets held as at 31 December are summarised as follows:

	The Group and the Bank	
	2012	2011
	HK$'000	HK$'000
Industrial properties	**4,644**	-
Residential properties	**12,198**	-
	16,842	-

The estimated market value of repossessed assets held by the Group and the Bank as at 31 December 2012 amounted to HK$24,229,000 (2011: HK$2,530,000) and HK$21,581,000 (2011: Nil) respectively. They comprise properties in respect of which the Group and the Bank have acquired access or control (e.g. through court proceedings or voluntary actions by the proprietors concerned) for release in full or in part of the obligations of the borrowers.

When the repossessed assets are not readily convertible into cash, the Group may consider the following alternatives:

- adjusting the selling prices
- selling the loans together with the assets
- arranging loan restructuring

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(D) Balances and placements with banks and other financial institutions

The following tables present an analysis of balances and placements with banks and other financial institutions that are neither overdue nor impaired as at 31 December by rating agency designation.

	The Group			
	2012			
	Aaa to A3	Lower than A3	Unrated	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Central banks	13,139,030	-	-	13,139,030
Banks and other financial institutions	24,276,860	12,304,614	7,725,531	44,307,005
	37,415,890	12,304,614	7,725,531	57,446,035

	The Group			
	2011			
	Aaa to A3	Lower than A3	Unrated	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Central banks	10,554,122	-	-	10,554,122
Banks and other financial institutions	25,055,790	5,512,998	25,450,185	56,018,973
	35,609,912	5,512,998	25,450,185	66,573,095

	The Bank			
	2012			
	Aaa to A3	Lower than A3	Unrated	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Central banks	35,306	-	-	35,306
Banks and other financial institutions	16,135,722	5,524,320	1,259,564	22,919,606
	16,171,028	5,524,320	1,259,564	22,954,912

	The Bank			
	2011			
	Aaa to A3	Lower than A3	Unrated	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Central banks	517,779	-	-	517,779
Banks and other financial institutions	16,827,133	2,369,543	9,123,777	28,320,453
	17,344,912	2,369,543	9,123,777	28,838,232

As at 31 December 2012 and 2011, there were no overdue or impaired balances and placements with banks and other financial institutions for the Group and the Bank.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities

The following tables present an analysis of the carrying value of debt securities by issue rating. In the absence of such issue ratings, the ratings designated for the issuers are reported.

	The Group 2012					
	Aaa	**Aa1 to Aa3**	**A1 to A3**	**Lower than A3**	**Unrated**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Available-for-sale securities	**649,815**	**20,427,584**	**12,120,299**	**205,282**	**4,901,735**	**38,304,715**
Held-to-maturity securities	**-**	**884,701**	**585,679**	**896**	**250**	**1,471,526**
Loans and receivables	**-**	**-**	**199,891**	**-**	**957,371**	**1,157,262**
Financial assets at fair value through profit or loss	**621**	**4,271,737**	**581,712**	**271,090**	**-**	**5,125,160**
Total	**650,436**	**25,584,022**	**13,487,581**	**477,268**	**5,859,356**	**46,058,663**

	The Group 2011					
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Available-for-sale securities	622,547	17,806,293	5,338,923	202,942	2,741,381	26,712,086
Held-to-maturity securities	-	1,082,794	465,957	1,699	250	1,550,700
Loans and receivables	-	-	1,875,919	-	-	1,875,919
Financial assets at fair value through profit or loss	500	1,108,780	869,415	267,066	-	2,245,761
Total	623,047	19,997,867	8,550,214	471,707	2,741,631	32,384,466

	The Bank 2012					
	Aaa	**Aa1 to Aa3**	**A1 to A3**	**Lower than A3**	**Unrated**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Available-for-sale securities	**649,815**	**15,972,027**	**12,120,299**	**205,282**	**3,151,827**	**32,099,250**
Held-to-maturity securities	**-**	**-**	**585,679**	**896**	**250**	**586,825**
Loans and receivables	**-**	**-**	**199,891**	**-**	**957,371**	**1,157,262**
Financial assets at fair value through profit or loss	**621**	**4,271,737**	**581,712**	**271,090**	**-**	**5,125,160**
Total	**650,436**	**20,243,764**	**13,487,581**	**477,268**	**4,109,448**	**38,968,497**

	The Bank 2011					
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Available-for-sale securities	622,547	14,619,883	5,338,923	202,942	2,741,381	23,525,676
Held-to-maturity securities	-	102,631	465,957	1,699	250	570,537
Loans and receivables	-	-	1,875,919	-	-	1,875,919
Financial assets at fair value through profit or loss	500	1,108,780	869,415	267,066	-	2,245,761
Total	623,047	15,831,294	8,550,214	471,707	2,741,631	28,217,893

As at 31 December 2012, the Group's and the Bank's exposure to MBS/ABS amounted to HK$895,000 (2011: HK$27,080,000), representing 0.01% (2011: 0.08%) of the total debt securities of the Group and 0.01% (2011: 0.10%) of the total debt securities of the Bank.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

As at 31 December 2012 and 2011, there were no overdue or impaired debt securities for the Group and the Bank.

4.2 Market Risk

Market risk refers to the risk of losses arising from adverse movements in the value of foreign exchange, commodity, interest rate and equity positions held by the Group due to the volatility of financial market price (debt security price/interest rate, foreign exchange rate, equity price, commodity price). The Group adopts a robust market risk appetite to achieve a balance between risk and return.

The Group's objective in managing market risk is to secure healthy growth of the treasury business, by effective management of potential market risk in the Group's business, according to the Group's overall risk appetite and strategy of treasury business on the basis of a well established risk management regime and related measures.

In accordance with the Bank's corporate governance principles in respect of risk management, the Board of Directors and RMC, senior management and functional units perform their duties and responsibilities to manage the Bank's market risk. The risk management units are responsible for assisting senior management to monitor the market risk profile and compliance of management policies and limits of the Bank to ensure that overall and individual market risks are within the acceptable level. Independent units are assigned to monitor the risk exposure against risk limits on a daily basis, together with profit and loss reports submitted to the Management on a regular basis, while limit excesses should be reported at once when they occur. The subsidiary sets up independent risk monitoring teams to monitor daily market risk and limit compliance, and submit management information and reports to the Bank on a regular basis.

The Group sets up market risk indicators and limits to identify, measure, monitor and control market risk. Major risk indicators and limits established include but are not limited to VAR, Stop Loss, Open Position, Stress Testing and Sensitivity Analysis (Basis Point Value), etc. To meet management requirements, major risk indicators and limits are classified into four levels, and approved by RMC, the Asset and Liability Management Committee or senior management respectively. Treasury business units are required to conduct their business within approved market risk indicators and limits.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(A) VAR

The Group uses the VAR to measure and report general market risk to RMC and senior management on a periodic basis. The Group adopts a uniformed VAR calculation model, using historical simulation approach and 2-year historical data, to calculate the VAR of the Group over 1-day holding period with 99% confidence level, and sets up the VAR limit of the Group.

The following table sets out the VAR for all general market risk exposure[1] of the Group.

	Year	At 31 December	Minimum for the year	Maximum for the year	Average for the year
		HK$'000	HK$'000	HK$'000	HK$'000
VAR for all market risk	2012	2,095	1,188	2,814	2,232
VAR for foreign exchange risk	2012	2,007	1,150	2,774	2,171
VAR for interest risk	2012	256	148	534	251

In 2012, the average daily revenue[2] of the Group earned from market risk-related trading activities was HK$750,000.

Notes:

1 Structural FX positions have been excluded.

2 Revenues from structural FX positions and back-to-back transactions have been excluded.

3 VAR was formally applied by the Group in 2012. There are no comparative disclosures in 2011.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(A) VAR (continued)

Although VAR is a valuable guide to risk, it should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Group recognises these limitations by formulating stress test indicators and limits to assess and manage the market risk uncovered by VAR. The stress testing programme of the market risk includes sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis on historical events including the 1997 Asian Financial Crisis and 2008 Financial Tsunami, etc.

(B) Currency risk

The Group's assets and liabilities are denominated in major currencies, particularly the HK dollar, the US dollar and Renminbi. To ensure the currency risk exposure of the Group is kept to an acceptable level, risk limits (e.g. Position and VAR limit) are used to serve as a monitoring tool. Moreover, the Group seeks to minimise the gap between assets and liabilities in the same currency. Foreign exchange contracts (e.g. FX swap) are usually used to manage FX risk associated with foreign currency-denominated assets and liabilities.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

The tables below summarise the Group's and the Bank's exposure to foreign currency exchange rate risk as at 31 December. Included in the tables are the assets and liabilities at carrying amounts in HK dollars equivalent, categorised by the original currency.

	The Group							
	2012							
	Renminbi	US Dollars	HK Dollars	Euro	Japanese Yen	Pound Sterling	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	30,049,216	1,858,532	6,814,663	428,490	106,430	613,309	917,680	40,788,320
Placements with banks and other financial institutions maturing between one and twelve months	14,226,915	2,272,850	809,179	-	-	-	-	17,308,944
Financial assets at fair value through profit or loss	-	772,821	4,272,358	-	-	-	79,981	5,125,160
Derivative financial instruments	113,918	3,910	646,749	-	-	-	-	764,577
Advances and other accounts	41,284,919	31,387,484	64,596,843	377,712	84,599	12,113	289,015	138,032,685
Investment in securities								
- Available-for-sale securities	9,199,442	7,715,820	12,651,215	785,618	1,468,167	15,128	6,525,471	38,360,861
- Held-to-maturity securities	884,701	464,743	1,146	-	-	-	120,936	1,471,526
- Loans and receivables	1,157,262	-	-	-	-	-	-	1,157,262
Investment properties	47,413	-	979,670	-	-	-	-	1,027,083
Properties, plant and equipment	763,834	4,276	5,456,885	-	-	-	-	6,224,995
Other assets (including deferred tax assets)	238,635	223,760	1,024,881	6	2,554	4	2,185	1,492,025
Total assets	97,966,255	44,704,196	97,253,589	1,591,826	1,661,750	640,554	7,935,268	251,753,438
Liabilities								
Deposits and balances from banks and other financial institutions	12,185,592	7,171,977	785,576	21,639	15,116	7,868	74,303	20,262,071
Financial liabilities at fair value through profit or loss	-	-	4,975,073	-	-	-	-	4,975,073
Derivative financial instruments	82,226	115,283	262,098	-	-	-	-	459,607
Deposits from customers	66,697,901	31,214,436	77,772,653	2,083,241	153,534	741,624	6,870,328	185,533,717
Other accounts and provisions (including current and deferred tax liabilities)	7,314,706	892,457	2,511,139	48,414	84,561	1,723	56,749	10,909,749
Total liabilities	86,280,425	39,394,153	86,306,539	2,153,294	253,211	751,215	7,001,380	222,140,217
Net on-balance sheet position	11,685,830	5,310,043	10,947,050	(561,468)	1,408,539	(110,661)	933,888	29,613,221
Off-balance sheet net notional position*	(4,489,727)	(3,248,672)	9,701,784	567,903	(1,406,739)	114,453	(846,095)	392,907
Contingent liabilities and commitments	36,717,979	25,800,962	24,774,429	645,012	120,838	-	9,875	88,069,095

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

	The Group							
	2011							
	Renminbi	US Dollars	HK Dollars	Euro	Japanese Yen	Pound Sterling	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	31,755,587	3,875,707	6,247,430	1,137,543	134,900	100,390	742,776	43,994,333
Placements with banks and other financial institutions maturing between one and twelve months	20,433,570	1,495,263	1,240,747	-	-	-	-	23,169,580
Financial assets at fair value through profit or loss	-	766,259	1,403,148	-	-	-	76,354	2,245,761
Derivative financial instruments	65,299	6,001	745,103	-	-	-	-	816,403
Advances and other accounts	26,669,960	40,465,402	64,321,827	272,602	297,283	-	887,151	132,914,225
Investment in securities								
- Available-for-sale securities	6,381,679	6,339,356	11,184,833	511,059	-	93,761	2,245,297	26,755,985
- Held-to-maturity securities	980,163	121,596	104,580	225,695	-	-	118,666	1,550,700
- Loans and receivables	-	-	-	1,875,919	-	-	-	1,875,919
Investment properties	45,688	-	802,260	-	-	-	-	847,948
Properties, plant and equipment	463,161	1,065	4,119,185	-	-	-	-	4,583,411
Other assets (including deferred tax assets)	165,459	57,198	649,071	-	1,316	1	4,146	877,191
Total assets	86,960,566	53,127,847	90,818,184	4,022,818	433,499	194,152	4,074,390	239,631,456
Liabilities								
Deposits and balances from banks and other financial institutions	10,925,158	16,001,440	861,463	132	211,516	2,619	63,960	28,066,288
Financial liabilities at fair value through profit or loss	-	-	1,077,896	-	-	-	-	1,077,896
Derivative financial instruments	55,771	165,291	451,556	-	-	-	-	672,618
Deposits from customers	64,244,114	27,651,490	72,832,671	4,007,694	143,143	1,100,153	4,490,203	174,469,468
Other accounts and provisions (including current and deferred tax liabilities)	5,188,863	681,887	3,073,162	87,096	114,537	2,046	61,399	9,208,990
Total liabilities	80,413,906	44,500,108	78,296,748	4,094,922	469,196	1,104,818	4,615,562	213,495,260
Net on-balance sheet position	6,546,660	8,627,739	12,521,436	(72,104)	(35,697)	(910,666)	(541,172)	26,136,196
Off-balance sheet net notional position*	(2,216,052)	(7,515,536)	8,491,862	74,164	36,636	911,189	533,472	315,735
Contingent liabilities and commitments	19,225,118	29,009,786	19,190,225	386,957	255,138	2,741	2,182	68,072,147

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

	The Bank							
	2012							
	Renminbi	US Dollars	HK Dollars	Euro	Japanese Yen	Pound Sterling	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	12,525,861	975,691	6,337,008	359,911	64,572	586,813	908,852	21,758,708
Placements with banks and other financial institutions maturing between one and twelve months	-	770,243	809,179	-	-	-	-	1,579,422
Financial assets at fair value through profit or loss	-	772,821	4,272,358	-	-	-	79,981	5,125,160
Derivative financial instruments	-	2,954	646,749	-	-	-	-	649,703
Advances and other accounts	3,219,627	23,639,146	62,322,872	354,192	80,856	12,113	289,015	89,917,821
Investment in securities								
- Available-for-sale securities	2,993,977	7,715,820	12,651,215	785,618	1,468,167	15,128	6,525,471	32,155,396
- Held-to-maturity securities	-	464,743	1,146	-	-	-	120,936	586,825
- Loans and receivables	1,157,262	-	-	-	-	-	-	1,157,262
Investment in subsidiaries	3,030,038	-	5,141,029	-	-	-	-	8,171,067
Investment properties	-	-	979,670	-	-	-	-	979,670
Properties, plant and equipment	-	4,276	5,456,885	-	-	-	-	5,461,161
Other assets (including deferred tax assets)	48,219	844	1,017,063	6	9	4	2,185	1,068,330
Total assets	22,974,984	34,346,538	99,635,174	1,499,727	1,613,604	614,058	7,926,440	168,610,525
Liabilities								
Deposits and balances from banks and other financial institutions	439,855	2,859,023	742,677	14,040	15,109	12,757	90,370	4,173,831
Financial liabilities at fair value through profit or loss	-	-	4,975,073	-	-	-	-	4,975,073
Derivative financial instruments	-	114,327	262,098	-	-	-	-	376,425
Deposits from customers	17,594,501	26,480,371	74,571,116	1,919,414	138,846	709,223	6,765,029	128,178,500
Other accounts and provisions (including current and deferred tax liabilities)	29,806	465,418	2,471,178	24,283	23,802	1,723	55,510	3,071,720
Total liabilities	18,064,162	29,919,139	83,022,142	1,957,737	177,757	723,703	6,910,909	140,775,549
Net on-balance sheet position	4,910,822	4,427,399	16,613,032	(458,010)	1,435,847	(109,645)	1,015,531	27,834,976
Off-balance sheet net notional position*	(1,852,324)	(2,480,964)	6,508,735	464,424	(1,434,003)	114,453	(927,414)	392,907
Contingent liabilities and commitments	57,113	7,033,803	24,414,935	145,028	37,858	-	9,875	31,698,612

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

	The Bank 2011							
	Renminbi	US Dollars	HK Dollars	Euro	Japanese Yen	Pound Sterling	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	16,060,990	3,511,622	5,580,458	921,222	49,662	77,215	740,409	26,941,578
Placements with banks and other financial institutions maturing between one and twelve months	1,390,503	869,953	-	-	-	-	-	2,260,456
Financial assets at fair value through profit or loss	-	766,259	1,403,148	-	-	-	76,354	2,245,761
Derivative financial instruments	-	4,045	745,103	-	-	-	-	749,148
Advances and other accounts	2,153,962	29,897,707	61,883,399	266,528	71,061	-	887,151	95,159,808
Investment in securities								
- Available-for-sale securities	3,195,269	6,339,356	11,184,833	511,059	-	93,761	2,245,297	23,569,575
- Held-to-maturity securities	-	121,596	104,580	225,695	-	-	118,666	570,537
- Loans and receivables	-	-	-	1,875,919	-	-	-	1,875,919
Investment in subsidiaries	81,653	-	5,141,029	-	-	-	-	5,222,682
Investment properties	-	-	802,260	-	-	-	-	802,260
Properties, plant and equipment	-	1,065	4,119,185	-	-	-	-	4,120,250
Other assets (including deferred tax assets)	4,469	782	644,952	-	14	1	2,722	652,940
Total assets	22,886,846	41,512,385	91,608,947	3,800,423	120,737	170,977	4,070,599	164,170,914
Liabilities								
Deposits and balances from banks and other financial institutions	1,072,459	7,473,671	816,345	21,097	5,099	7,028	80,936	9,476,635
Financial liabilities at fair value through profit or loss	-	-	1,077,896	-	-	-	-	1,077,896
Derivative financial instruments	-	163,076	451,556	-	-	-	-	614,632
Deposits from customers	19,822,327	25,355,859	70,080,020	3,822,538	122,799	1,072,828	4,471,031	124,747,402
Other accounts and provisions (including current and deferred tax liabilities)	1,892	397,751	3,022,091	28,657	28,532	1,577	59,316	3,539,816
Total liabilities	20,896,678	33,390,357	75,447,908	3,872,292	156,430	1,081,433	4,611,283	139,456,381
Net on-balance sheet position	1,990,168	8,122,028	16,161,039	(71,869)	(35,693)	(910,456)	(540,684)	24,714,533
Off-balance sheet net notional position*	(1,873,761)	(7,135,668)	7,769,703	74,164	36,636	911,189	533,472	315,735
Contingent liabilities and commitments	120,827	16,531,470	18,749,692	262,351	39,428	2,741	333	35,706,842

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

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

Sensitivity analysis to foreign exchange risk exposure (Non Structural)

At 31 December 2012, the majority of the net positions of the Group and the Bank were denominated in US dollar and Renminbi, therefore the Group and the Bank do not expose to significant foreign exchange risk other than US dollar and Renminbi. If US dollar exchange rate had changed by 1%, with other variables held constant, profit after tax for the year of the Group and the Bank would have been changed by HK$13,238,000 (2011: HK$6,821,000) and HK$13,184,000 (2011: HK$6,782,000) respectively. If Renminbi exchange rate had changed by 1%, with other variables held constant, profit after tax for the year of the Group and the Bank would have been changed by HK$1,351,000 (2011: HK$884,000) and HK$307,000 (2011: HK$244,000) respectively.

(C) Interest rate risk

Interest rate risk means the risks to a bank's earnings and economic value arising from adverse movements in interest rate and term structure of the bank's asset and liability positions. The Group's interest rate risk exposures are mainly structural. The major types of interest rate risk from structural positions are:

- Repricing risk - mismatches in the maturity or repricing periods of assets and liabilities that may affect net interest income;
- Basis risk - different pricing basis for different transactions so that the yield on assets and cost of liabilities may change by different amounts within the same repricing period;
- Yield curve risk - non-parallel shifts in the yield curve that may have an adverse impact on net interest income or economic value;
- Option risk - exercise of the options embedded in assets, liabilities or off-balance sheet items that can cause a change in the cashflows of assets and liabilities.

The Group's risk management framework also applies to interest rate risk management. ALCO exercises its oversight of interest rate risk in accordance with "Banking Book Interest Rate Risk Management Policy" approved by RMC. FMD is responsible for interest rate risk management. With the cooperation of the Treasury Division, FMD assists the ALCO to manage day-to-day interest rate risk positions.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

The Group sets out interest rate risk indicators and limits to identify, measure, monitor and control interest rate risk. The indicators and limits include, but are not limited to, re-pricing gap limits, basis risk, duration, price value of a basis point (PVBP), net interest income sensitivity ratio, economic value sensitivity ratio, etc. The indicators and limits are classified into three levels, which are approved by RMC, ALCO and Treasury Management Sub-committee ("TMC") respectively. Risk-taking business units are required to conduct their business within the boundary of the interest rate risk limits. Before launching a new product or business in the banking book, relevant departments are required to go through a risk assessment process, which includes assessment of underlying interest rate risk and consideration of the adequacy of current risk monitoring mechanism. Any material impact on interest rate risk noted during the risk assessment process will be submitted to RMC for approval.

Net interest income sensitivity ratio (NII) and economic value sensitivity ratio (EV) assess the impact of interest rate movement on the Group's net interest income and capital base. They are the Group's key interest rate risk indicators. The former assesses the impact of interest rate movement on net interest income as a percentage to projected net interest income for the year. The latter assesses the impact of interest rate movement on economic value (i.e. the present value of cash-flows of assets, liabilities and off-balance-sheet items discounted using market interest rate) as a percentage to the latest capital base. Limits are set by RMC on these two indicators to monitor and control the Group's banking book interest rate risk.

The Group uses scenario analysis and stress test to assess the banking book interest rate risk the Group would face under adverse circumstances. Scenario analysis and stress test are also devised to assess the impact on net interest income and economic value arising from the optionality of demand and savings deposits and the prepayment of mortgage loans.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

Sensitivity analysis to market risk exposure of banking book of the Group

The Group is principally exposed to HKD, USD and RMB in terms of interest rate risk. As at 31 December 2012, if HKD, USD and RMB market interest rates had been 100 basis points higher with other variables held constant, the impacts on net interest income over the next twelve months and on reserves for the Group and the Bank would have been as follows:

	Impact on net interest income over the next twelve months at 31 December				Impact on reserves at 31 December			
	The Group		The Bank		The Group		The Bank	
	2012	2011	**2012**	2011	**2012**	2011	**2012**	2011
Scenarios	**HK$'000**	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000
Up 100 basis points parallel shift in HK dollar yield curves	**210,914**	173,383	**177,966**	153,181	**(55,265)**	(37,656)	**(55,265)**	(37,656)
Up 100 basis points parallel shift in US dollar yield curves	**(23,706)**	(55,874)	**(22,928)**	(52,696)	**(170,405)**	(128,679)	**(170,405)**	(128,679)
Up 100 basis points parallel shift in Renminbi yield curves	**(225)**	68,429	**(25,985)**	7,232	**(238,843)**	(125,726)	**(76,116)**	(62,236)

The increase in positive earnings impact of HKD and USD compared to 2011 is reduced by the fall in RMB. Reserves would have been reduced because of the expected reduction in valuation of available-for-sale portfolio due to the above simulated market rates movement. The reduction of reserves is larger compared with 2011 because the size and duration of available-for-sale portfolio is increased.

To construct stressful scenarios, severe assumptions are made, including parallel movement of interest rates. In the absence of actions that would be taken to mitigate the impact of interest rates shock, all positions are assumed to run to maturity and reprice or mature simultaneously within a given time band. As the risk is complicated by having optionality embedded in certain products, behavioural assumptions are made to reflect more accurately the interest rate risk exposures.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

The tables below summarise the Group's and the Bank's exposure to interest rate risk as at 31 December. Included in the tables are the assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	The Group						
	2012						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets							
Cash and balances with banks and other financial institutions	39,612,508	-	-	-	-	1,175,812	40,788,320
Placements with banks and other financial institutions maturing between one and twelve months	-	7,994,913	9,314,031	-	-	-	17,308,944
Financial assets at fair value through profit or loss	299,495	1,853,803	2,460,306	511,556	-	-	5,125,160
Derivative financial instruments	-	-	-	-	-	764,577	764,577
Advances and other accounts	86,735,570	22,603,759	26,508,400	2,169,049	15,907	-	138,032,685
Investment in securities							
- Available-for-sale securities	3,710,026	9,752,899	9,738,231	12,168,070	2,935,489	56,146	38,360,861
- Held-to-maturity securities	593,661	312,381	-	565,484	-	-	1,471,526
- Loans and receivables	-	292,075	865,187	-	-	-	1,157,262
Investment properties	-	-	-	-	-	1,027,083	1,027,083
Properties, plant and equipment	-	-	-	-	-	6,224,995	6,224,995
Other assets (including deferred tax assets)	-	-	-	-	-	1,492,025	1,492,025
Total assets	130,951,260	42,809,830	48,886,155	15,414,159	2,951,396	10,740,638	251,753,438
Liabilities							
Deposits and balances from banks and other financial institutions	6,943,862	4,961,018	7,014,546	-	-	1,342,645	20,262,071
Financial liabilities at fair value through profit or loss	1,419,971	2,092,893	1,462,209	-	-	-	4,975,073
Derivative financial instruments	-	-	-	-	-	459,607	459,607
Deposits from customers	106,761,023	30,258,216	34,853,172	5,637,173	37,894	7,986,239	185,533,717
Other accounts and provisions (including current and deferred tax liabilities)	1,913,225	1,710,360	3,349,599	24,653	1	3,911,911	10,909,749
Total liabilities	117,038,081	39,022,487	46,679,526	5,661,826	37,895	13,700,402	222,140,217
Interest sensitivity gap	13,913,179	3,787,343	2,206,629	9,752,333	2,913,501	(2,959,764)	29,613,221

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

	The Group						
	2011						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets							
Cash and balances with banks and other financial institutions	41,830,459	-	-	-	-	2,163,874	43,994,333
Placements with banks and other financial institutions maturing between one and twelve months	-	9,635,651	13,533,929	-	-	-	23,169,580
Financial assets at fair value through profit or loss	99,989	1,011,057	373,002	513,813	247,900	-	2,245,761
Derivative financial instruments	-	-	-	-	-	816,403	816,403
Advances and other accounts	74,162,458	27,424,388	25,002,509	6,324,626	244	-	132,914,225
Investment in securities							
- Available-for-sale securities	6,444,004	7,053,021	5,138,085	6,277,450	1,799,526	43,899	26,755,985
- Held-to-maturity securities	247,729	241,049	503,474	558,448	-	-	1,550,700
- Loans and receivables	1,875,919	-	-	-	-	-	1,875,919
Investment properties	-	-	-	-	-	847,948	847,948
Properties, plant and equipment	-	-	-	-	-	4,583,411	4,583,411
Other assets (including deferred tax assets)	-	-	-	-	-	877,191	877,191
Total assets	124,660,558	45,365,166	44,550,999	13,674,337	2,047,670	9,332,726	239,631,456
Liabilities							
Deposits and balances from banks and other financial institutions	12,962,586	4,011,804	10,741,870	-	-	350,028	28,066,288
Financial liabilities at fair value through profit or loss	299,981	389,850	388,065	-	-	-	1,077,896
Derivative financial instruments	-	-	-	-	-	672,618	672,618
Deposits from customers	96,775,799	33,370,694	29,479,124	7,432,118	162,148	7,249,585	174,469,468
Other accounts and provisions (including current and deferred tax liabilities)	1,190,610	1,001,353	2,848,635	-	-	4,168,392	9,208,990
Total liabilities	111,228,976	38,773,701	43,457,694	7,432,118	162,148	12,440,623	213,495,260
Interest sensitivity gap	13,431,582	6,591,465	1,093,305	6,242,219	1,885,522	(3,107,897)	26,136,196

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

	The Bank						
	2012						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets							
Cash and balances with banks and other financial institutions	20,850,907	-	-	-	-	907,801	21,758,708
Placements with banks and other financial institutions maturing between one and twelve months	-	1,407,081	172,341	-	-	-	1,579,422
Financial assets at fair value through profit or loss	299,495	1,853,803	2,460,306	511,556	-	-	5,125,160
Derivative financial instruments	-	-	-	-	-	649,703	649,703
Advances and other accounts	70,446,666	12,860,187	5,093,960	1,517,008	-	-	89,917,821
Investment in securities							
- Available-for-sale securities	3,710,026	9,559,545	8,953,155	7,597,728	2,278,796	56,146	32,155,396
- Held-to-maturity securities	465,889	120,936	-	-	-	-	586,825
- Loans and receivables	-	292,075	865,187	-	-	-	1,157,262
Investment in subsidiaries	-	-	-	-	-	8,171,067	8,171,067
Investment properties	-	-	-	-	-	979,670	979,670
Properties, plant and equipment	-	-	-	-	-	5,461,161	5,461,161
Other assets (including deferred tax assets)	-	-	-	-	-	1,068,330	1,068,330
Total assets	95,772,983	26,093,627	17,544,949	9,626,292	2,278,796	17,293,878	168,610,525
Liabilities							
Deposits and balances of banks and other financial institutions	1,699,668	142,039	955,453	-	-	1,376,671	4,173,831
Financial liabilities at fair value through profit or loss	1,419,971	2,092,893	1,462,209	-	-	-	4,975,073
Derivative financial instruments	-	-	-	-	-	376,425	376,425
Deposits from customers	83,903,734	20,027,417	16,189,231	67,327	-	7,990,791	128,178,500
Other accounts and provisions (including current and deferred tax liabilities)	463,446	-	-	-	-	2,608,274	3,071,720
Total liabilities	87,486,819	22,262,349	18,606,893	67,327	-	12,352,161	140,775,549
Interest sensitivity gap	8,286,164	3,831,278	(1,061,944)	9,558,965	2,278,796	4,941,717	27,834,976

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

	The Bank						
	2011						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets							
Cash and balances with banks and other financial institutions	25,004,720	-	-	-	-	1,936,858	26,941,578
Placements with banks and other financial institutions maturing between one and twelve months	-	1,077,538	1,182,918	-	-	-	2,260,456
Financial assets at fair value through profit or loss	99,989	1,011,057	373,002	513,813	247,900	-	2,245,761
Derivative financial instruments	-	-	-	-	-	749,148	749,148
Advances and other accounts	60,144,581	15,846,689	13,324,206	5,844,308	24	-	95,159,808
Investment in securities							
- Available-for-sale securities	6,115,223	6,793,083	4,216,309	5,094,513	1,306,548	43,899	23,569,575
- Held-to-maturity securities	247,729	118,665	204,143	-	-	-	570,537
- Loans and receivables	1,875,919	-	-	-	-	-	1,875,919
Investment in subsidiaries	-	-	-	-	-	5,222,682	5,222,682
Investment properties	-	-	-	-	-	802,260	802,260
Properties, plant and equipment	-	-	-	-	-	4,120,250	4,120,250
Other assets (including deferred tax assets)	-	-	-	-	-	652,940	652,940
Total assets	93,488,161	24,847,032	19,300,578	11,452,634	1,554,472	13,528,037	164,170,914
Liabilities							
Deposits and balances of banks and other financial institutions	5,198,920	1,560,854	2,319,384	-	-	397,477	9,476,635
Financial liabilities at fair value through profit or loss	299,981	389,850	388,065	-	-	-	1,077,896
Derivative financial instruments	-	-	-	-	-	614,632	614,632
Deposits from customers	78,059,357	22,290,177	13,015,412	4,127,957	-	7,254,499	124,747,402
Other accounts and provisions (including current and deferred tax liabilities)	480,379	-	-	-	-	3,059,437	3,539,816
Total liabilities	84,038,637	24,240,881	15,722,861	4,127,957	-	11,326,045	139,456,381
Interest sensitivity gap	9,449,524	606,151	3,577,717	7,324,677	1,554,472	2,201,992	24,714,533

Interest rate risk exposure of trading book of the Group and the Bank is insignificant.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk

Liquidity risk is the risk that banks fail to provide sufficient funds to grow assets or pay the due obligations, and need to bear an unacceptable loss. The Group follows the sound liquidity risk appetite, to provide stable, reliable and adequate sources of cash to meet liquidity needs under normal circumstances or stressed scenarios; and survive with net positive cumulative cash flow in extreme scenarios, without requesting HKMA to act as the lender of last resort.

The Group's liquidity risk management objective is to effectively manage the liquidity of on-balance sheet and off-balance sheet items with reasonable cost based on the liquidity risk appetite to achieve sound operation and sustainable profitability. Customer deposits are the Group’s primary source of funds. To ensure stable and sufficient source of funds are in place, the Group actively attracts new deposits, keeps the core deposit and obtains supplementary funding from interbank market. According to different term maturities and the results of funding needs estimated from stressed scenarios, the Group adjusts its asset structure (including loans, bonds investment, interbank placement, etc.) to maintain sufficient liquid assets in support of normal business needs and ensure its ability to raise enough funds at a reasonable cost to serve external claims in case of emergency. The Group is committed to diversify the source of funds and the use of funds to avoid excessive concentration of assets and liabilities and prevent triggering liquidity risk due to the break of funding strand when problem occurred in one concentrated funding source. The Group has established intragroup liquidity risk management guideline to manage the liquidity funding within the Group, to restrict the reliance of funding on each other. The Group also pays attention to manage liquidity risk created by off-balance sheet activities, such as loan commitments and derivatives. The Group has overall liquidity risk management strategy to cover the liquidity management of foreign currency assets and liabilities, collaterals, intra-day liquidity, intra-group liquidity, the liquidity risk arising from other risks, etc., and has formulated corresponding contingency plan.

RMC, a standing committee established by the Board of Directors, is the decision making authority of liquidity risk management, and assumes the ultimate responsibility of liquidity risk management. As authorised by RMC, ALCO exercises its oversight of liquidity risk and ensures the daily operations of the Group are in accordance with risk appetite and policies as set by RMC. Financial Management Division of Finance Department is responsible for overseeing the Group’s liquidity risk. It cooperates with the Treasury Division to assist the ALCO to perform liquidity management functions according to their specific responsibilities.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

The Group established liquidity risk management indicators and limits to identify, measure, monitor and control liquidity risk on daily basis. Such indicators and limits include, but are not limited to liquidity ratio and loan-to-deposit ratio. The Group applies cash flow analysis to assess the Group's liquidity condition under normal conditions and also performs liquidity stress test (including institution specific and market wide crisis) at least on monthly basis to assess the Group's capability to withstand various severe liquidity crises. Also, Assets and Liabilities Management System is developed to provide data and generate regular management reports for facilitating the liquidity risk management duties.

In accordance with the requirements of Supervisory Policy Manual LM-2 "Sound Systems and Controls for Liquidity Risk Management" issued by the HKMA in 2011, the Group is in the process of enhancing various controls, including the behavior model and assumptions of existing cash flow analysis and stress test to enhance the Group's cash flow analysis under both normal and stressed conditions, and maintaining an asset buffer portfolio. In liquidity stress test, a new combined scenario which is a combination of institution specific and market wide crisis is being set up to assess the Group's capability to withstand a more severe liquidity crisis. The asset buffer portfolio will include high quality marketable securities to ensure funding needs even under stressed scenarios. The contingency funding plan is being established which will set out the conditions to trigger the plan based on stress test results and early warning indicators, the action plans and relevant procedures and responsibility of various departments.

The Group's liquidity risk management also covers new product or business development. Before launching a new product or business, the relevant departments are required to go through a risk assessment process, which includes the assessment of underlying liquidity risk and consideration of the adequacy of the current risk management mechanism. Any material impact on liquidity risk noted during the risk assessment process will be reported to RMC for approval.

The Group has established a set of uniform liquidity risk management policies. The principal banking subsidiary develops its own liquidity management policies according to its own characteristics, assumes its own liquidity risk management responsibility, executes its daily risk management processes independently, and reports to the Group's Management on a regular basis.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(A) Liquidity ratio

	2012	2011
Average liquidity ratio	**44.46%**	39.37%

The average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of the Bank for the year.

The liquidity ratio is computed on the solo basis (the Hong Kong offices only) and is in accordance with the Fourth Schedule to the Banking Ordinance.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis

Tables below analyse assets and liabilities of the Group and the Bank as at 31 December into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

	The Group							
	2012							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	17,089,375	23,698,945	-	-	-	-	-	40,788,320
Placements with banks and other financial institutions maturing between one and twelve months	-	-	7,994,913	9,314,031	-	-	-	17,308,944
Financial assets at fair value through profit or loss	-	-	-	-	-	-	-	-
– debt securities held for trading								
- others	-	299,495	1,773,822	2,198,420	621	-	-	4,272,358
– debt securities designated at fair value through profit or loss								
- others	-	-	-	341,867	510,935	-	-	852,802
Derivative financial instruments	501,902	103,271	56,300	100,792	2,312	-	-	764,577
Advances and other accounts								
– advances to customers	6,188,032	5,665,625	11,888,615	35,699,386	45,325,555	24,916,629	279,225	129,963,067
– trade bills	4,749	1,925,544	4,576,361	1,562,964	-	-	-	8,069,618
Investment in securities								
– debt securities held for available-for-sale								
- certificates of deposit held	-	400,657	40,564	4,003,596	1,125,146	-	-	5,569,963
- others	-	1,595,169	5,577,764	7,310,513	15,315,817	2,935,489	-	32,734,752
– debt securities held for held-to-maturity								
- certificates of deposit held	-	464,743	-	-	-	-	-	464,743
- others	-	127,773	312,631	-	566,379	-	-	1,006,783
– debt securities held for loans and receivables	-	-	292,075	865,187	-	-	-	1,157,262
– equity securities	-	-	-	-	-	-	56,146	56,146
Investment properties	-	-	-	-	-	-	1,027,083	1,027,083
Properties, plant and equipment	-	-	-	-	-	-	6,224,995	6,224,995
Other assets (including deferred tax assets)	379,851	1,043,080	10,792	25,907	29,765	-	2,630	1,492,025
Total assets	24,163,909	35,324,302	32,523,837	61,422,663	62,876,530	27,852,118	7,590,079	251,753,438

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	The Group							
	2012							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities								
Deposits and balances from banks and other financial institutions	1,801,973	6,484,534	4,961,018	7,014,546	-	-	-	20,262,071
Financial liabilities at fair value through profit or loss								
– others	-	1,419,971	2,092,893	1,462,209	-	-	-	4,975,073
Derivative financial instruments	205,008	12,057	33,996	100,712	107,834	-	-	459,607
Deposits from customers	67,183,813	45,339,114	30,153,082	35,241,829	7,577,978	37,901	-	185,533,717
Other accounts and provisions (including current and deferred tax liabilities)	2,703,673	1,903,000	1,890,679	3,594,797	811,449	6,151	-	10,909,749
Total liabilities	71,894,467	55,158,676	39,131,668	47,414,093	8,497,261	44,052	-	222,140,217
Net liquidity gap	(47,730,558)	(19,834,374)	(6,607,831)	14,008,570	54,379,269	27,808,066	7,590,079	29,613,221

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	The Group							
	2011							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	27,545,031	16,449,302	-	-	-	-	-	43,994,333
Placements with banks and other financial institutions maturing between one and twelve months	-	-	9,635,651	13,533,929	-	-	-	23,169,580
Financial assets at fair value through profit or loss								
– debt securities held for trading								
- others	-	99,989	635,789	373,002	500	-	-	1,109,280
– debt securities designated at fair value through profit or loss								
- others	-	-	-	293,869	594,712	247,900	-	1,136,481
Derivative financial instruments	587,300	11,605	32,901	116,818	67,779	-	-	816,403
Advances and other accounts								
– advances to customers	2,846,884	6,935,770	11,001,742	35,122,628	38,924,531	24,124,709	95,218	119,051,482
– trade bills	115	1,617,566	4,995,685	6,705,121	-	-	-	13,318,487
– advances to banks and other financial institutions	-	-	-	544,256	-	-	-	544,256
Investment in securities								
– debt securities held for available-for-sale								
- certificates of deposit held	-	-	269,994	112,756	968,039	-	-	1,350,789
- others	-	5,275,152	3,685,012	6,247,984	8,353,623	1,799,526	-	25,361,297
– debt securities held for held-to-maturity								
- certificates of deposit held	-	225,695	-	-	-	-	-	225,695
- others	-	-	122,383	503,474	697,199	1,949	-	1,325,005
– debt securities held for loans and receivables	-	1,875,919	-	-	-	-	-	1,875,919
– equity securities	-	-	-	-	-	-	43,899	43,899
Investment properties	-	-	-	-	-	-	847,948	847,948
Properties, plant and equipment	-	-	-	-	-	-	4,583,411	4,583,411
Other assets (including deferred tax assets)	157,936	638,654	9,348	27,823	40,899	-	2,531	877,191
Total assets	31,137,266	33,129,652	30,388,505	63,581,660	49,647,282	26,174,084	5,573,007	239,631,456

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	The Group							
	2011							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities								
Deposits and balances from banks and other financial institutions	740,877	12,571,737	4,005,861	10,747,813	-	-	-	28,066,288
Financial liabilities at fair value through profit or loss								
– others	-	299,981	389,850	388,065	-	-	-	1,077,896
Derivative financial instruments	247,907	59,349	28,939	122,358	166,556	47,509	-	672,618
Deposits from customers	56,822,738	44,447,805	32,384,158	31,577,957	9,074,613	162,197	-	174,469,468
Other accounts and provisions (including current and deferred tax liabilities)	3,209,830	826,097	1,190,525	3,397,758	584,780	-	-	9,208,990
Total liabilities	61,021,352	58,204,969	37,999,333	46,233,951	9,825,949	209,706	-	213,495,260
Net liquidity gap	(29,884,086)	(25,075,317)	(7,610,828)	17,347,709	39,821,333	25,964,378	5,573,007	26,136,196

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	The Bank							
	2012							
	On demand HK$'000	Up to 1 month HK$'000	1-3 months HK$'000	3-12 months HK$'000	1-5 years HK$'000	Over 5 years HK$'000	Indefinite HK$'000	Total HK$'000
Assets								
Cash and balances with banks and other financial institutions	13,445,491	8,313,217	-	-	-	-	-	21,758,708
Placements with banks and other financial institutions maturing between one and twelve months	-	-	1,407,081	172,341	-	-	-	1,579,422
Financial assets at fair value through profit or loss								
– debt securities held for trading								
- others	-	299,495	1,773,822	2,198,420	621	-	-	4,272,358
– debt securities designated at fair value through profit or loss								
- others	-	-	-	341,867	510,935	-	-	852,802
Derivative financial instruments	501,902	82,359	39,413	26,029	-	-	-	649,703
Advances and other accounts								
– advances to customers	6,141,226	4,193,107	7,413,310	13,744,696	35,790,554	17,026,644	104,166	84,413,703
– trade bills	577	1,214,552	3,421,208	867,781	-	-	-	5,504,118
Investment in securities								
– debt securities held for available-for-sale								
- certificates of deposit held	-	400,657	40,564	4,003,596	1,125,146	-	-	5,569,963
- others	-	1,595,169	5,384,410	6,525,438	10,745,474	2,278,796	-	26,529,287
– debt securities held for held-to-maturity								
- certificates of deposit held	-	464,743	-	-	-	-	-	464,743
- others	-	-	121,186	-	896	-	-	122,082
– debt securities held for loans and receivables	-	-	292,075	865,187	-	-	-	1,157,262
– equity securities	-	-	-	-	-	-	56,146	56,146
Investment in subsidiaries	-	-	-	-	-	-	8,171,067	8,171,067
Investment properties	-	-	-	-	-	-	979,670	979,670
Properties, plant and equipment	-	-	-	-	-	-	5,461,161	5,461,161
Other assets (including deferred tax assets)	38,893	1,026,350	21	1,538	995	-	533	1,068,330
Total assets	20,128,089	17,589,649	19,893,090	28,746,893	48,174,621	19,305,440	14,772,743	168,610,525

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	The Bank							
	2012							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities								
Deposits and balances from banks and other financial institutions	1,865,120	1,211,219	142,039	955,453	-	-	-	4,173,831
Financial liabilities at fair value through profit or loss								
– others	-	1,419,971	2,092,893	1,462,209	-	-	-	4,975,073
Derivative financial instruments	205,008	5,812	23,158	36,924	105,523	-	-	376,425
Deposits from customers	56,526,767	35,084,235	19,922,283	16,577,888	67,327	-	-	128,178,500
Other accounts and provisions (including current and deferred tax liabilities)	1,536,694	573,405	73,848	118,513	769,260	-	-	3,071,720
Total liabilities	60,133,589	38,294,642	22,254,221	19,150,987	942,110	-	-	140,775,549
Net liquidity gap	(40,005,500)	(20,704,993)	(2,361,131)	9,595,906	47,232,511	19,305,440	14,772,743	27,834,976

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	The Bank							
	2011							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	18,077,434	8,864,144	-	-	-	-	-	26,941,578
Placements with banks and other financial institutions maturing between one and twelve months	-	-	1,077,538	1,182,918	-	-	-	2,260,456
Financial assets at fair value through profit or loss								
– debt securities held for trading								
- others	-	99,989	635,789	373,002	500	-	-	1,109,280
– debt securities designated at fair value through profit or loss								
- others	-	-	-	293,869	594,712	247,900	-	1,136,481
Derivative financial instruments	587,300	10,024	24,474	59,571	67,779	-	-	749,148
Advances and other accounts								
– advances to customers	2,773,293	5,124,773	7,602,353	19,107,228	31,357,088	17,760,370	70,732	83,795,837
– trade bills	115	934,383	4,034,017	5,851,200	-	-	-	10,819,715
– advances to banks and other financial institutions	-	-	-	544,256	-	-	-	544,256
Investment in securities								
– debt securities held for available-for-sale								
- certificates of deposit held	-	-	269,994	112,756	968,039	-	-	1,350,789
- others	-	4,946,370	3,425,073	5,326,208	7,170,688	1,306,548	-	22,174,887
– debt securities held for held-to-maturity								
- certificates of deposit held	-	225,695	-	-	-	-	-	225,695
- others	-	-	-	203,893	139,000	1,949	-	344,842
– debt securities held for loans and receivables	-	1,875,919	-	-	-	-	-	1,875,919
– equity securities	-	-	-	-	-	-	43,899	43,899
Investment in subsidiaries	-	-	-	-	-	-	5,222,682	5,222,682
Investment properties	-	-	-	-	-	-	802,260	802,260
Properties, plant and equipment	-	-	-	-	-	-	4,120,250	4,120,250
Other assets (including deferred tax assets)	16,500	633,492	64	1,822	656	-	406	652,940
Total assets	21,454,642	22,714,789	17,069,302	33,056,723	40,298,462	19,316,767	10,260,229	164,170,914

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	The Bank							
	2011							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities								
Deposits and balances from banks and other financial institutions	791,478	4,804,919	1,560,854	2,319,384	-	-	-	9,476,635
Financial liabilities at fair value through profit or loss								
– others	-	299,981	389,850	388,065	-	-	-	1,077,896
Derivative financial instruments	247,907	56,281	21,420	74,959	166,556	47,509	-	614,632
Deposits from customers	48,881,014	35,405,806	21,303,641	15,028,987	4,127,954	-	-	124,747,402
Other accounts and provisions (including current and deferred tax liabilities)	2,377,749	304,390	85,427	197,856	574,394	-	-	3,539,816
Total liabilities	52,298,148	40,871,377	23,361,192	18,009,251	4,868,904	47,509	-	139,456,381
Net liquidity gap	(30,843,506)	(18,156,588)	(6,291,890)	15,047,472	35,429,558	19,269,258	10,260,229	24,714,533

The above maturity classifications have been prepared in accordance with relevant provisions under the Banking (Disclosure) Rules. The Group has reported assets such as advances and debt securities which have been overdue for not more than one month as "On demand". In the case of an asset that is repayable by different payments or instalments, only that portion of the asset that is actually overdue is reported as overdue. Any part of the asset that is not due is reported according to the residual maturity unless the repayment of the asset is in doubt in which case the amount is reported as "Indefinite". The above assets are stated after deduction of provisions, if any.

The analysis of debt securities by remaining period to maturity is disclosed in order to comply with relevant provisions under the Banking (Disclosure) Rules. The disclosure does not imply that the securities will be held to maturity.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) Analysis of undiscounted cash flows by contractual maturities

(a) Non-derivative cash flows

The tables below summarise the cash flows of the Group and the Bank as at 31 December for non-derivative financial liabilities by remaining contractual maturities.

	The Group					
	2012					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Financial liabilities						
Deposits and balances from banks and other financial institutions	8,294,893	4,992,085	7,086,541	-	-	20,373,519
Financial liabilities at fair value through profit or loss	1,420,000	2,093,000	1,462,500	-	-	4,975,500
Deposits from customers	112,549,463	30,259,278	35,805,901	8,603,246	52,637	187,270,525
Other financial liabilities	4,517,866	1,809,154	3,377,424	33,300	6,150	9,743,894
Total financial liabilities	126,782,222	39,153,517	47,732,366	8,636,546	58,787	222,363,438

	The Group					
	2011					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Financial liabilities						
Deposits and balances from banks and other financial institutions	13,327,549	4,047,157	10,936,950	-	-	28,311,656
Financial liabilities at fair value through profit or loss	300,000	390,000	388,500	-	-	1,078,500
Deposits from customers	101,301,509	32,500,206	32,062,308	10,011,925	220,582	176,096,530
Other financial liabilities	3,940,581	1,110,630	3,163,290	1,289	-	8,215,790
Total financial liabilities	118,869,639	38,047,993	46,551,048	10,013,214	220,582	213,702,476

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) Analysis of undiscounted cash flows by contractual maturities (continued)

(a) Non-derivative cash flows (continued)

	The Bank					
	2012					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Financial liabilities						
Deposits and balances from banks and other financial institutions	3,076,929	142,692	958,674	-	-	4,178,295
Financial liabilities at fair value through profit or loss	1,420,000	2,093,000	1,462,500	-	-	4,975,500
Deposits from customers	91,624,727	19,968,167	16,743,656	69,304	-	128,405,854
Other financial liabilities	2,109,594	-	-	-	-	2,109,594
Total financial liabilities	98,231,250	22,203,859	19,164,830	69,304	-	139,669,243

	The Bank					
	2011					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Financial liabilities						
Deposits and balances from banks and other financial institutions	5,598,595	1,563,851	2,348,856	-	-	9,511,302
Financial liabilities at fair value through profit or loss	300,000	390,000	388,500	-	-	1,078,500
Deposits from customers	84,305,748	21,358,351	15,175,688	4,250,852	-	125,090,639
Other financial liabilities	2,681,632	-	-	-	-	2,681,632
Total financial liabilities	92,885,975	23,312,202	17,913,044	4,250,852	-	138,362,073

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) Analysis of undiscounted cash flows by contractual maturities (continued)

(b) Derivative cash flows

(i) Derivatives settled on a net basis

The Group's derivatives that will be settled on a net basis include:

- Exchange rate contracts: FX margin, non-deliverable currency forwards;
- Interest rate contracts: interest rate swaps;
- Commodity contracts: bullion margin contracts, commodity swaps; and
- Equity contracts: exchange traded equity options and equity linked swaps.

The tables below analyse the Group's and the Bank's derivative financial instruments as at 31 December that will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the tables are the net contractual undiscounted cash flows of derivatives with net negative fair value.

	The Group					
	2012					
	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Exchange rate contracts	**(204,766)**	**(24,626)**	**9,359**	**-**	**-**	**(220,033)**
Interest rate contracts	**(3,057)**	**(22,098)**	**(91,009)**	**(68,833)**	**-**	**(184,997)**
Commodity contracts	**(350)**	**-**	**-**	**-**	**-**	**(350)**
Equity contracts	**-**	**-**	**(454)**	**-**	**-**	**(454)**
	(208,173)	**(46,724)**	**(82,104)**	**(68,833)**	**-**	**(405,834)**

	The Group					
	2011					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts	(247,251)	(31,008)	(79,674)	23,837	-	(334,096)
Interest rate contracts	(1,327)	(10,120)	(107,266)	(91,584)	(5,482)	(215,779)
Commodity contracts	(2,071)	(151)	-	-	-	(2,222)
	(250,649)	(41,279)	(186,940)	(67,747)	(5,482)	(552,097)

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) Analysis of undiscounted cash flows by contractual maturities (continued)

(b) Derivative cash flows (continued)

(i) Derivatives settled on a net basis (continued)

	The Bank					
	2012					
	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Exchange rate contracts	**(204,766)**	**(24,626)**	**9,359**	**-**	**-**	**(220,033)**
Interest rate contracts	**(313)**	**(10,936)**	**(52,284)**	**(66,408)**	**-**	**(129,941)**
Commodity contracts	**(257)**	**-**	**-**	**-**	**-**	**(257)**
	(205,336)	**(35,562)**	**(42,925)**	**(66,408)**	**-**	**(350,231)**

	The Bank					
	2011					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts	(247,251)	(31,008)	(79,674)	23,837	-	(334,096)
Interest rate contracts	16	(4,943)	(73,663)	(91,584)	(5,482)	(175,656)
Commodity contracts	(1,928)	-	-	-	-	(1,928)
	(249,163)	(35,951)	(153,337)	(67,747)	(5,482)	(511,680)

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) Analysis of undiscounted cash flows by contractual maturities (continued)

(b) Derivative cash flows (continued)

(ii) Derivatives settled on a gross basis

The Group's derivatives that will be settled on a gross basis include OTC currency options, currency forwards, and OTC equity options.

The tables below analyse the Group's and the Bank's derivative financial instruments as at 31 December that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the tables are the gross contractual undiscounted cash flows for all derivatives that are settled on a gross basis.

	The Group				
	2012				
	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Exchange rate contracts:					
- Outflow	**(13,329,984)**	**(4,144,315)**	**(11,094,464)**	**-**	**(28,568,763)**
- Inflow	**13,418,460**	**4,167,232**	**11,099,574**	**-**	**28,685,266**
Equity contracts:					
- Outflow	**(97)**	**-**	**-**	**-**	**(97)**
- Inflow	**97**	**-**	**-**	**-**	**97**
Total outflow	**(13,330,081)**	**(4,144,315)**	**(11,094,464)**	**-**	**(28,568,860)**
Total inflow	**13,418,557**	**4,167,232**	**11,099,574**	**-**	**28,685,363**

	The Group				
	2011				
	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts:					
- Outflow	(11,417,779)	(1,925,850)	(4,816,609)	-	(18,160,238)
- Inflow	11,367,954	1,928,099	4,828,157	-	18,124,210
Total outflow	(11,417,779)	(1,925,850)	(4,816,609)	-	(18,160,238)
Total inflow	11,367,954	1,928,099	4,828,157	-	18,124,210

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) Analysis of undiscounted cash flows by contractual maturities (continued)

(b) Derivative cash flows (continued)

(ii) Derivatives settled on a gross basis (continued)

	The Bank				
	2012				
	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts:					
- Outflow	(9,709,942)	(3,245,098)	(2,912,372)	-	(15,867,412)
- Inflow	9,786,503	3,266,395	2,905,657	-	15,958,555
Equity contracts:					
- Outflow	(97)	-	-	-	(97)
- Inflow	97	-	-	-	97
Total outflow	(9,710,039)	(3,245,098)	(2,912,372)	-	(15,867,509)
Total inflow	9,786,600	3,266,395	2,905,657	-	15,958,652

	The Bank				
	2011				
	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts:					
- Outflow	(10,758,766)	(1,652,950)	(621,855)	-	(13,033,571)
- Inflow	10,710,899	1,654,478	624,204	-	12,989,581
Total outflow	(10,758,766)	(1,652,950)	(621,855)	-	(13,033,571)
Total inflow	10,710,899	1,654,478	624,204	-	12,989,581

(c) Off-balance sheet items

Loan commitments

The contractual amounts of the Group's and the Bank's off-balance sheet financial instruments as at 31 December 2012 that the Group and the Bank commits to extend credit to customers and other facilities amounting to HK$64,207,586,000 (2011: HK$50,503,226,000) and HK$27,481,060,000 (2011: HK$31,434,914,000) respectively. Those loan commitments can be drawn within 1 year.

Financial guarantees and other financial facilities

Financial guarantees and other financial facilities of the Group and the Bank as at 31 December 2012 amounting to HK$23,861,509,000 (2011: HK$17,568,921,000) and HK$4,217,552,000 (2011: HK$4,271,928,000) respectively are maturing no later than 1 year.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital Management

The major objective of the Group's capital management is to maximise total shareholders' return while maintaining a capital adequacy position in relation to the Group's overall risk profile. The ALCO periodically reviews the Group's capital structure and adjusts the capital mix where appropriate to maintain an optimal balance among risk, return and capital adequacy.

The Group has developed and maintained a sound framework of policies and controls on capital management to support the development of the Group's business and to meet the statutory capital adequacy ratio. The ALCO monitors the Group's capital adequacy. The Group has complied with all the statutory capital standards of the HKMA for the reported periods in respect of banking operation as further elaborated below.

The Group has adopted the foundation internal ratings-based ("FIRB") approach to calculate the credit risk capital charge for its non-securitisation exposures and internal ratings-based (securitisation) approach to calculate the credit risk capital charge for its securitisation exposures. A small residual credit exposures was approved by HKMA to be exempted from FIRB approach and remained under standardised (credit risk) ("STC") approach.

From October 2012, the Group gained the approval from the HKMA to adopt the internal models ("IMM") approach to calculate general market risk capital charge for foreign exchange and interest rate exposures and exclude its structural FX positions arising from overseas branches and Nanyang Commercial Bank (China), Limited in the calculation of the market risk capital charge. The Group continues to adopt the standardised (market risk) ("STM") approach to calculate the market risk capital charge for remaining exposures.

The Group continues to adopt standardised (operational risk) ("STO") approach to calculate the minimum capital requirement for operational risk in year 2012.

In response to the implementation of Basel II Enhancements, the Banking (Capital) (Amendment) Rules 2011 became effective on 1 January 2012. The amendments were mainly to revise the market risk framework and incorporate other enhancements to the Basel II framework. The Group has calculated the capital charge according to the related regulatory requirements.

In view of the implementation of Basel III requirements in phase since 1 January 2013, the Group will follow the rules stipulated in the Banking (Capital) (Amendment) Rules 2012 to calculate its CAR.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital Management (continued)

The Group has continued to adopt an internal capital adequacy assessment process (“ICAAP”) to comply with the HKMA’s requirements in the Supervisory Policy Manual “Supervisory Review Process” in 2012. Based on the HKMA's guidelines on Pillar II, ICAAP has been initiated to assess the extra capital needed to cover the material risks not captured under Pillar I, and therefore minimum common equity CAR, minimum core CAR and the minimum CAR are determined. The Group considers this ICAAP process as an on-going process for capital management and periodically reviews and adjusts its capital structure in relation to the overall risk profile.

In addition, the capital plan of the Group is drawn up annually and then submitted to the Board for approval after endorsement of the ALCO. The plan is built up by assessing the implications of various factors upon Capital adequacy such as the business strategies, return on equity, risk appetite, credit rating, as well as regulatory requirements. Hence, the future capital requirement is determined and capital sources are identified also. The plan is to ensure the Group’s capital adequacy and achieve optimal capital structure in order to align with our business development needs and risk profile.

As a result of the change in the bases of regulatory capital calculation, the amounts shown below are not directly comparable.

(A) Capital adequacy ratio

	2012	2011
Capital adequacy ratio	**15.89%**	17.06%
Core capital ratio	**15.08%**	16.42%

The capital ratios are computed on the consolidated basis that comprises the positions of the Bank and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules.

The differences between the basis of consolidation for accounting and regulatory purposes are described in Note 26 to the Financial Statements on page 140.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital Management (continued)

(B) Components of capital base after deductions

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

	2012	2011
	HK$'000	HK$'000
Core capital:		
Paid up ordinary share capital	700,000	700,000
Reserves	19,217,120	17,334,150
Profit and loss account	2,140,665	2,319,287
	22,057,785	20,353,437
Deductions from core capital	(29,786)	(23,795)
Core capital	22,027,999	20,329,642
Supplementary capital:		
Fair value gains arising from holdings of available-for-sale securities	193,952	51,862
Fair value gains arising from holdings of securities designated at fair value through profit or loss	20,569	10,768
Collective loan impairment allowances	78,719	25,260
Regulatory reserve	124,468	49,961
Surplus provisions	796,494	668,424
	1,214,202	806,275
Deductions from supplementary capital	(29,787)	(23,795)
Supplementary capital	1,184,415	782,480
Total capital base after deductions	23,212,414	21,112,122

Subsidiaries which are not included in the consolidation group for the calculation of capital adequacy ratios are denoted in Note 26 to the Financial Statements on page 140. Investment costs in such subsidiaries are deducted from the capital base.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.5 Fair values of financial assets and liabilities

(A) Financial instruments not measured at fair value

Fair value estimates are made at a specific point in time based on relevant market information and information about various financial instruments. The following methods and assumptions have been used to estimate the fair value of each class of financial instrument as far as practicable.

Balances with banks and other financial institutions and Trade bills

The maturities of these financial assets and liabilities are within one year and the carrying value approximates fair value.

Advances to customers, banks and other financial institutions

Substantially all the advances to customers, banks and other financial institutions are on floating rate terms, bear interest at prevailing market interest rates and their carrying value approximates fair value.

Held-to-maturity securities

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

Loans and receivables

A discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity and their carrying value approximates fair value.

Deposits from customers

Substantially all the deposits from customers mature within one year from the balance sheet date and their carrying value approximates fair value.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.5 Fair values of financial assets and liabilities (continued)

(B) Financial instruments measured at fair value

The Group has an established governance structure and controls framework to ensure that fair values are either determined or validated by control units independent of the front offices. Control units have overall responsibility for independent verification of results and all other significant fair value measurements. Significant valuation issues are reported to senior management.

Financial instruments measured at fair value are classified into following three levels:

– Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities, including debt instruments issued by certain governments and certain foreign exchange derivative contracts.

– Level 2: Valuation technique using inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. This level includes the majority of the OTC derivative contracts, debt securities with quote from pricing services providers.

– Level 3: Valuation technique using inputs for the asset or liability that is not based on observable market data (unobservable inputs). This level includes equity investment with significant unobservable components.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.5 Fair values of financial assets and liabilities (continued)

(B) Financial instruments measured at fair value (continued)

The Group uses valuation techniques or broker/dealer quotations to determine the fair value of financial instruments when unable to obtain the open market quotation in active markets.

The main parameters used in valuation techniques for financial instruments held by the Group include bond prices, interest rates, foreign exchange rates, equity and stock prices, volatilities, counterparty credit spreads and others, which are all observable and obtainable from open market.

There have been no significant transfers between level 1 and 2 during the year 2012 and 2011.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.5 Fair values of financial assets and liabilities (continued)

(B) Financial instruments measured at fair value (continued)

(i) Fair value hierarchy

	The Group			
	2012			
	Level 1	**Level 2**	**Level 3**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Financial assets				
Financial assets at fair value through profit or loss				
- Trading securities				
- Debt securities	**-**	**4,272,358**	**-**	**4,272,358**
- Financial assets designated at fair value through profit or loss				
- Debt securities	**-**	**852,802**	**-**	**852,802**
Derivative financial instruments	**501,902**	**262,675**	**-**	**764,577**
Available-for-sale securities				
- Debt securities	**1,468,168**	**36,836,547**	**-**	**38,304,715**
- Equity securities	**-**	**-**	**56,146**	**56,146**
Financial liabilities				
Financial liabilities at fair value through profit or loss				
- Trading liabilities	**-**	**4,975,073**	**-**	**4,975,073**
Derivative financial instruments	**205,008**	**254,599**	**-**	**459,607**

	The Group			
	2011			
	Level 1	Level 2	Level 3	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Financial assets				
Financial assets at fair value through profit or loss				
- Trading securities				
- Debt securities	-	1,109,280	-	1,109,280
- Financial assets designated at fair value through profit or loss				
- Debt securities	-	1,131,435	5,046	1,136,481
Derivative financial instruments	586,916	229,487	-	816,403
Available-for-sale securities				
- Debt securities	-	26,712,086	-	26,712,086
- Equity securities	-	-	43,899	43,899
Financial liabilities				
Financial liabilities at fair value through profit or loss				
- Trading liabilities	-	1,077,896	-	1,077,896
Derivative financial instruments	247,907	424,711	-	672,618

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.5 Fair values of financial assets and liabilities (continued)

(B) Financial instruments measured at fair value (continued)

(i) Fair value hierarchy (continued)

	The Bank			
	2012			
	Level 1	Level 2	Level 3	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Financial assets				
Financial assets at fair value through profit or loss				
- Trading securities				
- Debt securities	-	4,272,358	-	4,272,358
- Financial assets designated at fair value through profit or loss				
- Debt securities	-	852,802	-	852,802
Derivative financial instruments	501,902	147,801	-	649,703
Available-for-sale securities				
- Debt securities	1,468,168	30,631,082	-	32,099,250
- Equity securities	-	-	56,146	56,146
Financial liabilities				
Financial liabilities at fair value through profit or loss				
- Trading liabilities	-	4,975,073	-	4,975,073
Derivative financial instruments	205,008	171,417	-	376,425

	The Bank			
	2011			
	Level 1	Level 2	Level 3	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Financial assets				
Financial assets at fair value through profit or loss				
- Trading securities				
- Debt securities	-	1,109,280	-	1,109,280
- Financial assets designated at fair value through profit or loss				
- Debt securities	-	1,131,435	5,046	1,136,481
Derivative financial instruments	586,916	162,232	-	749,148
Available-for-sale securities				
- Debt securities	-	23,525,676	-	23,525,676
- Equity securities	-	-	43,899	43,899
Financial liabilities				
Financial liabilities at fair value through profit or loss				
- Trading liabilities	-	1,077,896	-	1,077,896
Derivative financial instruments	247,907	366,725	-	614,632

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.5 Fair values of financial assets and liabilities (continued)

(B) Financial instruments measured at fair value (continued)

(ii) Reconciliation of level 3 items

	The Group and the Bank	
	2012	
	Financial assets	
	Financial assets designated at fair value through profit or loss	**Available-for-sale securities**
	Debt securities	**Equity securities**
	HK$'000	**HK$'000**
At 1 January 2012	**5,046**	**43,899**
Gains		
- Other comprehensive income	**-**	**12,384**
Sales	**(5,046)**	**(137)**
At 31 December 2012	**-**	**56,146**
Total gains for the year included in profit or loss for assets held as at 31 December 2012	**-**	**-**

	The Group and the Bank	
	2011	
	Financial assets	
	Financial assets designated at fair value through profit or loss	Available-for-sale securities
	Debt securities	Equity securities
	HK$'000	HK$'000
At 1 January 2011	19,312	34,915
Gains		
- Profit or loss	3,613	-
- Other comprehensive income	-	8,984
Sales	(17,879)	-
At 31 December 2011	5,046	43,899
Total gains for the year included in profit or loss for assets held as at 31 December 2011	3,613	-

Gains included in profit or loss for the year as well as gains relating to financial assets and liabilities held as at year end are presented in "Net trading gain", "Net gain/(loss) on financial instruments designated at fair value through profit or loss" or "Net charge of impairment allowances" depending on the nature or the category of the related financial instruments.

Notes to the Financial Statements (continued)

5. Net interest income

	2012	2011
	HK$'000	HK$'000
Interest income		
Due from banks and other financial institutions	**2,329,108**	1,605,671
Advances to customers	**4,355,000**	3,452,243
Listed investments	**319,579**	274,409
Unlisted investments	**680,723**	446,792
Others	**26,046**	23,908
	7,710,456	5,803,023
Interest expense		
Due to banks and other financial institutions	**(601,733)**	(400,755)
Deposits from customers	**(3,014,699)**	(2,015,621)
Others	**(161,211)**	(101,906)
	(3,777,643)	(2,518,282)
Net interest income	**3,932,813**	3,284,741

Included within interest income is HK$8,079,000 (2011: HK$1,264,000) of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2012. No interest income accrued on impaired investment in securities (2011: HK$36,000).

Included within interest income and interest expense are HK$7,653,870,000 (2011: HK$5,749,266,000) and HK$3,763,585,000 (2011: HK$2,516,786,000), for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

Notes to the Financial Statements (continued)

6. Net fee and commission income

	2012	2011
	HK$'000	HK$'000
Fee and commission income		
Loan commissions	**183,902**	187,756
Securities brokerage	**164,207**	210,891
Bills commissions	**150,725**	180,329
Insurance	**77,018**	71,781
Payment services	**74,734**	77,805
Funds distribution	**72,126**	47,279
Safe deposit box	**21,688**	20,846
Credit card business	**761**	531
Currency exchange	**600**	787
Others	**77,016**	65,820
	822,777	863,825
Fee and commission expense		
Securities brokerage	**(26,224)**	(37,601)
Payment services	**(6,604)**	(6,755)
Others	**(34,770)**	(29,283)
	(67,598)	(73,639)
Net fee and commission income	**755,179**	790,186
Of which arise from		
- financial assets or financial liabilities not at fair value through profit or loss		
- Fee and commission income	**193,677**	233,985
- Fee and commission expense	**(1,584)**	(749)
	192,093	233,236
- trust and other fiduciary activities		
- Fee and commission income	**12,262**	13,865
- Fee and commission expense	**(1,183)**	(1,088)
	11,079	12,777

7. Net trading gain

	2012	2011
	HK$'000	HK$'000
Net gain/(loss) from:		
- foreign exchange and foreign exchange products	**131,080**	143,121
- interest rate instruments	**16,136**	(62,772)
	147,216	80,349

Notes to the Financial Statements (continued)

8. Net gain on other financial assets

	2012	2011
	HK$'000	HK$'000
Net gain from disposal of available-for-sale securities	11,839	53,559
Others	4,762	221
	16,601	53,780

9. Other operating income

	2012	2011
	HK$'000	HK$'000
Dividend income from investment in securities		
- unlisted investments	6,940	6,016
Gross rental income from investment properties	40,881	33,873
Less: Outgoings in respect of investment properties	(2,066)	(4,783)
Others	11,354	10,968
	57,109	46,074

Included in the "Outgoings in respect of investment properties" is HK$177,000 (2011: HK$111,000) of direct operating expenses related to investment properties that were not let during the year.

10. Net charge of impairment allowances

	2012	2011
	HK$'000	HK$'000
Advances to customers		
Individually assessed		
- new allowances	(155,261)	(17,007)
- releases	5,185	1,947
- recoveries	13,523	20,020
Net (charge)/reversal of individually assessed loan impairment allowances (Note 24)	(136,553)	4,960
Collectively assessed		
- new allowances	(260,395)	(168,494)
Net charge of collectively assessed loan impairment allowances (Note 24)	(260,395)	(168,494)
Net charge of loan impairment allowances	(396,948)	(163,534)
Available-for-sale securities		
Net charge of impairment allowances on available-for-sale securities		
- Individually assessed	-	(725)
Held-to-maturity securities		
Net reversal of impairment allowances on held-to-maturity securities		
- Individually assessed (Note 25)	-	2,953
Net charge of impairment allowances	(396,948)	(161,306)

Notes to the Financial Statements (continued)

11. Operating expenses

	2012	2011
	HK$'000	HK$'000
Staff costs (including directors' emoluments)		
- salaries and other costs	904,165	830,380
- pension cost	109,887	91,340
	1,014,052	921,720
Premises and equipment expenses (excluding depreciation)		
- rental of premises	211,026	188,465
- information technology	111,466	108,269
- others	47,921	48,347
	370,413	345,081
Depreciation (Note 28)	166,939	115,441
Auditor's remuneration		
- audit services	7,377	7,160
- non-audit services	671	929
Lehman Brothers related products*	(5,688)	(447,661)
Other operating expenses	392,533	342,167
	1,946,297	1,284,837

* The net amount of HK$7,230,000 recovered by the Group from the underlying collateral of the Lehman Brothers minibonds was credited to operating expenses in 2012 (2011: HK$454,296,000).

12. Net gain from disposal of/fair value adjustments on investment properties

	2012	2011
	HK$'000	HK$'000
Net loss from disposal of investment properties	-	(316)
Net gain from fair value adjustments on investment properties (Note 27)	178,766	136,553
	178,766	136,237

13. Net loss from disposal/revaluation of properties, plant and equipment

	2012	2011
	HK$'000	HK$'000
Net (loss)/gain from disposal of premises	(995)	366
Net loss from disposal of other fixed assets	(3,894)	(12,953)
Net loss from revaluation of premises (Note 28)	(1,738)	(1,881)
	(6,627)	(14,468)

Notes to the Financial Statements (continued)

14. Taxation

Taxation in the consolidated income statement represents:

	2012	2011
	HK$'000	HK$'000
Current tax		
Hong Kong profits tax		
- current year taxation	365,036	405,275
- over-provision in prior years	(7,942)	(1,532)
	357,094	403,743
Overseas taxation	74,235	130,105
	431,329	533,848
Deferred tax credit (Note 34)	(11,516)	(56,611)
	419,813	477,237

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

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

	2012	2011
	HK$'000	HK$'000
Profit before taxation	2,759,771	2,926,195
Calculated at a taxation rate of 16.5% (2011: 16.5%)	455,362	482,822
Effect of different taxation rates in other countries	21,756	23,146
Income not subject to taxation	(70,295)	(47,833)
Expenses not deductible for taxation purposes	13,482	13,773
Tax losses not recognized	298	1,300
Over-provision in prior years	(7,942)	(1,532)
Foreign withholding tax	7,152	5,561
Taxation charge	419,813	477,237
Effective tax rate	15.21%	16.31%

15. Profit attributable to the equity holders of the Bank

The profit of the Bank for the year ended 31 December 2012 attributable to the equity holders of the Bank and dealt with in the financial statements of the Bank amounted to HK$2,072,764,000 (2011: HK$2,180,414,000).

Notes to the Financial Statements (continued)

16. Dividends

	2012		2011	
	Per share HK$	**Total HK$'000**	Per share HK$	Total HK$'000
Interim dividend	**56**	**392,000**	-	-

On 12 June 2012, the Board declared an interim dividend of HK$56 per ordinary share for 2012 amounting to HK$392,000,000.

17. Retirement benefit costs

The principal defined contribution schemes for the Group's employees are ORSO scheme exempted under the MPF Schemes Ordinance and the BOC-Prudential Easy Choice MPF Scheme. Under the ORSO scheme, employees make monthly contributions to the ORSO scheme equal to 5% of their basic salaries, while the employer makes monthly contributions equal to 5% to 15% of the employees' monthly basic salaries, depending on years of service. The employees are entitled to receive 100% of the employer's contributions upon termination of employment after completing 10 years of service, or at a scale ranging from 30% to 90% for employees who have completed between 3 to 9 years of service, on conditions of retirement, early retirement, permanent incapacity and ill-health or termination of employment other than summary dismissal.

Notes to the Financial Statements (continued)

17. Retirement benefit costs (continued)

With the implementation of the MPF Schemes Ordinance on 1 December 2000, the Group also participates in the BOC-Prudential Easy Choice MPF Scheme, of which the trustee is BOCI-Prudential Trustee and the investment manager is BOCI-Prudential Manager, which are related parties of the Bank.

The Group's total contributions made to the ORSO scheme for the year ended 31 December 2012 amounted to approximately HK$36,771,000 (2011: approximately HK$36,382,000), after a deduction of forfeited contributions of approximately HK$318,000 (2011: approximately HK$400,000). For the MPF Scheme, the Group contributed approximately HK$5,375,000 (2011: approximately HK$4,581,000) for the year ended 31 December 2012.

18. Share option schemes

(a) Share Option Scheme and Sharesave Plan

The principal terms of the Share Option Scheme and the Sharesave Plan were approved and adopted by written resolutions of all the shareholders of the BOCHK (Holdings) dated 10 July 2002.

The purpose of the Share Option Scheme is to provide the participants with the opportunity to acquire proprietary interests in the BOCHK (Holdings). The Board of BOCHK (Holdings) may, in its absolute discretion, offer to grant options under the Share Option Scheme to any person as the Board of BOCHK (Holdings) may select. The subscription price for the shares shall be determined on the date of grant by the Board of BOCHK (Holdings) as an amount per share calculated on the basis of established rules. An option may be exercised in whole or in part at any time after the date prescribed by the Board of BOCHK (Holdings) and from time to time as specified in the offer and on or before the termination date prescribed by the Board of BOCHK (Holdings).

The purpose of the Sharesave Plan is to encourage broad-based employee ownership of the shares of the BOCHK (Holdings). The amount of the monthly contribution under the savings contract to be made in connection with an option shall be the amount which the relevant eligible employee is willing to contribute, which amount shall not be less than 1% and not more than 10% of the eligible employee's monthly salary as at the date of application or such other maximum or minimum amounts as permitted by the Board of BOCHK (Holdings). When an option is exercised during an exercise period, it may be exercised in whole or in part.

No options were granted pursuant to the Share Option Scheme or the Sharesave Plan during the year 2012 (2011: Nil). Both the Share Option Scheme and the Sharesave Plan expired in July 2012.

Notes to the Financial Statements (continued)

18. Share option schemes (continued)

(b) Pre-Listing Share Option Scheme

On 5 July 2002, several directors together with senior management personnel of the Group were granted options by BOC (BVI), the immediate holding company of the BOCHK (Holdings), pursuant to a Pre-Listing Share Option Scheme to purchase from BOC (BVI) an aggregate of 5,615,200 existing issued shares of the BOCHK (Holdings). The Group has taken advantage of the transitional provisions set out in paragraph 53 of HKFRS 2 under which the recognition and measurement policies have not been applied to all options granted to employees on or before 7 November 2002.

Details of the share options outstanding as at 31 December 2012 and 2011 are disclosed as follows:

	Total number of share options to directors and senior management	**Average exercise price (HK$ per share)**
At 1 January 2012	**1,084,500**	**8.50**
Less: Share Options lapsed during the year	**(1,084,500)**	**8.50**
At 31 December 2012	**-**	
Exercisable at 31 December 2012	**-**	

	Total number of share options to directors and senior management	Average exercise price (HK$ per share)
At 1 January 2011	1,084,500	8.50
At 31 December 2011	1,084,500	
Exercisable at 31 December 2011	1,084,500	

No share options were exercised during the year 2012 and 2011.

The options granted under this scheme can be exercised at HK$8.50 per share in respect of the option price of HK$1.00. These options have a vesting period of four years from the date on which dealings in the shares commenced on the Stock Exchange with a valid exercise period of ten years. No offer to grant any options under the Pre-Listing Share Option Scheme will be made on or after the date on which dealings in the shares commenced on the Stock Exchange. The valid exercise period of Pre-Listing Share Option Scheme ended on 4 July 2012 and all the non-exercised share options under this scheme have lapsed.

Notes to the Financial Statements (continued)

19. Directors', senior management's and key personnel's emoluments

(a) Directors' emoluments

Details of the emoluments paid to or receivable by the directors of the Bank in respect of their services rendered for the Bank and managing the subsidiaries within the Group during the year are as follows:

	2012	2011
	HK$'000	HK$'000
Fees	**6,515**	4,681
Other emoluments	**10,426**	12,604
	16,941	17,285

In July 2002, options were granted to several directors of the Bank by the immediate holding company of BOCHK (Holdings), BOC (BVI), under the Pre-Listing Share Option Scheme as set out in Note 18(b). Full details of the scheme are stated in Note 18. During the year, no options were exercised and no benefits arising from the granting of these share options were included in the directors' emoluments disclosed above or recognised in the income statement (2011: Nil).

Notes to the Financial Statements (continued)

19. Directors', senior management's and key personnel's emoluments (continued)

(b) Remuneration for senior management and Key Personnel under CG-5

Pursuant to CG-5 Guideline on a Sound Remuneration System issued by the HKMA, details of the remuneration for senior management and Key Personnel of the Group during the year are as follows:

(i) Remuneration awarded during the year

	2012					
	Senior management			Key personnel		
	Non-deferred	Deferred	Total	Non-deferred	Deferred	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Fixed remuneration						
Cash	9,530	-	9,530	5,215	-	5,215
Variable remuneration						
Cash	3,740	500	4,240	1,961	-	1,961
Total	13,270	500	13,770	7,176	-	7,176

	2011					
	Senior management			Key personnel		
	Non-deferred	Deferred	Total	Non-deferred	Deferred	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Fixed remuneration						
Cash	9,968	-	9,968	5,142	-	5,142
Variable remuneration						
Cash	3,876	260	4,136	1,913	-	1,913
Total	13,844	260	14,104	7,055	-	7,055

The remuneration above includes 5 (2011: 7) members of senior management and 4 (2011: 4) members of Key Personnel.

Notes to the Financial Statements (continued)

19. Directors', senior management's and key personnel's emoluments (continued)

(b) Remuneration for senior management and Key Personnel under CG-5 (continued)

(ii) Deferred remuneration outstanding

	2012		2011	
	Senior management	Key personnel	Senior management	Key personnel
	HK$'000	HK$'000	HK$'000	HK$'000
Deferred remuneration				
Vested	90	-	-	-
Unvested	670	-	260	-
	760	-	260	-
At 1 January	260	-	-	-
Awarded	500	-	260	-
Paid out	(90)	-	-	-
Reduced through performance adjustments	-	-	-	-
At 31 December	670	-	260	-

For the purpose of disclosure, senior management and Key Personnel mentioned in this section are defined according to the HKMA's Guideline on a Sound Remuneration System.

Senior management: The senior executives designated by the Board who are responsible for oversight of the firm-wide strategy or material business lines, including Chief Executive and Deputy General Managers.

Key Personnel: The employees whose individual business activities involve the assumption of material risk which may have significant impact on risk exposure, or whose individual responsibilities are directly and materially linked to the risk management, or those who have direct influence to the profit, including Head of material business line, Head of Trading, as well as Head of risk control functions.

20. Cash and balances with banks and other financial institutions

	The Group		The Bank	
	2012	2011	2012	2011
	HK$'000	HK$'000	HK$'000	HK$'000
Cash	651,229	590,818	383,218	363,802
Balances with central banks	13,139,030	10,554,122	35,306	517,779
Balances with banks and other financial institutions	13,263,797	16,400,091	13,026,968	17,195,853
Placements with banks and other financial institutions maturing within one month	13,734,264	16,449,302	8,313,216	8,864,144
	40,788,320	43,994,333	21,758,708	26,941,578

Notes to the Financial Statements (continued)

21. Financial assets at fair value through profit or loss

	The Group and the Bank					
	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	2012	2011	**2012**	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000
At fair value						
Debt securities						
- Listed in Hong Kong	**-**	-	**264,125**	247,900	**264,125**	247,900
- Listed outside Hong Kong	**-**	-	**508,696**	518,359	**508,696**	518,359
	-	-	**772,821**	766,259	**772,821**	766,259
- Unlisted	**4,272,358**	1,109,280	**79,981**	370,222	**4,352,339**	1,479,502
Total	**4,272,358**	1,109,280	**852,802**	1,136,481	**5,125,160**	2,245,761

Financial assets at fair value through profit or loss are analysed by type of issuer as follows:

	The Group and the Bank	
	2012	2011
	HK$'000	HK$'000
Sovereigns	**4,271,737**	1,108,780
Public sector entities*	**621**	500
Banks and other financial institutions	**-**	293,869
Corporate entities	**852,802**	842,612
	5,125,160	2,245,761

* Included financial assets at fair value through profit or loss of HK$621,000 (2011: HK$500,000) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

Financial assets at fair value through profit or loss are analysed as follows:

	The Group and the Bank	
	2012	2011
	HK$'000	HK$'000
Treasury bills	**4,271,737**	1,108,780
Other financial assets at fair value through profit or loss	**853,423**	1,136,981
	5,125,160	2,245,761

Notes to the Financial Statements (continued)

22. Derivative financial instruments

The Group enters into the following exchange rate, interest rate, commodity and equity related derivative financial instrument contracts for trading and risk management purposes:

Currency forwards represent commitments to purchase and sell foreign currency on a future date.

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an exchange of currencies, interest rates (for example, fixed rate for floating rate), or a combination of all these (for example, cross-currency interest rate swaps). Except for certain currency swap contracts, no exchange of principal takes place.

Foreign currency options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of the financial instrument at a predetermined price. In consideration for the assumption of foreign exchange and interest rate risk, the seller receives a premium from the purchaser. Options are negotiated over-the-counter ("OTC") between the Group and its counterparty.

The contract/notional amounts and fair values of derivative financial instruments held by the Group are set out in the following tables. The contract/notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet dates and certain of them provide a basis for comparison with fair value instruments recognised on the consolidated balance sheet. However, they do not necessarily indicate the amounts of future cash flows involved or the current fair values of the instruments and, therefore, do not indicate the Group's exposure to credit or market risks. The derivative financial instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in foreign exchange rates, market interest rates, metal prices or equity prices relative to their terms. The aggregate fair values of derivative financial instruments assets and liabilities can fluctuate significantly from time to time.

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

The Group trades derivative products (both exchange-traded or OTC) mainly for customer business. The Group strictly follows risk management policies in providing derivative products to our customers and in trading of derivative products in the interbank market.

Derivatives are also used to manage the interest rate risk of the banking book. A derivative instrument must be included in the approved product list before any transactions for that instrument can be made. Every derivative transaction must be input into the relevant system for settlement, mark to market revaluation, reporting and control.

The following tables summarise the contract/notional amounts of each class of derivative financial instrument as at 31 December:

	The Group		
	2012		
	Trading	Not qualified for hedge accounting	Total
	HK$'000	HK$'000	HK$'000
Exchange rate contracts			
Spot and forwards	23,183,476	-	23,183,476
Swaps	19,932,539	-	19,932,539
Foreign currency options			
- Options purchased	29,589	-	29,589
- Options written	29,589	-	29,589
	43,175,193	-	43,175,193
Interest rate contracts			
Swaps	35,851,341	720,082	36,571,423
Commodity contracts	142,395	-	142,395
Equity contracts	47,104	-	47,104
Other contracts	4,496	-	4,496
Total	79,220,529	720,082	79,940,611

Not qualified for hedge accounting: derivative transactions which do not qualify as hedges for accounting purposes but are managed in conjunction with the financial instruments designated at fair value through profit or loss are separately disclosed in compliance with the requirements set out in the Banking (Disclosure) Rules.

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

	The Group		
	2011		
	Trading	Not qualified for hedge accounting	Total
	HK$'000	HK$'000	HK$'000
Exchange rate contracts			
Spot and forwards	38,126,849	-	38,126,849
Swaps	12,343,293	-	12,343,293
Foreign currency options			
- Options purchased	17,165	-	17,165
- Options written	17,165	-	17,165
	50,504,472	-	50,504,472
Interest rate contracts			
Swaps	28,510,868	721,698	29,232,566
Commodity contracts	305,772	-	305,772
Other contracts	5,705	-	5,705
Total	79,326,817	721,698	80,048,515

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

	The Bank		
	2012		
	Trading	Not qualified for hedge accounting	Total
	HK$'000	HK$'000	HK$'000
Exchange rate contracts			
Spot and forwards	16,092,063	-	16,092,063
Swaps	14,574,798	-	14,574,798
Foreign currency option			
- Options purchased	29,589	-	29,589
- Options written	29,589	-	29,589
	30,726,039	-	30,726,039
Interest rate contracts			
Swaps	2,133,652	720,082	2,853,734
Commodity contracts	92,496	-	92,496
Equity contracts	9,636	-	9,636
Other contracts	4,496	-	4,496
Total	32,966,319	720,082	33,686,401

	The Bank		
	2011		
	Trading	Not qualified for hedge accounting	Total
	HK$'000	HK$'000	HK$'000
Exchange rate contracts			
Spot and forwards	34,075,862	-	34,075,862
Swaps	11,267,612	-	11,267,612
Foreign currency option			
- Options purchased	17,165	-	17,165
- Options written	17,165	-	17,165
	45,377,804	-	45,377,804
Interest rate contracts			
Swaps	4,617,366	721,698	5,339,064
Commodity contracts	254,696	-	254,696
Other contracts	5,705	-	5,705
Total	50,255,571	721,698	50,977,269

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

The following tables summarise the fair values of each class of derivative financial instrument as at 31 December:

The Group 2012

	Fair value assets			Fair value liabilities		
	Trading	Not qualified for hedge accounting	Total	Trading	Not qualified for hedge accounting	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts						
Spot and forwards	565,560	-	565,560	(255,436)	-	(255,436)
Swaps	142,451	-	142,451	(22,390)	-	(22,390)
Foreign currency option						
- Options purchased	130	-	130	-	-	-
- Options written	-	-	-	(130)	-	(130)
	708,141	-	708,141	(277,956)	-	(277,956)
Interest rate contracts						
Swaps	53,255	-	53,255	(108,691)	(72,348)	(181,039)
Commodity contracts	2,967	-	2,967	(399)	-	(399)
Equity contracts	213	-	213	(213)	-	(213)
Other contracts	1	-	1	-	-	-
Total	764,577	-	764,577	(387,259)	(72,348)	(459,607)

The Group 2011

	Fair value assets			Fair value liabilities		
	Trading	Not qualified for hedge accounting	Total	Trading	Not qualified for hedge accounting	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts						
Spot and forwards	760,384	-	760,384	(400,191)	-	(400,191)
Swaps	10,841	-	10,841	(57,385)	-	(57,385)
Foreign currency option						
- Options purchased	72	-	72	-	-	-
- Options written	-	-	-	(72)	-	(72)
	771,297	-	771,297	(457,648)	-	(457,648)
Interest rate contracts						
Swaps	40,998	-	40,998	(120,847)	(91,464)	(212,311)
Commodity contracts	4,095	-	4,095	(2,659)	-	(2,659)
Other contracts	13	-	13	-	-	-
Total	816,403	-	816,403	(581,154)	(91,464)	(672,618)

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

	The Bank 2012					
	Fair value assets			Fair value liabilities		
	Trading HK$'000	Not qualified for hedge accounting HK$'000	Total HK$'000	Trading HK$'000	Not qualified for hedge accounting HK$'000	Total HK$'000
Exchange rate contracts						
Spot and forwards	530,800	-	530,800	(230,900)	-	(230,900)
Swaps	115,895	-	115,895	(17,301)	-	(17,301)
Foreign currency option						
- Options purchased	130	-	130	-	-	-
- Options written	-	-	-	(130)	-	(130)
	646,825	-	646,825	(248,331)	-	(248,331)
Interest rate contracts						
Swaps	-	-	-	(55,436)	(72,348)	(127,784)
Commodity contracts	2,824	-	2,824	(257)	-	(257)
Equity contracts	53	-	53	(53)	-	(53)
Other contracts	1	-	1	-	-	-
Total	649,703	-	649,703	(304,077)	(72,348)	(376,425)

	The Bank 2011					
	Fair value assets			Fair value liabilities		
	Trading HK$'000	Not qualified for hedge accounting HK$'000	Total HK$'000	Trading HK$'000	Not qualified for hedge accounting HK$'000	Total HK$'000
Exchange rate contracts						
Spot and forwards	733,599	-	733,599	(385,008)	-	(385,008)
Swaps	10,360	-	10,360	(54,288)	-	(54,288)
Foreign currency option						
- Options purchased	72	-	72	-	-	-
- Options written	-	-	-	(72)	-	(72)
	744,031	-	744,031	(439,368)	-	(439,368)
Interest rate contracts						
Swaps	1,740	-	1,740	(81,872)	(91,464)	(173,336)
Commodity contracts	3,364	-	3,364	(1,928)	-	(1,928)
Other contracts	13	-	13	-	-	-
Total	749,148	-	749,148	(523,168)	(91,464)	(614,632)

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

The credit risk weighted amounts of the above derivative financial instruments are as follows:

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Exchange rate contracts				
Forwards	**174,157**	619,563	**80,560**	566,541
Swaps	**77,605**	25,906	**54,064**	22,902
Interest rate contracts				
Swaps	**31,045**	21,507	**2,548**	4,150
Commodity contracts	**2,809**	-	**-**	-
Equity contracts	**1,173**	-	**-**	-
Total	**286,789**	666,976	**137,172**	593,593

The credit risk weighted amounts are calculated in accordance with the Banking (Capital) Rules. The amounts are dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

There is no effect of valid bilateral netting agreement on the fair values or the credit risk weighted amounts of the derivative financial instruments.

Notes to the Financial Statements (continued)

23. Advances and other accounts

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Personal loans and advances	**22,002,049**	20,863,287	**15,651,764**	16,318,123
Corporate loans and advances	**109,151,060**	98,980,942	**69,411,566**	67,917,818
Advances to customers*	**131,153,109**	119,844,229	**85,063,330**	84,235,941
Loan impairment allowances				
- Individually assessed	**(220,593)**	(87,615)	**(58,444)**	(11,652)
- Collectively assessed	**(969,449)**	(705,132)	**(591,183)**	(428,451)
	129,963,067	119,051,482	**84,413,703**	83,795,838
Trade bills	**8,069,618**	13,318,487	**5,504,118**	10,819,714
Advances to banks and other financial institutions	**-**	544,256	**-**	544,256
Total	**138,032,685**	132,914,225	**89,917,821**	95,159,808

As at 31 December 2012, advances to customers of the Group and the Bank included accrued interest of HK$522,723,000 (2011: HK$533,810,000) and HK$303,115,000 (2011: HK$308,728,000) respectively.

As at 31 December 2012 and 2011, no impairment allowance was made in respect of trade bills and advances to banks and other financial institutions.

* Included advances to customers of the Group denominated in HK dollars of HK$65,256,992,000 (2011: HK$61,458,683,000) and US dollars equivalent to HK$27,860,495,000 (2011: HK$34,285,493,000). Included advances to customers of the Bank denominated in HK dollars of HK$62,941,947,000 (2011: HK$58,979,430,000) and US dollars equivalent to HK$20,197,752,000 (2011: HK$23,881,658,000).

24. Loan impairment allowances

	The Group			The Bank		
	2012					
	Individual assessment					
	Personal	**Corporate**	**Total**	**Personal**	**Corporate**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
At 1 January 2012	**4,566**	**83,049**	**87,615**	**2,698**	**8,954**	**11,652**
Charged/(credited) to income statement	**2,979**	**133,574**	**136,553**	**(2,377)**	**54,043**	**51,666**
Loans written off during the year as uncollectible	**(38)**	**(9,796)**	**(9,834)**	**-**	**(9,456)**	**(9,456)**
Recoveries	**1,071**	**12,452**	**13,523**	**471**	**5,728**	**6,199**
Unwind of discount on impairment allowances	**(377)**	**(7,702)**	**(8,079)**	**-**	**(1,606)**	**(1,606)**
Exchange difference	**104**	**711**	**815**	**(4)**	**(7)**	**(11)**
At 31 December 2012	**8,305**	**212,288**	**220,593**	**788**	**57,656**	**58,444**

Notes to the Financial Statements (continued)

24. Loan impairment allowances (continued)

	The Group			The Bank		
	2012					
	Collective assessment					
	Personal	Corporate	Total	Personal	Corporate	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2012	42,177	662,955	705,132	6,901	421,550	428,451
Charged/(credited) to income statement	4,979	255,416	260,395	(505)	163,217	162,712
Exchange difference	45	3,877	3,922	-	20	20
At 31 December 2012	47,201	922,248	969,449	6,396	584,787	591,183

	The Group			The Bank		
	2011					
	Individual assessment					
	Personal	Corporate	Total	Personal	Corporate	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2011	2,189	103,100	105,289	859	11,588	12,447
(Credited)/charged to income statement	(2,044)	(2,916)	(4,960)	(1,865)	7,228	5,363
Loans written off during the year as uncollectible	-	(33,697)	(33,697)	-	(10,806)	(10,806)
Recoveries	4,506	15,513	20,019	3,771	1,598	5,369
Unwind of discount on impairment allowances	(365)	(899)	(1,264)	(67)	(652)	(719)
Exchange difference	280	1,948	2,228	-	(2)	(2)
At 31 December 2011	4,566	83,049	87,615	2,698	8,954	11,652

	The Group			The Bank		
	2011					
	Collective assessment					
	Personal	Corporate	Total	Personal	Corporate	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2011	6,575	521,735	528,310	5,565	337,253	342,818
Charged to income statement	35,332	133,162	168,494	1,336	84,046	85,382
Exchange difference	270	8,058	8,328	-	251	251
At 31 December 2011	42,177	662,955	705,132	6,901	421,550	428,451

Notes to the Financial Statements (continued)

25. Investment in securities

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
(a) Available-for-sale securities				
Debt securities, at fair value				
- Listed in Hong Kong	**3,125,220**	1,402,102	**3,125,220**	1,402,102
- Listed outside Hong Kong	**5,363,706**	4,487,726	**5,363,706**	4,487,726
	8,488,926	5,889,828	**8,488,926**	5,889,828
- Unlisted	**29,815,789**	20,822,258	**23,610,324**	17,635,848
	38,304,715	26,712,086	**32,099,250**	23,525,676
Equity securities, at fair value				
- Unlisted	**56,146**	43,899	**56,146**	43,899
	38,360,861	26,755,985	**32,155,396**	23,569,575
(b) Held-to-maturity securities				
Listed, at amortised cost				
- outside Hong Kong	**-**	121,596	**-**	121,596
Unlisted, at amortised cost	**1,471,526**	1,429,104	**586,825**	448,941
	1,471,526	1,550,700	**586,825**	570,537
(c) Loans and receivables				
Unlisted, at amortised cost	**1,157,262**	1,875,919	**1,157,262**	1,875,919
Total	**40,989,649**	30,182,604	**33,899,483**	26,016,031
Market value of listed held-to-maturity securities	**-**	118,147	**-**	118,147

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

Investment in securities is analysed by type of issuer as follows:

	The Group			
	2012			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Sovereigns	14,408,938	884,701	-	15,293,639
Public sector entities*	506,992	-	-	506,992
Banks and other financial institutions	16,454,503	465,639	-	16,920,142
Corporate entities	6,990,428	121,186	1,157,262	8,268,876
	38,360,861	1,471,526	1,157,262	40,989,649

	The Group			
	2011			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Sovereigns	10,439,564	980,163	-	11,419,727
Public sector entities*	175,915	-	-	175,915
Banks and other financial institutions	11,344,638	330,025	1,875,919	13,550,582
Corporate entities	4,795,868	240,512	-	5,036,380
	26,755,985	1,550,700	1,875,919	30,182,604

* Included available-for-sale securities of HK$506,992,000 (2011: HK$175,915,000) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

	The Bank			
	2012			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Sovereigns	9,953,382	-	-	9,953,382
Public sector entities**	506,992	-	-	506,992
Banks and other financial institutions	16,454,503	465,639	-	16,920,142
Corporate entities	5,240,519	121,186	1,157,262	6,518,967
	32,155,396	586,825	1,157,262	33,899,483

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

	The Bank			
	2011			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Sovereigns	7,990,028	-	-	7,990,028
Public sector entities**	175,915	-	-	175,915
Banks and other financial institutions	11,344,638	330,025	1,875,919	13,550,582
Corporate entities	4,058,994	240,512	-	4,299,506
	23,569,575	570,537	1,875,919	26,016,031

** Included available-for-sale securities of HK$506,992,000 (2011: HK$175,915,000) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

The movements in investment in securities are summarised as follows:

	The Group		
	2012		
	Available-for-sale securities	**Held-to-maturity securities**	**Loans and receivables**
	HK$'000	**HK$'000**	**HK$'000**
At 1 January 2012	**26,755,985**	**1,550,700**	**1,875,919**
Additions	**127,753,821**	**2,086,927**	**1,367,099**
Disposals, redemptions and maturity	**(116,673,519)**	**(2,200,797)**	**(2,143,510)**
Amortisation	**50,460**	**7,575**	**14,195**
Change in fair value	**328,116**	**-**	**-**
Exchange difference	**145,998**	**27,121**	**43,559**
At 31 December 2012	**38,360,861**	**1,471,526**	**1,157,262**

	The Group		
	2011		
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK$'000	HK$'000	HK$'000
At 1 January 2011	23,743,216	2,382,575	1,054,646
Additions	182,365,290	3,281,486	3,405,538
Disposals, redemptions and maturity	(179,542,115)	(4,106,159)	(2,476,506)
Amortisation	21,518	(3,004)	31,489
Change in fair value	3,249	-	-
Net reversal of impairment allowances (Note 10)	-	2,953	-
Exchange difference	164,827	(7,151)	(139,248)
At 31 December 2011	26,755,985	1,550,700	1,875,919

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

	The Bank		
	2012		
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK$'000	HK$'000	HK$'000
At 1 January 2012	23,569,575	570,537	1,875,919
Additions	122,537,850	1,762,996	1,367,099
Disposals, redemptions and maturity	(114,406,071)	(1,765,360)	(2,143,510)
Amortisation	(2,221)	(232)	14,195
Change in fair value	340,360	-	-
Exchange difference	115,903	18,884	43,559
At 31 December 2012	32,155,396	586,825	1,157,262

	The Bank		
	2011		
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK$'000	HK$'000	HK$'000
At 1 January 2011	22,321,695	2,382,575	1,054,646
Additions	179,167,233	1,027,097	3,405,538
Disposals, redemptions and maturity	(177,987,097)	(2,810,311)	(2,476,506)
Amortisation	(13,063)	(24,252)	31,489
Change in fair value	(18,200)	-	-
Net reversal of impairment allowances	-	2,953	-
Exchange difference	99,007	(7,525)	(139,248)
At 31 December 2011	23,569,575	570,537	1,875,919

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

Available-for-sale and held-to-maturity securities are analysed as follows:

	The Group			
	Available-for-sale securities		Held-to-maturity securities	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Treasury bills	**13,385,213**	10,214,915	**884,701**	980,163
Certificates of deposit held	**5,569,963**	1,350,789	**464,743**	225,695
Others	**19,405,685**	15,190,281	**122,082**	344,842
	38,360,861	26,755,985	**1,471,526**	1,550,700

	The Bank			
	Available-for-sale securities		Held-to-maturity Securities	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Treasury bills	**8,929,657**	7,765,378	**-**	-
Certificates of deposit held	**5,569,963**	1,350,789	**464,743**	225,695
Others	**17,655,776**	14,453,408	**122,082**	344,842
	32,155,396	23,569,575	**586,825**	570,537

The movements in impairment allowances on available-for-sale and held-to-maturity securities are summarised as follows:

	The Group and the Bank			
	Available-for-sale securities		Held-to-maturity Securities	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
At 1 January	**-**	-	**-**	3,303
Charged/(credited) to income statement	**-**	725	**-**	(2,953)
Disposals	**-**	(725)	**-**	(350)
At 31 December	**-**	-	**-**	-

Notes to the Financial Statements (continued)

26. Interests in subsidiaries

	The Bank	
	2012	2011
	HK$'000	HK$'000
Unlisted shares, at cost	**8,171,067**	5,222,682

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

Name	Place of incorporation/ operation	Particulars of issued and paid up ordinary share capital	Equity interest held by the Bank Directly	Principal activities
Nanyang Commercial Bank (China), Limited	The People's Republic of China	Registered capital RMB6,500,000,000	100%	Banking business
Nanyang Commercial Bank Trustee Limited *	Hong Kong	300,000 shares of HK$10 each	100%	Trustee services
Kwong Li Nam Investment Agency Limited *	Hong Kong	30,500 shares of HK$100 each	100%	Investment agency
Nanyang Commercial Bank (Nominees) Limited *	Hong Kong	500 shares of HK$100 each	100%	Nominee services

Remarks:

Name of subsidiaries which are not included in the consolidation group for regulatory purposes in respect of capital adequacy is marked with * in the above table. The Bank and its subsidiaries specified by the HKMA form the basis of consolidation for its regulatory purposes in accordance with the Banking (Capital) Rules. For accounting purposes, subsidiaries are consolidated in accordance with the accounting standards issued by the HKICPA pursuant to section 18A of the Professional Accountants Ordinance.

Notes to the Financial Statements (continued)

27. Investment properties

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
At 1 January	**847,948**	618,263	**802,260**	579,940
Additions	**-**	13,105	**-**	13,105
Disposals	**-**	(6,208)	**-**	-
Fair value gains	**178,766**	136,553	**177,410**	135,195
Reclassification from properties, plant and equipment (Note 28)	**-**	84,461	**-**	74,020
Exchange difference	**369**	1,774	**-**	-
At 31 December	**1,027,083**	847,948	**979,670**	802,260

The carrying value of investment properties is analysed based on the remaining terms of the leases as follows:

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Held in Hong Kong				
On long-term lease (over 50 years)	**884,150**	732,050	**884,150**	732,050
On medium-term lease (10 – 50 years)	**95,520**	70,210	**95,520**	70,210
Held outside Hong Kong				
On long-term lease (over 50 years)	**-**	1,728	**-**	-
On medium-term lease (10 – 50 years)	**47,413**	43,960	**-**	-
	1,027,083	847,948	**979,670**	802,260

As at 31 December 2012, investment properties are included in the balance sheets at valuation carried out at 31 December 2012 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited. The fair value represents the estimated amount at which the asset should be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Notes to the Financial Statements (continued)

28. Properties, plant and equipment

	The Group		
	Premises	Equipment, fixtures and fittings	Total
	HK$'000	HK$'000	HK$'000
Net book value at 1 January 2012	**4,231,342**	**352,069**	**4,583,411**
Additions	**306,817**	**122,702**	**429,519**
Disposals	**(5,887)**	**(4,504)**	**(10,391)**
Revaluation	**1,386,559**	**-**	**1,386,559**
Depreciation for the year (Note 11)	**(73,522)**	**(93,417)**	**(166,939)**
Exchange difference	**1,486**	**1,350**	**2,836**
Net book value at 31 December 2012	**5,846,795**	**378,200**	**6,224,995**
At 31 December 2012			
Cost or valuation	**5,846,795**	**764,461**	**6,611,256**
Accumulated depreciation	**-**	**(386,261)**	**(386,261)**
Net book value at 31 December 2012	**5,846,795**	**378,200**	**6,224,995**
Net book value at 1 January 2011	3,196,912	242,468	3,439,380
Additions	21,416	177,135	198,551
Disposals	(67,242)	(13,079)	(80,321)
Revaluation	1,211,838	-	1,211,838
Depreciation for the year (Note 11)	(55,383)	(60,058)	(115,441)
Reclassification to investment properties (Note 27)	(84,461)	-	(84,461)
Exchange difference	8,262	5,603	13,865
Net book value at 31 December 2011	4,231,342	352,069	4,583,411
At 31 December 2011			
Cost or valuation	4,231,342	663,934	4,895,276
Accumulated depreciation	-	(311,865)	(311,865)
Net book value at 31 December 2011	4,231,342	352,069	4,583,411

The analysis of cost or valuation of the above assets is as follows:

	Premises	Equipment, fixtures and fittings	Total
	HK$'000	HK$'000	HK$'000
At 31 December 2012			
At cost	**-**	**764,461**	**764,461**
At valuation	**5,846,795**	**-**	**5,846,795**
	5,846,795	**764,461**	**6,611,256**
At 31 December 2011			
At cost	-	663,934	663,934
At valuation	4,231,342	-	4,231,342
	4,231,342	663,934	4,895,276

Notes to the Financial Statements (continued)

28. Properties, plant and equipment (continued)

	The Bank		
	Premises	Equipment, fixtures and fittings	Total
	HK$'000	HK$'000	HK$'000
Net book value at 1 January 2012	**4,038,737**	**81,513**	**4,120,250**
Additions	**27,031**	**21,368**	**48,399**
Disposals	**-**	**(483)**	**(483)**
Revaluation	**1,379,172**	**-**	**1,379,172**
Depreciation for the year	**(63,035)**	**(23,140)**	**(86,175)**
Exchange difference	**-**	**(2)**	**(2)**
Net book value at 31 December 2012	**5,381,905**	**79,256**	**5,461,161**
At 31 December 2012			
Cost or valuation	**5,381,905**	**266,767**	**5,648,672**
Accumulated depreciation	**-**	**(187,511)**	**(187,511)**
Net book value at 31 December 2012	**5,381,905**	**79,256**	**5,461,161**
Net book value at 1 January 2011	3,015,655	86,355	3,102,010
Additions	14,961	18,791	33,752
Disposals	(67,242)	(13)	(67,255)
Revaluation	1,195,735	-	1,195,735
Depreciation for the year	(46,352)	(23,620)	(69,972)
Reclassification to investment properties (Note 27)	(74,020)	-	(74,020)
Net book value at 31 December 2011	4,038,737	81,513	4,120,250
At 31 December 2011			
Cost or valuation	4,038,737	261,479	4,300,216
Accumulated depreciation	-	(179,966)	(179,966)
Net book value at 31 December 2011	4,038,737	81,513	4,120,250

The analysis of cost or valuation of the above assets is as follows:

	Premises	Equipment, fixtures and fittings	Total
	HK$'000	HK$'000	HK$'000
At 31 December 2012			
At cost	**-**	**266,767**	**266,767**
At valuation	**5,381,905**	**-**	**5,381,905**
	5,381,905	**266,767**	**5,648,672**
At 31 December 2011			
At cost	-	261,479	261,479
At valuation	4,038,737	-	4,038,737
	4,038,737	261,479	4,300,216

Notes to the Financial Statements (continued)

28. Properties, plant and equipment (continued)

The carrying value of premises is analysed based on the remaining terms of the leases as follows:

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Held in Hong Kong				
On long-term lease (over 50 years)	**4,009,054**	2,788,280	**4,009,054**	2,788,280
On medium-term lease (10 – 50 years)	**1,371,270**	1,248,943	**1,371,270**	1,248,943
Held outside Hong Kong				
On long-term lease (over 50 years)	**-**	37,432	**-**	-
On medium-term lease (10 – 50 years)	**446,070**	141,821	**1,581**	1,514
On short-term lease (less than 10 years)	**20,401**	14,866	**-**	-
	5,846,795	4,231,342	**5,381,905**	4,038,737

As at 31 December 2012, premises are included in the balance sheets at valuation carried out at 31 December 2012 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited. The fair value represents the estimated amount at which the asset should be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

As a result of the above-mentioned revaluations, changes in value of the Group's and the Bank's premises were recognised in the Group's and the Bank's premises revaluation reserve and the income statement as follows:

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Increase in valuation credited to premises revaluation reserve	**1,388,296**	1,213,719	**1,379,172**	1,195,288
(Decrease)/increase in valuation (debited)/credited to income statement	**(1,738)**	(1,881)	**-**	447
	1,386,558	1,211,838	**1,379,172**	1,195,735

As at 31 December 2012, the net book value of premises that would have been included in the Group's and Bank's balance sheets had the assets been carried at cost less accumulated depreciation and impairment losses was HK$528,943,000 (2011: HK$226,859,000) and HK$217,003,000 (2011:HK$193,243,000) respectively.

Notes to the Financial Statements (continued)

29. Other assets

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Repossessed assets	**17,792**	942	**16,842**	-
Accounts receivable and prepayments	**1,424,506**	818,535	**1,050,826**	652,284
	1,442,298	819,477	**1,067,668**	652,284

30. Financial liabilities at fair value through profit or loss

	The Group and the Bank	
	2012	2011
	HK$'000	HK$'000
Trading liabilities		
- Short positions in Exchange Fund Bills and Notes	**4,975,073**	1,077,896

As at 31 December 2012, there are no financial liabilities designated at fair value through profit or loss (2011: Nil).

Notes to the Financial Statements (continued)

31. Deposits from customers and hedge accounting

(a) Deposits from customers

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Current, savings and other deposit accounts (per balance sheets)	**185,533,717**	174,469,468	**128,178,500**	124,747,402
Analysed by:				
Demand deposits and current accounts				
- corporate	**14,545,822**	11,847,789	**7,188,715**	6,328,499
- personal	**2,433,335**	1,628,352	**2,111,554**	1,450,028
	16,979,157	13,476,141	**9,300,269**	7,778,527
Savings deposits				
- corporate	**16,078,426**	14,590,706	**14,368,581**	13,158,043
- personal	**33,772,779**	28,599,476	**32,504,466**	27,788,030
	49,851,205	43,190,182	**46,873,047**	40,946,073
Time, call and notice deposits				
- corporate	**58,500,903**	65,148,525	**33,244,808**	40,556,901
- personal	**60,202,452**	52,654,620	**38,760,376**	35,465,901
	118,703,355	117,803,145	**72,005,184**	76,022,802
	185,533,717	174,469,468	**128,178,500**	124,747,402

(b) Hedge accounting

Hedges of net investments in foreign operations

As at 31 December 2012, a proportion of the Group's RMB-denominated deposits from customers of HK$1,390,910,000 (2011: HK$2,073,358,000) are designated as a hedging instrument to hedge against the net investments in foreign operations.

There are no gains or losses on ineffective portion recognised in the income statement during the year (2011: Nil).

32. Other accounts and provisions

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Other accounts payable	**9,937,324**	8,334,637	**2,132,197**	2,711,207
Provisions	**61,661**	62,033	**52,710**	56,269
	9,998,985	8,396,670	**2,184,907**	2,767,476

Notes to the Financial Statements (continued)

33. Assets pledged as security

As at 31 December 2012, liabilities of the Group and the Bank both amounting to HK$4,234,713,000 (2011: HK$872,412,000) were secured by assets deposited with central depositories to facilitate settlement operations. In addition, the liabilities of the Group amounting to HK$348,822,000 (2011: HK$617,973,000) were secured by debt securities. The amount of assets pledged by the Group and the Bank to secure these liabilities was HK$4,643,771,000 (2011: HK$1,495,704,000) and HK$4,239,175,000 (2011: HK$873,977,000) included in "Trading securities" and "Available-for-sale securities".

34. Deferred taxation

Deferred tax is recognised in respect of the temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements in accordance with HKAS 12 "Income Taxes".

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

	The Group					
	2012					
	Accelerated tax depreciation	**Property revaluation**	**Losses**	**Impairment allowances**	**Other temporary differences**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
At 1 January 2012	**18,231**	**674,564**	**-**	**(146,369)**	**(21,747)**	**524,679**
Charged/(credited) to income statement (Note 14)	**4,079**	**3,912**	**(297)**	**(18,532)**	**(678)**	**(11,516)**
Charged to other comprehensive income	**-**	**218,290**	**-**	**-**	**47,000**	**265,290**
Exchange difference	**(2)**	**320**	**-**	**(194)**	**76**	**200**
At 31 December 2012	**22,308**	**897,086**	**(297)**	**(165,095)**	**24,651**	**778,653**

	The Group					
	2011					
	Accelerated tax depreciation	Property revaluation	Losses	Impairment allowances	Other temporary differences	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2011	12,554	495,653	-	(94,197)	6,844	420,854
Charged/(credited) to income statement (Note 14)	5,717	4,594	-	(50,220)	(16,702)	(56,611)
Charged/(credited) to other comprehensive income	-	172,968	-	-	(11,131)	161,837
Exchange difference	(40)	1,349	-	(1,952)	(758)	(1,401)
At 31 December 2011	18,231	674,564	-	(146,369)	(21,747)	524,679

Notes to the Financial Statements (continued)

34. Deferred taxation (continued)

	The Bank				
	2012				
	Accelerated tax depreciation	Property revaluation	Impairment allowances	Other temporary differences	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2012	**18,430**	**625,811**	**(70,503)**	**(1,101)**	**572,637**
Charged/(credited) to income statement	**4,079**	**-**	**(27,126)**	**1,035**	**(22,012)**
Charged to other comprehensive income	**-**	**217,913**	**-**	**50,297**	**268,210**
Exchange difference	**-**	**-**	**(6)**	**-**	**(6)**
At 31 December 2012	**22,509**	**843,724**	**(97,635)**	**50,231**	**818,829**

	The Bank				
	2011				
	Accelerated tax depreciation	Property revaluation	Impairment allowances	Other temporary differences	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2011	13,487	457,065	(55,937)	22,370	436,985
Charged/(credited) to income statement	4,943	(288)	(14,536)	(6,977)	(16,858)
Charged/(credited) to other comprehensive income	-	169,034	-	(16,494)	152,540
Exchange difference	-	-	(30)	-	(30)
At 31 December 2011	18,430	625,811	(70,503)	(1,101)	572,637

Notes to the Financial Statements (continued)

34. Deferred taxation (continued)

Deferred tax assets and liabilities are offset on an individual entity basis when there is a legal right to set off current tax assets against current tax liabilities and when the deferred taxation relates to the same authority. The following amounts, determined after appropriate offsetting, are shown in the balance sheets:

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Deferred tax assets	**(49,727)**	(57,714)	**(662)**	(656)
Deferred tax liabilities	**828,380**	582,393	**819,491**	573,293
	778,653	524,679	**818,829**	572,637

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Deferred tax assets to be recovered after more than twelve months	**(73,889)**	(40,052)	**(662)**	(656)
Deferred tax liabilities to be settled after more than twelve months	**778,149**	583,494	**769,260**	574,394
	704,260	543,442	**768,598**	573,738

As at 31 December 2012, the Group and the Bank have not recognised deferred tax assets in respect of tax losses amounting to HK$4,617,000 (2011: HK$5,314,000) and HK$4,483,000 (2011: HK$5,198,000) which is considered unlikely to be utilised. Of the amount, HK$134,000 (2011: HK$116,000) for the Group and Nil (2011: Nil) for the Bank have no expiry date and HK$4,483,000 (2011: HK$5,198,000) for the Group and the Bank is scheduled to expire within five years.

35. Share capital

	2012	2011
	HK$'000	HK$'000
Authorised:		
7,000,000 ordinary shares of HK$100 each	**700,000**	700,000
Issued and fully paid:		
7,000,000 ordinary shares of HK$100 each	**700,000**	700,000

Notes to the Financial Statements (continued)

36. Reserves

The Group's and the Bank's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity and statement of changes in equity respectively on pages 10 to 11 of the financial statements.

37. Notes to consolidated cash flow statement

(a) Reconciliation of operating profit to operating cash (outflow)/inflow before taxation

	2012	2011
	HK$'000	HK$'000
Operating profit	**2,587,632**	2,804,426
Depreciation	**166,939**	115,441
Net charge of impairment allowances	**396,948**	161,306
Unwind of discount on impairment allowances	**(8,079)**	(1,264)
Advances written off net of recoveries	**3,689**	(13,678)
Change in balances with banks and other financial institutions with original maturity over three months	**(482,176)**	(6,004,508)
Change in placements with banks and other financial institutions with original maturity over three months	**5,102,436**	(13,708,025)
Change in financial assets at fair value through profit or loss	**(2,410,450)**	(420,471)
Change in derivative financial instruments	**(161,185)**	68,663
Change in advances and other accounts	**(5,515,755)**	(8,923,197)
Change in investment in securities	**(14,544,859)**	(722,651)
Change in other assets	**(622,821)**	349,775
Change in deposits and balances from banks and other financial institutions	**(7,804,217)**	9,291,599
Change in financial liabilities at fair value through profit or loss	**3,897,177**	(107,479)
Change in deposits from customers	**11,064,249**	33,132,563
Change in other accounts and provisions	**1,602,315**	2,023,343
Effect of changes in exchange rates	**18,043**	(535,667)
Operating cash (outflow)/inflow before taxation	**(6,710,114)**	17,510,176
Cash flows from operating activities included:		
- Interest received	**7,616,520**	5,003,691
- Interest paid	**(3,506,002)**	(1,853,550)
- Dividend received	**6,940**	6,016

(b) Analysis of the balances of cash and cash equivalents

	2012	2011
	HK$'000	HK$'000
Cash and balances with banks and other financial institutions with original maturity within three months	**28,267,206**	31,955,395
Placements with banks and other financial institutions with original maturity within three months	**2,621,986**	3,380,186
Treasury bills with original maturity within three months	**2,812,021**	6,396,448
	33,701,213	41,732,029

The basis and presentation of the above analyses have been refined and the comparative amounts have been revised accordingly.

Notes to the Financial Statements (continued)

38. Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment and the aggregate credit risk weighted amount:

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Direct credit substitutes	**12,758,884**	7,190,596	**306,569**	319,899
Transaction-related contingencies	**2,614,550**	1,683,929	**502,009**	442,879
Trade-related contingencies	**8,488,076**	8,694,396	**3,408,974**	3,509,150
Commitments that are unconditionally cancellable without prior notice	**57,032,568**	43,938,343	**22,160,355**	26,872,836
Other commitments with an original maturity of				
- up to one year	**2,212,197**	1,486,232	**1,521,088**	1,004,859
- over one year	**4,962,820**	5,078,651	**3,799,617**	3,557,219
	88,069,095	68,072,147	**31,698,612**	35,706,842
Credit risk weighted amount	**14,156,562**	9,276,672	**3,274,903**	3,193,805

The credit risk weighted amount is calculated in accordance with the Banking (Capital) Rules. The amount is dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

39. Capital commitments

The Group and the Bank have the following outstanding capital commitments not provided for in the financial statements:

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Authorised and contracted for but not provided for	**8,688**	12,106	**3,777**	5,179
Authorised but not contracted for	**212**	3,255	**-**	3,255
	8,900	15,361	**3,777**	8,434

The above capital commitments mainly relate to commitments to purchase computer equipment and software, and to renovate the Group's premises.

Notes to the Financial Statements (continued)

40. Operating lease commitments

(a) The Group as lessee

The Group and the Bank have commitments to make the following future minimum lease payments under non-cancellable operating leases:

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Land and buildings				
- not later than one year	**223,950**	177,452	**48,784**	40,356
- later than one year but not later than five years	**653,918**	468,675	**59,874**	39,806
- later than five years	**420,901**	244,365	**9,482**	320
	1,298,769	890,492	**118,140**	80,482
Other commitments				
- not later than one year	**184**	56	**-**	-
- later than one year but not later than five years	**22**	65	**-**	-
	1,298,975	890,613	**118,140**	80,482

(b) The Group as lessor

The Group and the Bank have contracted with tenants for the following future minimum lease receivables under non-cancellable operating leases:

	The Group		The Bank	
	2012	2011	**2012**	2011
	HK$'000	HK$'000	**HK$'000**	HK$'000
Land and buildings				
- not later than one year	**33,100**	39,977	**26,488**	33,418
- later than one year but not later than five years	**25,637**	32,416	**20,133**	19,215
	58,737	72,393	**46,621**	52,633

The Group leases its investment properties (Note 27) under operating lease arrangements, with leases typically for a period from 1 to 3 years. The terms of the leases generally require the tenants to pay security deposits.

In year 2012, total contingent rents was recognised as income for the Group is HK$112,000 (2011: Nil). No contingent rents was recognised as income for the Bank (2011: Nil).

Notes to the Financial Statements (continued)

41. Litigation

The Group is currently being served a number of claims and counterclaims by various independent parties. These claims and counterclaims are in relation to the normal commercial activities of the Group.

No material provision was made against these claims and counterclaims because the directors believe that the Group has meritorious defences against the claimants or the amounts involved in these claims are not expected to be material.

42. Segmental reporting

(a) By operating segment

The Group divides its business into four major segments, Personal Banking, Corporate Banking, Treasury and Investment.

Both Personal Banking business and Corporate Banking business provide general banking services. Personal Banking serves individual customers while Corporate Banking deals with non-individual customers. The Treasury segment is responsible for managing the capital, liquidity, and the interest rate and foreign exchange positions of the Group in addition to proprietary trades. It provides funds to other business segments and receives funds from deposit taking activities of Personal Banking and Corporate Banking. These inter-segment funding is charged according to the internal funds transfer pricing mechanism of the Group. The assets and liabilities of Treasury have not been adjusted to reflect the effect of inter-segment borrowing and lending (i.e. the profit and loss information in relation to Treasury is not comparable to the assets and liabilities information about Treasury).

Investment includes bank premises and equipment used by supporting units. Charges are paid to this segment from other business segments based on market rates per square foot for their occupation of the Group's premises. The exchange difference arising from capital of our subsidiary, Nanyang Commercial Bank (China), Limited, which is recognised in its income statement, is also included in this class.

"Others" refers to other group operations and mainly comprises of items related to the Group as a whole and totally independent of the other four business segments.

Revenues and expenses of any business segment mainly include items directly attributable to the segment. For management overheads, allocations are made on reasonable bases.

Notes to the Financial Statements (continued)

42. Segmental reporting (continued)

(a) By operating segment (continued)

	The Group							
	2012							
	Personal Banking	Corporate Banking	Treasury	Investment	Others	Subtotal	Eliminations	Consolidated
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Net interest income/(expense)								
- external	(784,960)	2,336,718	2,381,051	4	-	3,932,813	-	3,932,813
- inter-segment	1,589,823	(319,320)	(1,270,503)	-	-	-	-	-
	804,863	2,017,398	1,110,548	4	-	3,932,813	-	3,932,813
Net fee and commission income/(expense)	310,863	426,546	20,806	108	(3,144)	755,179	-	755,179
Net trading gain/(loss)	27,573	93,693	62,931	(37,646)	665	147,216	-	147,216
Net gain on financial instruments designated at fair value through profit or loss	-	-	21,959	-	-	21,959	-	21,959
Net gain on other financial assets	-	4,762	11,376	463	-	16,601	-	16,601
Other operating income	2	41	-	143,487	11,311	154,841	(97,732)	57,109
Net operating income before impairment allowances	1,143,301	2,542,440	1,227,620	106,416	8,832	5,028,609	(97,732)	4,930,877
Net charge of impairment allowances	(7,958)	(388,990)	-	-	-	(396,948)	-	(396,948)
Net operating income	1,135,343	2,153,450	1,227,620	106,416	8,832	4,631,661	(97,732)	4,533,929
Operating expenses	(637,703)	(903,926)	(392,859)	(75,125)	(34,416)	(2,044,029)	97,732	(1,946,297)
Operating profit/(loss)	497,640	1,249,524	834,761	31,291	(25,584)	2,587,632	-	2,587,632
Net gain from disposal of/fair value adjustments on investment properties	-	-	-	178,766	-	178,766	-	178,766
Net loss from disposal/ revaluation of properties, plant and equipment	-	-	-	(6,627)	-	(6,627)	-	(6,627)
Profit/(loss) before taxation	497,640	1,249,524	834,761	203,430	(25,584)	2,759,771	-	2,759,771
Assets								
Segment assets	23,673,053	116,089,179	104,531,029	7,329,689	130,488	251,753,438	-	251,753,438
Liabilities								
Segment liabilities	98,868,912	96,141,906	25,747,324	6,813	1,375,262	222,140,217	-	222,140,217
Other information								
Capital expenditure	-	-	-	429,519	-	429,519	-	429,519
Depreciation	25,037	40,495	24,059	73,522	3,826	166,939	-	166,939
Amortisation of securities	-	-	72,230	-	-	72,230	-	72,230

Notes to the Financial Statements (continued)

42. Segmental reporting (continued)

(a) By operating segment (continued)

	The Group							
	2011							
	Personal Banking HK$'000	Corporate Banking HK$'000	Treasury HK$'000	Investment HK$'000	Others HK$'000	Subtotal HK$'000	Eliminations HK$'000	Consolidated HK$'000
Net interest income/(expense)								
- external	(274,306)	1,837,500	1,721,507	4	36	3,284,741	-	3,284,741
- inter-segment	760,116	(82,130)	(677,986)	-	-	-	-	-
	485,810	1,755,370	1,043,521	4	36	3,284,741	-	3,284,741
Net fee and commission income/(expense)	315,659	453,130	22,490	1,422	(2,515)	790,186	-	790,186
Net trading gain/(loss)	48,286	79,419	(10,484)	(37,174)	302	80,349	-	80,349
Net loss on financial instruments designated at fair value through profit or loss	-	-	(4,561)	-	-	(4,561)	-	(4,561)
Net (loss)/gain on other financial assets	(277)	498	53,559	-	-	53,780	-	53,780
Other operating income	2,837	935	4	122,394	11,868	138,038	(91,964)	46,074
Net operating income before impairment allowances	852,315	2,289,352	1,104,529	86,646	9,691	4,342,533	(91,964)	4,250,569
Net (charge)/reversal of impairment allowances	(33,288)	(130,246)	2,228	-	-	(161,306)	-	(161,306)
Net operating income	819,027	2,159,106	1,106,757	86,646	9,691	4,181,227	(91,964)	4,089,263
Operating expenses	(606,129)	(851,873)	(270,882)	(57,467)	409,550	(1,376,801)	91,964	(1,284,837)
Operating profit	212,898	1,307,233	835,875	29,179	419,241	2,804,426	-	2,804,426
Net gain from disposal of/fair value adjustments on investment properties	-	-	-	136,237	-	136,237	-	136,237
Net gain/(loss) from disposal/ revaluation of properties, plant and equipment	-	24	-	(14,492)	-	(14,468)	-	(14,468)
Profit before taxation	212,898	1,307,257	835,875	150,924	419,241	2,926,195	-	2,926,195
Assets								
Segment assets	22,429,651	112,100,397	99,468,390	5,498,528	134,490	239,631,456	-	239,631,456
Liabilities								
Segment liabilities	85,905,585	96,627,683	29,648,616	5,741	1,307,635	213,495,260	-	213,495,260
Other information								
Capital expenditure	-	-	-	211,656	-	211,656	-	211,656
Depreciation	17,150	26,482	12,359	54,649	4,801	115,441	-	115,441
Amortisation of securities	-	-	50,003	-	-	50,003	-	50,003

Notes to the Financial Statements (continued)

42. Segmental reporting (continued)

(a) By operating segment (continued)

	The Bank							
	2012							
	Personal Banking HK$'000	Corporate Banking HK$'000	Treasury HK$'000	Investment HK$'000	Others HK$'000	Subtotal HK$'000	Eliminations HK$'000	Consolidated HK$'000
Net interest income/(expense)								
- external	(208,250)	1,611,789	1,228,375	-	-	2,631,914	-	2,631,914
- inter-segment	728,065	(346,646)	(381,419)	-	-	-	-	-
	519,815	1,265,143	846,956	-	-	2,631,914	-	2,631,914
Net fee and commission income/(expense)	308,506	324,958	(3,959)	-	(3,144)	626,361	-	626,361
Net trading gain/(loss)	22,403	64,552	(17,980)	23	665	69,663	-	69,663
Net gain on financial instruments designated at fair value through profit or loss	-	-	21,959	-	-	21,959	-	21,959
Net gain on other financial assets	-	-	10,431	463	-	10,894	-	10,894
Other operating income	2	41	-	142,224	668	142,935	(97,732)	45,203
Net operating income before impairment allowances	850,726	1,654,694	857,407	142,710	(1,811)	3,503,726	(97,732)	3,405,994
Net reversal/(charge) of impairment allowances	2,881	(217,259)	-	-	-	(214,378)	-	(214,378)
Net operating income	853,607	1,437,435	857,407	142,710	(1,811)	3,289,348	(97,732)	3,191,616
Operating expenses	(464,281)	(376,984)	(66,388)	(63,035)	(34,417)	(1,005,105)	97,732	(907,373)
Operating profit/(loss)	389,326	1,060,451	791,019	79,675	(36,228)	2,284,243	-	2,284,243
Net gain from disposal of/fair value adjustments on investment properties	-	-	-	177,410	-	177,410	-	177,410
Net loss from disposal/ revaluation of properties, plant and equipment	-	-	-	(78)	-	(78)	-	(78)
Profit/(loss) before taxation	389,326	1,060,451	791,019	257,007	(36,228)	2,461,575	-	2,461,575
Assets								
Segment assets	17,076,378	74,273,858	62,575,473	14,668,294	16,522	168,610,525	-	168,610,525
Liabilities								
Segment liabilities	75,385,669	54,988,673	9,320,769	6,179	1,074,259	140,775,549	-	140,775,549
Other information								
Capital expenditure	-	-	-	48,399	-	48,399	-	48,399
Depreciation	11,232	6,704	1,378	63,035	3,826	86,175	-	86,175
Amortisation of securities	-	-	11,742	-	-	11,742	-	11,742

Notes to the Financial Statements (continued)

42. Segmental reporting (continued)

(a) By operating segment (continued)

	The Bank							
	2011							
	Personal Banking HK$'000	Corporate Banking HK$'000	Treasury HK$'000	Investment HK$'000	Others HK$'000	Subtotal HK$'000	Eliminations HK$'000	Consolidated HK$'000
Net interest income/(expense)								
- external	(53,414)	1,182,910	1,013,413	-	36	2,142,945	-	2,142,945
- inter-segment	387,731	(28,945)	(358,786)	-	-	-	-	-
	334,317	1,153,965	654,627	-	36	2,142,945	-	2,142,945
Net fee and commission income/(expense)	311,060	366,902	(3,469)	-	(2,515)	671,978	-	671,978
Net trading gain/(loss)	45,690	61,599	(40,611)	47	302	67,027	-	67,027
Net loss on financial instruments designated at fair value through profit or loss	-	-	(4,561)	-	-	(4,561)	-	(4,561)
Net (loss)/gain on other financial assets	(277)	-	53,559	-	-	53,282	-	53,282
Other operating income	1	78	4	120,253	8,819	129,155	(91,964)	37,191
Net operating income before impairment allowances	690,791	1,582,544	659,549	120,300	6,642	3,059,826	(91,964)	2,967,862
Net reversal/(charge) of impairment allowances	529	(91,274)	2,228	-	-	(88,517)	-	(88,517)
Net operating income	691,320	1,491,270	661,777	120,300	6,642	2,971,309	(91,964)	2,879,345
Operating expenses	(476,635)	(376,049)	(18,327)	(46,352)	410,179	(507,184)	91,964	(415,220)
Operating profit	214,685	1,115,221	643,450	73,948	416,821	2,464,125	-	2,464,125
Net gain from disposal of/fair value adjustments on investment properties	-	-	-	135,195	-	135,195	-	135,195
Net gain from disposal/ revaluation of properties, plant and equipment	-	24	-	800	-	824	-	824
Profit before taxation	214,685	1,115,245	643,450	209,943	416,821	2,600,144	-	2,600,144
Assets								
Segment assets	17,689,047	78,851,759	57,424,489	10,189,232	16,387	164,170,914	-	164,170,914
Liabilities								
Segment liabilities	67,271,814	60,222,651	10,965,474	5,001	991,441	139,456,381	-	139,456,381
Other information								
Capital expenditure	-	-	-	46,857	-	46,857	-	46,857
Depreciation	11,596	5,875	1,375	46,353	4,773	69,972	-	69,972
Amortisation of securities	-	-	(5,826)	-	-	(5,826)	-	(5,826)

Notes to the Financial Statements (continued)

42. Segmental reporting (continued)

(b) By geographical area

The following information is presented based on the principal places of operations of the subsidiaries, or in the case of the Bank, on the locations of the branches responsible for reporting the results or booking the assets:

	The Group			
	2012		2011	
	Net operating income before impairment allowance	**Profit before taxation**	Net operating income before impairment allowance	Profit before taxation
	HK$'000	**HK$'000**	HK$'000	HK$'000
Hong Kong	**3,367,514**	**2,445,061**	2,948,054	2,596,262
Mainland China	**1,525,417**	**300,124**	1,277,528	323,544
Others	**37,946**	**14,586**	24,987	6,389
Total	**4,930,877**	**2,759,771**	4,250,569	2,926,195

	The Group			
	2012			
	Total assets	**Total liabilities**	**Non-current assets**	**Contingent liabilities and commitments**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Hong Kong	**156,910,130**	**139,227,486**	**6,436,888**	**31,329,350**
Mainland China	**93,205,859**	**82,827,479**	**811,262**	**56,538,445**
Others	**1,637,449**	**85,252**	**4,276**	**201,300**
Total	**251,753,438**	**222,140,217**	**7,252,426**	**88,069,095**

	The Group			
	2011			
	Total assets	Total liabilities	Non-current assets	Contingent liabilities and commitments
	HK$'000	HK$'000	HK$'000	HK$'000
Hong Kong	152,179,720	135,290,810	4,921,445	34,853,375
Mainland China	85,846,677	76,703,039	509,695	33,057,759
Others	1,605,059	1,501,411	1,065	161,013
Total	239,631,456	213,495,260	5,432,205	68,072,147

Notes to the Financial Statements (continued)

42. Segmental reporting (continued)

(b) By geographical area (continued)

	The Bank			
	2012		2011	
	Net operating income before impairment allowance	**Profit before taxation**	Net operating income before impairment allowance	Profit before taxation
	HK$'000	**HK$'000**	HK$'000	HK$'000
Hong Kong	**3,367,411**	**2,446,562**	2,947,940	2,598,966
Mainland China	**637**	**428**	(5,065)	(5,211)
Others	**37,946**	**14,585**	24,987	6,389
Total	**3,405,994**	**2,461,575**	2,967,862	2,600,144

	The Bank			
	2012			
	Total assets	**Total liabilities**	**Non-current assets**	**Contingent liabilities and commitments**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Hong Kong	**165,444,466**	**139,328,070**	**6,436,888**	**31,422,083**
Mainland China	**1,528,610**	**1,362,227**	**-**	**75,229**
Others	**1,637,449**	**85,252**	**4,276**	**201,300**
Total	**168,610,525**	**140,775,549**	**6,441,164**	**31,698,612**

	The Bank			
	2011			
	Total assets	Total liabilities	Non-current assets	Contingent liabilities and commitments
	HK$'000	HK$'000	HK$'000	HK$'000
Hong Kong	159,876,420	135,431,198	4,921,445	34,934,712
Mainland China	2,689,435	2,523,772	-	611,117
Others	1,605,059	1,501,411	1,065	161,013
Total	164,170,914	139,456,381	4,922,510	35,706,842

Notes to the Financial Statements (continued)

43. Loans to directors and officers

Particulars of advances made to directors and officers of the Bank pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

	2012	2011
	HK$'000	HK$'000
Aggregate amount of relevant transactions outstanding at year end	-	30
Maximum aggregate amount of relevant transactions outstanding during the year	30	59

44. Significant related party transactions

The Group is subject to the control of the State Council of the PRC Government through China Investment Corporation ("CIC"), its wholly-owned subsidiary Central Huijin Investment Ltd. ("Central Huijin"), BOC and BOCHK in which Central Huijin has controlling equity interests.

(a) Transactions with the parent companies and the other companies controlled by the parent companies

General information of the parent companies:

The Group is controlled by BOCHK. Central Huijin is the controlling entity of BOCHK, and it is a wholly-owned subsidiary of CIC which is a wholly state-owned company engaging in foreign currency investment management.

Central Huijin has controlling equity interests in certain other entities in the PRC.

The Group enters into banking and other transactions with these entities in the normal course of business which include loans, investment securities and money market transactions.

Notes to the Financial Statements (continued)

44. Significant related party transactions (continued)

(b) Transactions with government authorities, agencies, affiliates and other state controlled entities

The Group is subject to the control of the State Council of the PRC Government through CIC and Central Huijin, which also directly and indirectly controls a significant number of entities through its government authorities, agencies, affiliates and other state controlled entities. The Group enters into banking transactions with government authorities, agencies, affiliates and other state controlled entities in the normal course of business at commercial terms.

These transactions include, but are not limited to, the following:

- lending, provision of credits and guarantees, and deposit taking;
- inter-bank balance taking and placing;
- sales, purchase, underwriting and redemption of bonds issued by other state controlled entities;
- rendering of foreign exchange, remittance and investment related services;
- provision of fiduciary activities; and
- purchase of utilities, transport, telecommunication and postage services.

Notes to the Financial Statements (continued)

44. Significant related party transactions (continued)

(c) Summary of transactions entered into during the ordinary course of business with other related parties

The aggregate income/expenses and balances arising from related party transactions with other related parties of the Group are summarised as follows:

	2012	2011
	Other related parties	Other related parties
	HK$'000	HK$'000
Income statement items:		
Interest income	**9,672**	7,701
Interest expense	**(85,450)**	(62,493)
Insurance premium paid/insurance commission received (net)	**6,083**	6,420
Administrative services fees paid/payable	**(16,641)**	(15,433)
Rental fees received/receivable	**19,842**	18,178
Securities brokerage commission paid/payable (net)	**(14,321)**	(19,583)
Rental paid/payable	**(295)**	(295)
Funds selling commission received	**7,215**	7,409
Other expense	**(11,747)**	(3,121)
Other commission income	**3,782**	3,648
Other fees and commission expense	**(4,628)**	(2,879)
Dividend income	**5,215**	4,504
Net trading gains	**(171)**	(278)
Balance sheet items:		
Cash and balances with banks and other financial institutions	**1,717**	282,778
Derivative financial instruments assets	**-**	1,348
Advances and other accounts	**-**	1,346,438
Investment in securities	**53,472**	41,490
Other assets	**112,349**	45,034
Deposits and balances of banks and other financial institutions	**(10,715)**	(792,681)
Deposits from customers	**(8,218,014)**	(7,776,861)
Other accounts and provisions	**(800)**	(80,834)
Derivative financial instruments liabilities	**(53)**	-

(d) Key management personnel

Key management are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including directors and senior management. The Group accepts deposits from and grants loans and credit facilities to key management personnel in the ordinary course of business. During both the current and prior years, no material transaction was conducted with key management personnel of the Bank, its holding companies and parties related to them.

The key management compensation for the year ended 31 December is detailed as follows:

	2012	2011
	HK$'000	HK$'000
Salaries and other short-term employee benefits	**31,079**	30,435
Post-employment benefits	**1,597**	1,625
	32,676	32,060

(e) Balances with subsidiaries

As at 31 December 2012, the aggregate sums of amounts due from subsidiaries and amounts due to subsidiaries of the Bank arising from transactions entered into during the normal course of business at commercial terms are HK$470,919,000 (2011: HK$2,591,868,000) and HK$112,555,000 (2011: HK$157,243,000) respectively.

Notes to the Financial Statements (continued)

45. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions and is prepared with reference to the Completion Instructions for the prudential return "Foreign Currency Position of an Authorized Institution" issued by the HKMA.

	2012			
	Equivalent in thousand of HK$			
	US Dollars	**Renminbi**	**Other foreign currencies**	**Total foreign currencies**
Spot assets	**44,970,705**	**92,007,219**	**11,863,812**	**148,841,736**
Spot liabilities	**(40,978,415)**	**(86,860,201)**	**(10,193,513)**	**(138,032,129)**
Forward purchases	**19,309,220**	**13,322,971**	**5,522,921**	**38,155,112**
Forward sales	**(21,527,013)**	**(18,970,467)**	**(7,093,398)**	**(47,590,878)**
Net long/(short) position	**1,774,497**	**(500,478)**	**99,822**	**1,373,841**
Net structural position	**321,028**	**7,885,528**	**-**	**8,206,556**

	2011			
	Equivalent in thousand of HK$			
	US Dollars	Renminbi	Other foreign currencies	Total foreign currencies
Spot assets	52,900,757	84,893,540	8,772,053	146,566,350
Spot liabilities	(44,991,277)	(81,818,133)	(10,331,691)	(137,141,101)
Forward purchases	17,708,212	17,690,399	6,192,677	41,591,288
Forward sales	(24,785,848)	(20,970,120)	(4,637,216)	(50,393,184)
Net long/(short) position	831,844	(204,314)	(4,177)	623,353
Net structural position	315,414	4,712,402	-	5,027,816

Notes to the Financial Statements (continued)

46. Cross-border claims

The information on cross-border claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty, or if the claims are on an overseas branch of a bank whose head office is located in another country. Only regions constituting 10% or more of the aggregate cross-border claims are analysed by geographical areas and disclosed as follows:

	2012			
	Banks	**Public sector entities***	**Others**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Asia, other than Hong Kong				
- Mainland China	**26,367,246**	**559,646**	**29,262,032**	**56,188,924**
- Others	**11,466,066**	**1,468,168**	**1,307,642**	**14,241,876**
	37,833,312	**2,027,814**	**30,569,674**	**70,430,800**

	2011			
	Banks	Public sector entities*	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Asia, other than Hong Kong				
- Mainland China	32,081,508	309,716	31,847,007	64,238,231
- Others	8,475,580	-	3,011,115	11,486,695
	40,557,088	309,716	34,858,122	75,724,926

* None of corss-border claims on Asia, other than Hong Kong is eligible to be classified as public sector entities under the Banking (Capital) Rules. (2011: Nil)

Notes to the Financial Statements (continued)

47. Non-bank Mainland China exposures

The analysis of non-bank Mainland China exposures is based on the categories of non-bank counterparties and the type of direct exposures with reference to the HKMA return for non-bank Mainland China exposures, which includes the Mainland China exposures extended by the Bank and its subsidiary in Mainland China.

	2012			
	On-balance sheet exposure	**Off-balance sheet exposure**	**Total exposure**	**Individually assessed impairment allowances**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Mainland China entities	**28,859,693**	**1,393,186**	**30,252,879**	**-**
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	**4,022,501**	**2,238,762**	**6,261,263**	**486**
Other non-bank Mainland China exposures	**7,054,825**	**153,127**	**7,207,952**	**22,108**
	39,937,019	**3,785,075**	**43,722,094**	**22,594**
Exposures incurred by the Bank's mainland subsidiary	**52,903,227**	**21,938,024**	**74,841,251**	**162,149**

	2011			
	On-balance sheet exposure	Off-balance sheet exposure	Total exposure	Individually assessed impairment allowances
	HK$'000	HK$'000	HK$'000	HK$'000
Mainland China entities	25,002,607	2,922,553	27,925,160	-
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	3,604,449	934,627	4,539,076	2,414
Other non-bank Mainland China exposures	9,386,122	432,238	9,818,360	1,843
	37,993,178	4,289,418	42,282,596	4,257
Exposures incurred by the Bank's mainland subsidiary	39,466,478	15,136,892	54,603,370	75,963

During the year, the basis of the above analyses has been refined and the comparative amounts have been reclassified accordingly.

48. Ultimate holding company

The Group is subject to the control of the State Council of the PRC Government through CIC, its wholly-owned subsidiary Central Huijin, BOC and BOCHK in which Central Huijin has controlling equity interests.

49. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 18 March 2013.

Unaudited Supplementary Financial Information

1. Capital charge for credit, market and operational risks

The bases of regulatory capital calculation for credit risk, market risk and operational risk are described in Note 4.4 to the Financial Statements.

As a result of the change in the bases of regulatory capital calculation, the amounts shown below are not directly comparable.

The financial information contained in these supplementary notes has been prepared on a consolidated basis that comprises the positions of the Bank and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules. Subsidiaries that are not included in the consolidation for regulatory purposes in respect of calculation of capital adequacy ratio are denoted in Note 26 to the Financial Statements on page 140.

The table below summarises the capital requirements and capital charge calculated by applying 8% on the risk-weighted amounts, computed on the same consolidation basis for credit, market, and operational risks.

	2012	2011
	HK$'000	HK$'000
Credit risk	**11,494,335**	9,328,152
Market risk	**53,509**	391,676
Operational risk	**658,454**	585,678
	12,206,298	10,305,506

For detail of capital management and capital adequacy ratio of the Group, please refer to Note 4.4 to the Financial Statements.

Unaudited Supplementary Financial Information (continued)

2. Capital requirements for credit risk

The table below shows the capital requirements for credit risk for each class and subclass of exposures as specified in the Banking (Capital) Rules.

	2012	2011
	HK$'000	HK$'000
Capital required for exposures under the IRB approach		
Corporate		
Specialised lending under supervisory slotting criteria approach		
- Project finance	**114,846**	159,943
Small-and-medium sized corporate	**997,910**	807,922
Other corporates	**6,849,776**	4,848,716
Bank		
Banks	**1,867,574**	2,485,253
Securities firms	**-**	-
Retail		
Residential mortgages		
- Individuals	**42,467**	50,979
- Property-holding shell companies	**5,190**	5,602
Qualifying revolving retail	**-**	-
Small business retail	**29,100**	30,892
Other retail to individuals	**84,296**	50,837
Others		
Cash items	**-**	-
Other items	**628,756**	472,174
Securitisation	**-**	51
Total capital requirements for exposures under the IRB approach	**10,619,915**	8,912,369
Capital required for exposures under the standardised (credit risk) approach		
On-balance sheet exposures		
Sovereigns	**30,366**	4,855
Public sector entities	**4,958**	665
Multilateral development banks	**-**	-
Banks	**1,762**	1,545
Securities firms	**-**	-
Corporate	**536,152**	179,958
Regulatory retail	**27,531**	15,528
Residential mortgage loans	**230,177**	172,880
Other exposures which are not past due	**17,759**	10,306
Past due exposures	**1,611**	1,074
Off-balance sheet exposures		
Off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts	**23,478**	28,727
OTC derivative transactions	**626**	245
Securitisation	**-**	-
Total capital requirements for exposures under the standardised (credit risk) approach	**874,420**	415,783
Total capital requirements for credit risk exposures	**11,494,335**	9,328,152

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach

3.1 The internal rating systems and risk components

The Group adopts the foundation internal ratings-based (“FIRB”) approach to calculate the regulatory capital requirements for most of the corporate and bank exposures, and adopts the supervisory slotting criteria approach to project finance exposures under "specialised lending". The Group adopts retail IRB approach for retail exposures to individuals and small business. The following is the table showing the Group’s different capital calculation approaches to each asset class and sub-class of exposures.

<table>
<tr><th>Asset class</th><th>Exposure sub-class</th><th>Capital calculation approach</th></tr>
<tr><td rowspan="3">Corporate exposures</td><td>Specialised lending under supervisory slotting criteria approach (project finance)</td><td>Supervisory Slotting Criteria Approach</td></tr>
<tr><td>Small-and-medium sized corporates</td><td>FIRB Approach</td></tr>
<tr><td>Other corporates</td><td>FIRB Approach</td></tr>
<tr><td rowspan="3">Sovereign exposures</td><td>Sovereigns</td><td rowspan="3">Standardised (credit risk) Approach</td></tr>
<tr><td>Sovereign foreign public sector entities</td></tr>
<tr><td>Multilateral development banks</td></tr>
<tr><td rowspan="3">Bank exposures</td><td>Banks</td><td>FIRB Approach</td></tr>
<tr><td>Securities firms</td><td>FIRB Approach</td></tr>
<tr><td>Public sector entities (excluding sovereign foreign public sectors entities)</td><td>Standardised (credit risk) Approach</td></tr>
<tr><td rowspan="5">Retail exposures</td><td>Residential mortgages to individuals</td><td rowspan="5">Retail IRB Approach</td></tr>
<tr><td>Residential mortgages to property-holding shell companies</td></tr>
<tr><td>Qualifying revolving retail</td></tr>
<tr><td>Small business retail</td></tr>
<tr><td>Other retail to individuals</td></tr>
<tr><td>Equity exposures</td><td></td><td>Standardised (credit risk) Approach</td></tr>
<tr><td rowspan="2">Other exposures</td><td>Cash items</td><td rowspan="2">Specific Risk-weight Approach</td></tr>
<tr><td>Other items</td></tr>
</table>

(A) The structure of internal rating systems and the relationship between internal ratings and external ratings

The Group’s internal rating system is a two dimensional rating system that provides separate assessment of borrower and transaction characteristics. For corporate and bank portfolios, the obligor rating dimension reflects exclusively the risk of borrower default and the facility rating dimension reflects transaction specific factors that affect the loss severity in the case of borrower default.

The Group uses statistical models to provide own estimated probability of default (“PD”) for its corporate, bank and all retail borrowers and loss given default (“LGD”) and exposure at default (“EAD”) for retail exposures under Retail IRB Approach.

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Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.1 The internal rating systems and risk components (continued)

(A) The structure of internal rating systems and the relationship between internal ratings and external ratings (continued)

The Group uses internal rating system to assess the borrower's likelihood of default for all IRB portfolios. PD estimates the risk of borrower default over a one-year period. A borrower credit grade means a grouping of similar credit-worthiness to which borrowers are assigned on the basis of specified and distinct set of rating criteria, from which of the mid-point PD are derived for RWA calculation.

In the process of obligor rating assignment, variables of latest financial performance, management quality, industry risks and group connection of each obligor are assessed as critical factors to predict borrower's ability and willingness to meet with the contractual obligations under different economic conditions.

The borrowers for corporate and bank, and retail PD pools are assigned into eight broad obligor ratings including seven grades for non-defaulted obligors with sub-divisions in to 26 minor credit grades and one for defaulted obligors.. In the supervisory slotting criteria approach for the project finance exposures, there are four grades for non-defaulted borrowers and one for default borrowers in accordance with the HKMA guidance. The estimates for retail IRB portfolios are pooled by nature of obligors, facility types, collateral types and delinquency status in to PD, EAD and LGD pools. This pooling process provides the basis of accurate and consistent estimation for PD, LGD and EAD at the pool level for exposures arising from residential mortgages to both individuals and property-holding shell companies, qualifying revolving retail exposures and other retail exposures to individuals and small business retail exposures. All credit transactions for corporates and banks are assigned facility ratings (in terms of LGD) in accordance with the HKMA guidance. LGD estimates multiplied by the PD estimates produce the expected loss (EL) estimates, which are used to assess credit risk quantitatively.

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.1 The internal rating systems and risk components (continued)

(A) The structure of internal rating systems and the relationship between internal ratings and external ratings (continued)

For each internal rating, the equivalent external rating in terms of default risk is as below.

Internal Credit Grades	Definition of Internal Ratings	Standard & Poor's Equivalent
1	The obligors in grades "1" and "2" have extremely low default risk.	AAA
2	The obligor's capacity to meet its financial commitment on the obligation is extremely strong.	AA+
		AA
		AA-
3	The obligors in grade "3" have low default risk but are somewhat susceptible to the adverse effects of changes in circumstances and economic conditions. However, the obligor's capacity to meet its financial commitment on the obligation is very strong.	A+
		A
		A-
4	The obligors in grade "4" have relatively low default risk and are currently under adequate protection. However, adverse economic conditions or changing circumstances are likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.	BBB+
		BBB
		BBB-
5	The obligors in grade "5" have medium default risk which are less vulnerable to nonpayment than other speculative obligors. However, they face major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.	BB+
		BB
		BB-
6	The obligors in grade "6" have high default risk and are vulnerable to nonpayment. The obligors currently have the capacity to meet its financial commitment on the obligation but adverse business, financial, or economic conditions will very likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.	B+
		B
		B-
7	The obligors in grade "7" have very high default risk and are currently quite vulnerable to nonpayment. The obligors' ability to meet their financial commitment and obligation are dependent upon favorable business, financial, and economic conditions. In the event of adverse business, financial, or economic conditions, these obligors are not likely to have the capacity to meet its financial commitment on the obligation.	CCC
		CC
		C
8	Obligors rated "8" are in payment default.	D

.(B) Use of internal estimates

Besides using PD estimates for regulator capital calculation in corporate and bank exposures, the Group further uses PD estimates for sovereign exposures, together with the LGD and EAD estimates for corporate, bank and sovereign exposures developed in 2011 for the purpose of enhancing the use of internal rating estimates. From 2012 onwards, each of corporate, bank and sovereign exposures is estimated by individual LGD and EAD based on the nature of the facility type, collateral types. The estimates of risk components derived from internal rating systems have been used in credit approval, credit monitoring, reporting and analysis of credit risk information, etc.

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.1 The internal rating systems and risk components (continued)

(C) Process of managing and recognising credit risk mitigation

For those collaterals recognised under capital management, the Group has well-defined policies and procedures for collateral valuation and management which are compliant with the operational requirements for recognised collateral for credit risk mitigation as stated in the Banking (Capital) Rules.

For credit exposures adopting FIRB approach for capital calculation purpose, the recognised eligible guarantees include the guarantees provided by banks and securities firms with a lower risk weights than the counterparty, and corporates with internal credit ratings which are equivalent to external credit rating A- or above. The Group takes into account the credit risk mitigation effect of recognised collaterals through its determination of the net credit exposures and the effective LGD.

For retail IRB approach, the effect of the credit risk mitigation is incorporated into the internal risk parameters of PD or LGD depending on the nature of the guarantees and collaterals for calculating the risk exposures.

The credit and market risk concentrations within the credit risk mitigation (recognised collateral and guarantees for capital calculation) used by the Group are under a low level.

Up to the date of report, for capital calculation, the Group has not used any recognised credit derivative contracts, on- or off-balance sheet recognised netting for credit risk mitigation yet.

(D) The control mechanisms used for internal rating systems

The Group has established a comprehensive control mechanism to ensure the integrity, accuracy and consistency of the rating systems including the processes for using the risk components in the day-to-day business to assess credit risk.

All of IRB risk models are approved by the Credit and Loans Management Committee (“CLMC”) and Risk Management Committee (“RMC”) of the Board.

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.1 The internal rating systems and risk components (continued)

(D) The control mechanisms used for rating systems (continued)

In order to achieve reasonably accurate risk ratings assignment, the Group has established a rating approval process which is independent of the sales and marketing units. Since internal rating is one of the key inputs to credit decision making, a control mechanism is in place to ensure the integrity, accuracy and consistency of the rating assignment. For the wholesale (corporate and bank) portfolio, internal ratings are normally approved by credit officers who are functionally separated from the sales and marketing units. In some cases where the transactions are in small amount and of very low risk, the credit ratings can be assigned and approved by staff within the sales and marketing units, subject to post-approval review of ratings by credit risk management unit.

The rating assignment and risk quantification process of retail portfolio are highly automated. As an integral part of the daily credit assessment process, the accuracy and completeness of the data input for automatic rating assignment are verified by units independent from business development function.

The obligor rating assignment is reviewed at least annually as required by the Group's credit risk policy. When credit events occur to the obligor, rating review is triggered promptly in accordance with the Group's credit risk policy.

Rating override is designed to allow the credit analyst to include any other relevant credit information that has not yet been captured in the rating process. For reasons of conservatism and prudential considerations, overrides are unlimited in terms to downgrades but more restricted for better grades (upgrades). All upgrades will be limited to a maximum of two sub-grades supported by a very narrowly pre-defined list of appropriate reasons. All overrides need to be signed off by a higher level of credit approval authority. The internal rating policy sets a trigger point of 10% overrides on rating cases. The use of overrides and override reasons are analysed as part of rating system performance review on IRB rating models.

The performance of internal rating system is put under ongoing periodic monitoring. The senior management periodically reviews the performance and predictive ability of the internal rating system. The effectiveness of the internal rating system and processes are reviewed by independent control functions. The model maintenance unit conducts assessment on the discriminatory power, accuracy and stability of the rating system while the validation unit performs comprehensive review of the internal rating system. Internal audit reviews the internal rating system and the operations of the related credit risk control units. The results of the review are reported to the Board and senior management regularly.

A model validation team which is independent from the model development unit and rating assignment units, conducts periodic model validations using both qualitative and quantitative analysis. Model acceptance standards are established to ensure the discriminatory power, accuracy and stability of the rating systems meet regulator and management requirements. Reviews of a rating model will be triggered if the performance of the model deteriorates materially against pre-determined tolerant limits.

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.1 The internal rating systems and risk components (continued)

(E) Approach for determining provisions

The approach in determining provisions is in line with the Group's accounting policies. For details, please refer to Note 2.14 "Impairment of financial assets" to the Financial Statements.

3.2 Exposures by IRB calculation approach

The tables below show the Group's exposures other than securitisation exposures (including the EAD of on-balance sheet exposures and off-balance sheet exposures) by each IRB calculation approach:

	2012				
	Foundation IRB Approach	**Supervisory Slotting Criteria Approach**	**Retail IRB Approach**	**Specific Risk-weight Approach**	**Total exposures**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Corporate	**122,948,622**	**1,390,972**	**-**	**-**	**124,339,594**
Bank	**72,331,164**	**-**	**-**	**-**	**72,331,164**
Retail					
Residential mortgages to individuals and property-holding shell companies	**-**	**-**	**12,662,501**	**-**	**12,662,501**
Qualifying revolving retail	**-**	**-**	**-**	**-**	**-**
Other retail to individuals and small business retail	**-**	**-**	**7,757,612**	**-**	**7,757,612**
Others	**-**	**-**	**-**	**8,065,560**	**8,065,560**
Total	**195,279,786**	**1,390,972**	**20,420,113**	**8,065,560**	**225,156,431**

	2011				
	Foundation IRB Approach	Supervisory Slotting Criteria Approach	Retail IRB Approach	Specific Risk-weight Approach	Total exposures
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Corporate	105,021,848	1,893,758	-	-	106,915,606
Bank	88,007,701	-	-	-	88,007,701
Retail					
Residential mortgages to individuals and property-holding shell companies	-	-	14,263,338	-	14,263,338
Qualifying revolving retail	-	-	-	-	-
Other retail to individuals and small business retail	-	-	6,876,340	-	6,876,340
Others	-	-	-	6,158,687	6,158,687
Total	193,029,549	1,893,758	21,139,678	6,158,687	222,221,672

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.3 Exposures subject to supervisory estimates under the IRB approach

By definition, amounts reported under the supervisory slotting criteria approach continue to be subject to supervisory estimates. The table below shows the total EAD of the Group's exposures subject to supervisory estimates under the use of IRB approach.

	2012	2011
	HK$'000	HK$'000
Corporate	**124,339,594**	106,915,606
Bank	**72,331,164**	88,007,701
Others	**8,065,560**	6,158,687
	204,736,318	201,081,994

3.4 Exposures covered by credit risk mitigation used

(A) Exposures covered by recognised collateral

The table below shows the Group's exposures (after the effect of any on-balance sheet or off-balance sheet recognised netting) which are covered by recognised collateral after the application of haircuts required under the Banking (Capital) Rules. These exposures exclude OTC derivative transactions and repo-style transactions.

	2012	2011
	HK$'000	HK$'000
Corporate	**25,658,272**	27,129,230
Bank	**10,290**	23,324
Others	**-**	-
	25,668,562	27,152,554

(B) Exposures covered by recognised guarantees

The table below shows the Group's exposures (after the effect of any on-balance sheet or off-balance sheet recognised netting) which are covered by recognised guarantees after the application of haircuts required under the Banking (Capital) Rules. These exposures exclude OTC derivative transactions and repo-style transactions.

	2012	2011
	HK$'000	HK$'000
Corporate	**3,264,083**	2,384,748
Bank	**4,685,877**	5,954,083
Retail	**-**	-
Others	**-**	-
	7,949,960	8,338,831

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.5 Risk assessment for corporate and bank exposures under IRB approach

The tables below detail the Group's total EAD of corporate and bank exposures by exposure-weighted average risk-weight and exposure-weighted average PD for each obligor grade as at 31 December 2012.

The EAD and PD disclosed below in respect of corporate and bank exposures have taken into account the effect of recognised guarantees. No recognised netting was adopted by the Group.

For definition of each obligor grade, please refer to page 170.

(A) Corporate exposures (other than specialised lending under supervisory slotting criteria approach)

	2012		
Internal Credit Grades	**Exposure at default**	**Exposure-weighted average risk-weight**	**Exposure-weighted average PD**
	HK$'000	**%**	**%**
Grade 1	**-**	**0.00%**	**0.00%**
Grade 2	**1,416,071**	**17.04%**	**0.04%**
Grade 3	**14,550,465**	**23.33%**	**0.07%**
Grade 4	**20,724,203**	**41.86%**	**0.25%**
Grade 5	**55,925,400**	**76.95%**	**1.16%**
Grade 6	**29,612,068**	**120.47%**	**5.41%**
Grade 7	**398,911**	**231.94%**	**18.05%**
Grade 8 / Default	**321,504**	**186.02%**	**100.00%**
	122,948,622		

	2011		
Internal Credit Grades	Exposure at default	Exposure-weighted average risk-weight	Exposure-weighted average PD
	HK$'000	%	%
Grade 1	-	0.00%	0.00%
Grade 2	1,457,568	16.13%	0.04%
Grade 3	15,918,178	24.31%	0.07%
Grade 4	17,421,545	42.35%	0.27%
Grade 5	47,244,291	70.72%	1.18%
Grade 6	22,725,397	94.48%	5.15%
Grade 7	125,939	80.66%	19.88%
Grade 8 / Default	128,930	176.18%	100.00%
	105,021,848		

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.5 Risk assessment for corporate and bank exposures under IRB approach (continued)

(B) Corporate exposures (specialised lending under supervisory slotting criteria approach)

Supervisory Rating Grades	2012 Exposure at default	2012 Exposure-weighted average risk-weight	2011 Exposure at default	2011 Exposure-weighted average risk-weight
	HK$'000	%	HK$'000	%
Strong	15,791	70.00%	243,289	70.00%
Good	952,775	90.00%	1,019,406	90.00%
Satisfactory	422,406	115.00%	577,266	115.00%
Weak	-	0.00%	53,797	250.00%
Default	-	0.00%	-	0.00%
	1,390,972		1,893,758	

The supervisory rating grades and risk-weights of specialised lending are determined in accordance with section 158 of the Banking (Capital) Rules.

(C) Bank exposures

Internal Credit Grades	2012 Exposure at default	Exposure-weighted average risk-weight	Exposure-weighted average PD
	HK$'000	%	%
Grade 1	-	0.00%	0.00%
Grade 2	4,224,072	17.18%	0.04%
Grade 3	42,329,222	22.76%	0.06%
Grade 4	24,350,909	43.79%	0.22%
Grade 5	1,426,961	70.14%	0.52%
Grade 6	-	0.00%	0.00%
Grade 7	-	0.00%	0.00%
Grade 8 / Default	-	0.00%	0.00%
	72,331,164		

Internal Credit Grades	2011 Exposure at default	Exposure-weighted average risk-weight	Exposure-weighted average PD
	HK$'000	%	%
Grade 1	-	0.00%	0.00%
Grade 2	6,586,337	16.38%	0.04%
Grade 3	44,940,062	24.50%	0.07%
Grade 4	32,598,476	44.72%	0.23%
Grade 5	3,882,826	68.03%	0.75%
Grade 6	-	0.00%	0.00%
Grade 7	-	0.00%	0.00%
Grade 8 / Default	-	0.00%	0.00%
	88,007,701		

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.6 Risk assessment for retail exposures under IRB approach

The tables below show breakdown of retail exposures on a pool basis by expected loss percentage (EL%) range as at 31 December.

Residential mortgages

	2012	2011
	HK$'000	HK$'000
Up to 1%	**12,620,692**	14,191,953
>1%	**32,586**	63,834
Default	**9,223**	7,551
	12,662,501	14,263,338

Qualifying revolving retail

	2012	2011
	HK$'000	HK$'000
Up to 10%	**-**	-
>10%	**-**	-
Default	**-**	-
	-	-

Other retail

	2012	2011
	HK$'000	HK$'000
Up to 2%	**4,750,375**	3,769,802
>2%	**10,370**	11,504
Default	**2,662**	3,940
	4,763,407	3,785,246

Small business retail

	2012	2011
	HK$'000	HK$'000
Up to 1%	**2,888,452**	3,011,749
>1%	**89,464**	67,053
Default	**16,289**	12,292
	2,994,205	3,091,094

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.7 Analysis of actual loss and estimates

The table below shows the actual losses which represent the net charges (including write-offs and individually assessed impairment allowances) made by each class of exposures under the internal ratings-based approach for the year.

	2012	2011
	HK$'000	HK$'000
Corporate	**138,901**	8,461
Bank	**-**	(2,953)
Residential mortgages to individuals and property-holding shell companies	**4,865**	300
Other retail to individuals	**1,053**	222
Small business retail	**7,125**	6,789
	151,944	12,819

Increase in the impairment charge of corporate exposures was mainly caused by the pastdue or loan restructuring of some corporate customers.

The table below shows the expected loss which is the estimated loss likely to be incurred arising from the potential default of the obligors in respect of the exposure over a one-year period.

	Expected loss at 31 December 2011	Expected loss at 31 December 2010
	HK$'000	HK$'000
Corporate	**910,265**	627,870
Bank	**40,003**	32,959
Residential mortgages to individuals and property-holding shell companies	**5,162**	8,256
Other retail to individuals	**10,987**	2,989
Small business retail	**5,604**	4,605
	972,021	676,679

The tables below set out the actual default rate compared against the estimated PD of the respective portfolio.

	Actual default rate during 2012	**Estimated PD at 31 December 2011**
	%	**%**
Corporate	**0.90%**	**2.02%**
Bank	**0.00%**	**0.28%**
Residential mortgages to individuals and property-holding shell companies	**0.06%**	**0.69%**
Other retail to individuals	**0.10%**	**0.69%**
Small business retail	**0.46%**	**1.30%**

Unaudited Supplementary Financial Information (continued)

3. Credit risk under the internal ratings-based approach (continued)

3.7 Analysis of actual loss and estimates (continued)

	Actual default rate during 2011	Estimated PD at 31 December 2010
	%	%
Corporate	0.34%	1.83%
Bank	0.42%	0.30%
Residential mortgages to individuals and property-holding shell companies	0.02%	0.75%
Other retail to individuals	0.07%	0.73%
Small business retail	0.56%	1.29%

It should be noted that expected loss and actual loss are measured and calculated using different methodologies compliant to relevant regulatory and accounting standards, which are therefore not directly comparable. The limitation arises mainly from the fundamental differences in the definition of "loss". The expected loss under Basel II which estimates the economic loss arising from the potential default of the obligor by taking into account the time value of money and including the direct and indirect costs associated with the recoveries on the credit exposures, while actual loss is the net individually assessed impairment charges and write-offs made during the year in accordance with the accounting standards.

The actual default rate (actual PD) is measured by using the number of obligors (for wholesale exposures) or number of accounts (for retail exposures) defaulted whereas the estimated probability of default (estimated PD) is an estimate of the long run average default rate over an economic cycle and is the estimated one-year forward-looking PD from the date of rating assignment.

Hence, actual PD in a particular year ("point-in-time") will typically differ from the estimated PD which is the "through-the-cycle" estimates as economies move above or below the cyclical norms.

The estimated PD is in general more conservative than the actual default rate for most asset classes.

Unaudited Supplementary Financial Information (continued)

4. Credit risk under the standardised (credit risk) approach

4.1 Ratings from External Credit Assessment Institutions (“ECAI”)

The Group continues to adopt STC approach based on external rating to determine the risk weight of the following asset classes of exposures:

- Sovereign
- Public sector entity
- Multilateral development bank

The Group performs the ECAI issuer ratings mapping to its exposures in banking book in accordance with Part 4 of the Banking (Capital) Rules. The ECAIs recognised by the Group include Standard & Poor’s, Moody’s and Fitch.

4.2 Credit risk mitigation

For credit exposures adopting STC approach, the main types of recognised collaterals include cash deposits, debt securities and shares for non-past due exposures. In addition, real estate collateral is also recognised for past due exposures. The treatment of recognised collateral is compliant with the comprehensive approach for credit risk mitigation in capital calculation as mentioned in the Banking (Capital) Rules. For credit exposures under STC approach, the recognised guarantees for capital calculation include the guarantees given by sovereigns, public sector entities, multilateral development banks with a lower risk weight than the counterparty, and corporate with external rating of A- or above.

Unaudited Supplementary Financial Information (continued)

4. Credit risk under the standardised (credit risk) approach (continued)

4.3 Credit risk exposures other than securitisation exposures under the standardised (credit risk) approach

	2012						
	Total Exposures	Exposures after CRM* Rated	Exposures after CRM* Unrated	Risk-weighted amount Rated	Risk-weighted amount Unrated	Total exposures covered by recognised collateral	Total exposures covered by recognised guarantees or recognised credit derivative contracts
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
On-balance sheet exposures							
Sovereign	28,437,822	28,464,488	-	379,580	-	-	-
Public sector entity	570,774	544,985	-	61,979	-	-	26,667
Multilateral development bank	172,127	172,127	-	-	-	-	-
Bank	104,886	104,886	-	22,030	-	-	-
Securities firm	-	-	-	-	-	-	-
Corporate	7,134,247	869,193	6,250,606	451,275	6,250,606	14,447	-
Regulatory retail	493,222	-	458,854	-	344,141	34,368	-
Residential mortgage loans	5,755,312	-	5,754,434	-	2,877,217	-	878
Other exposures which are not past due	398,876	-	221,989	-	221,989	176,888	-
Past due exposures	18,419	-	18,419	-	20,132	14,993	-
Total for on-balance sheet exposures	43,085,685	30,155,679	12,704,302	914,864	9,714,085	240,696	27,545
Off-balance sheet exposures							
Off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts	353,159	89,906	263,254	64,488	228,988	488,347	12,313
OTC derivative transactions	9,733	-	9,733	-	7,827	-	-
Total for off-balance sheet exposures	362,892	89,906	272,987	64,488	236,815	488,347	12,313
Total for non-securitisation exposures	43,448,577	30,245,585	12,977,289	979,352	9,950,900	729,043	39,858
Exposures deducted from Core Capital or Supplementary Capital	53,473						

Unaudited Supplementary Financial Information (continued)

4. Credit risk under the standardised (credit risk) approach (continued)

4.3 Credit risk exposures other than securitisation exposures under the standardised (credit risk) approach (continued)

	2011						
	Total Exposures	Exposures after CRM*		Risk-weighted amount		Total exposures covered by recognised collateral	Total exposures covered by recognised guarantees or recognised credit derivative contracts
		Rated	Unrated	Rated	Unrated		
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
On-balance sheet exposures							
Sovereign	21,984,173	22,010,840	-	60,693	-	-	-
Public sector entity	244,057	217,469	-	8,311	-	-	26,667
Multilateral development bank	156,045	156,045	-	-	-	-	-
Bank	93,837	93,837	-	19,316	-	-	-
Securities firm	-	-	-	-	-	-	-
Corporate	2,939,236	952,256	1,760,385	489,087	1,760,385	226,595	-
Cash items	216	-	216	-	-	-	-
Regulatory retail	300,674	-	258,799	-	194,099	41,875	-
Residential mortgage loans	4,322,075	-	4,321,996	-	2,160,998	-	79
Other exposures which are not past due	206,728	-	128,828	-	128,828	77,900	-
Past due exposures	8,947	-	8,947	-	13,421	-	-
Total for on-balance sheet exposures	30,255,988	23,430,447	6,479,171	577,407	4,257,731	346,370	26,746
Off-balance sheet exposures							
Off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts	428,984	97,127	331,857	66,037	293,047	184,182	4,357
OTC derivative transactions	3,617	-	3,617	-	3,062	-	-
Total for off-balance sheet exposures	432,601	97,127	335,474	66,037	296,109	184,182	4,357
Total for non-securitisation exposures	30,688,589	23,527,574	6,814,645	643,444	4,553,840	530,552	31,103
Exposures deducted from Core Capital or Supplementary Capital	41,490						

* Recognised credit risk mitigation satisfying the requirements and conditions set out in the Banking (Capital) Rules.

Unaudited Supplementary Financial Information (continued)

5. Counterparty credit risk-related exposures

The Group's counterparty credit risk arising from OTC derivative transactions, repo-style transactions both in trading and banking book is subject to the same risk management framework as mentioned in Note 4 to the Financial Statements. The Group establishes credit limit through formal credit approval procedures to control the pre-settlement credit risk arising from OTC derivative transactions and settlement limit to control the settlement risk arising from foreign exchange-related transactions in both the trading book and banking book. The Group monitors the risk exposure due to fluctuations in the market by using the current exposure and the potential exposure value of the transactions. Exceptions or excesses are timely and closely identified and monitored by risk management units.

Currently, the Group uses the Current Exposure Method to measure and monitor the counterparty credit exposures, which comprises current exposures and potential future exposures.

The Group establishes prudent eligibility criteria and haircut policy of debt securities being pledged as collateral for repo-style transactions.

The Group formulates policy for classification of credit assets according to the PD of individual counterparty and the period of overdue. If there is objective evidence that an impairment loss has been incurred, impairment allowance will be provided according to HKFRS and regulatory requirements.

Unaudited Supplementary Financial Information (continued)

5. Counterparty credit risk-related exposures (continued)

5.1 Counterparty credit risk exposures

The following tables summarise the Group's exposures to counterparty credit risk arising from OTC derivative and repo-style transactions.

(A) Counterparty credit risk exposures under the internal ratings-based approach

	2012	2011
	HK$'000	HK$'000
OTC derivative:		
Gross total positive fair value	223,464	203,766
Credit equivalent amounts	592,012	1,032,115
Less: Value of recognised collateral		
- debt securities	-	-
- others	-	-
Net credit equivalent amounts	592,012	1,032,115
Exposure at default by counterparty type		
Corporate	155,844	452,759
Banks	436,168	579,356
Retail	-	-
Others	-	-
	592,012	1,032,115
Risk weighted amounts by counterparty type		
Corporate	177,909	523,919
Banks	101,054	139,995
Retail	-	-
Others	-	-
	278,963	663,914
Repo-style transactions:		
Net credit exposures	-	3,487,630
Exposure at default by counterparty type		
Corporate	-	-
Banks	-	3,487,630
Retail	-	-
Others	-	-
	-	3,487,630
Risk weighted amounts by counterparty type		
Corporate	-	-
Banks	-	1,851,904
Retail	-	-
Others	-	-
	-	1,851,904

Unaudited Supplementary Financial Information (continued)

5. Counterparty credit risk-related exposures (continued)

5.1 Counterparty credit risk exposures (continued)

(B) Counterparty credit risk exposures under the standardised (credit risk) approach

	2012	2011
	HK$'000	HK$'000
OTC derivative:		
Gross total positive fair value	**5,524**	3,250
Credit equivalent amounts	**9,733**	3,617
Less: Value of recognised collateral		
- debt securities	**-**	-
- others	**-**	-
Net credit equivalent amounts	**9,733**	3,617
Credit equivalent amounts net of recognised collateral by counterparty type		
Sovereign	**-**	-
Public sector entity	**-**	-
Banks	**-**	-
Corporate	**2,086**	1,395
Regulatory retails	**7,624**	2,222
Other exposures which are not past due exposures	**23**	-
Past due exposures	**-**	-
	9,733	3,617
Risk weighted amounts by counterparty type		
Sovereign	**-**	-
Public sector entity	**-**	-
Banks	**-**	-
Corporate	**2,086**	1,395
Regulatory retails	**5,718**	1,666
Other exposures which are not past due exposures	**23**	-
Past due exposures	**-**	-
	7,827	3,061

There are no outstanding repo-style transactions under the STC approach as at 31 December 2012 (2011:Nil).

There is no effect of valid bilateral netting agreement on the credit equivalent amounts of the derivative transactions as at 31 December 2012 (2011:Nil).

There are no outstanding credit derivative contracts as at 31 December 2012 (2011: Nil).

Unaudited Supplementary Financial Information (continued)

6. Assets securitisation

As an investing institution, the Group continues to adopt ratings-based method under the IRB approach to calculate the credit risk for asset securitisation exposures in the year 2012. Since this approach employs mapping of external credit ratings for risk weights calculations, the Group adopts the three ECAIs (Standard & Poor's, Moody's and Fitch) recognised by HKMA for this purpose.

The Group monitors the risks inherent in its securitisation assets on an ongoing basis. The external credit ratings, assessment of the underlying assets and market prices are used for managing credit risk associated with the investment. For interest rate risk in its banking book, control measure for asset backed securities and mortgage backed securities is mainly PVBP.

The Group has no outstanding exposures that are held with the intention of transferring exposures booked in the banking book and trading book into securitisation transactions as at 31 December 2012.

Securitisation exposures arising from the Group's investing activities are analysed as follows:

6.1 Securitisation exposures

	2012
	On-balance sheet Banking Book
	HK$'000
Residential mortgage loans	**-**
Commercial mortgage loans	**-**
Student loans	**-**
Re-securitisations	**-**
	-

	2011*
	HK$'000
Residential mortgage loans	-
Commercial mortgage loans	5,046
Student loans	-
	5,046

* As a result of the new requirements under Banking (Disclosure) (Amendment) Rules 2011, the amounts shown are not directly comparable with those of 31 December 2012.

There are no on-balance sheet securitisation positions booked in trading book as at 31 December 2012.

There are no off-balance sheet securitisation exposures booked in banking and trading books as at 31 December 2012.

There are no securitisation transactions in trading book subject to the IMM approach as at 31 December 2012.

There are no securitisation exposures deducted from core and/or supplementary capital as at 31 December 2012 and 2011.

Unaudited Supplementary Financial Information (continued)

6. Assets securitisation (continued)

6.1 Securitisation exposures (continued)

The Group has no credit risk mitigations which are treated as part of securitisation and re-securitisation transactions as at 31 December 2012.

The Group has no credit derivative contracts which are treated as part of synthetic securitisation transactions as at 31 December 2011.

6.2 Breakdown by risk-weights of the securitisation exposures (excluding re-securitisation exposures) under internal ratings-based (securitisation) approach

	2012	
	Securitisation exposures HK$'000	Capital requirements HK$'000
7%		
8%	-	-
10%	-	-
12%	-	-
15%	-	-
18%	-	-
20%	-	-
25%	-	-
35%	-	-
50%	-	-
60%	-	-
75%	-	-
100%	-	-
250%	-	-
425%	-	-
650%	-	-
Deducted from capital	-	-
	-	-

6.3 Breakdown by risk-weights of the re-securitisation exposures under internal ratings-based (securitisation) approach

	2012	
	Securitisation exposures HK$'000	Capital requirements HK$'000
20%	-	-
25%	-	-
30%	-	-
35%	-	-
40%	-	-
50%	-	-
60%	-	-
65%	-	-
100%	-	-
150%	-	-
200%	-	-
225%	-	-
300%	-	-
500%	-	-
650%	-	-
750%	-	-
850%	-	-
Deducted from capital	-	-
	-	-

Unaudited Supplementary Financial Information (continued)

6. Assets securitisation (continued)

6.4 Breakdown by risk-weights of the securitisation exposures under internal ratings-based (securitisation) approach

	2011*		
	Securitisation exposures	Risk-weighted amount	Capital requirements
	HK$'000	HK$'000	HK$'000
12%	5,046	642	51
	5,046	642	51

* As a result of the new requirements under Banking (Disclosure) (Amendment) Rules 2011, the amounts shown are not directly comparable with those of 31 December 2012.

6.5 Summary of accounting policies for securitisation exposures

The Group held certain securitised debt securities at the end of the reporting period. They are classified and measured for accounting purpose in accordance with the Group's accounting policies as outlined in Note 2.9 "Financial assets". For those investments measured at fair value, further details on their valuation are outlined in Note 4.5(B) Financial instruments measured at fair value.

7. Capital requirements for market risk

	2012	2011
	HK$'000	HK$'000
Under the standardised (market risk) approach		
Foreign exchange exposures (net)	**-**	362,123
Interest rate exposures		
- non-securitisation exposure	**10**	29,553
Equity exposures	**-**	-
Commodity exposures	**-**	-
Under the internal models approach		
General foreign exchange and interest rate exposures	**53,499**	-
Capital charge for market risk	**53,509**	391,676

Unaudited Supplementary Financial Information (continued)

7. Capital requirements for market risk (continued)

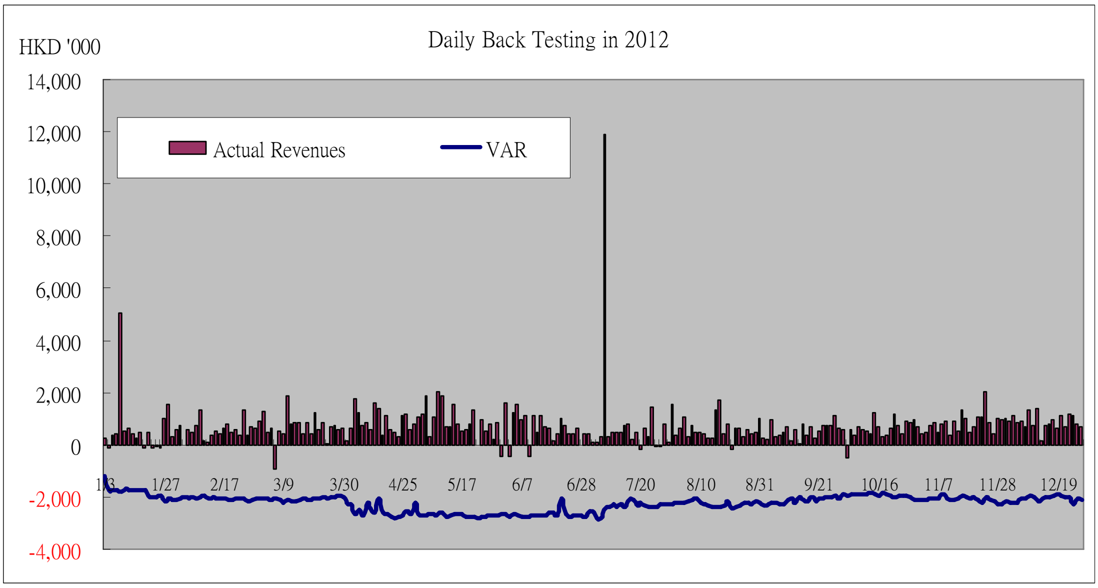
With the HKMA approval from October 2012, the Group has adopted the internal models ("IMM") approach to calculate general market risk capital charge for foreign exchange and interest rate exposures as at 31 December 2012. The market risk regulatory capital charge is calculated under the Banking (Capital) (Amendment) Rules 2011 to incorporate capital charge for stressed VAR. The following table sets out the IMM VAR and stressed VAR[1] for the general market risk exposure calculated under the IMM approach of the Group.

	Year	At 31 December HK$'000	Minimum for the year HK$'000	Maximum for the year HK$'000	Average for the year HK$'000
IMM VAR for foreign exchange and interest rate risk	2012	5,324	2,752	6,742	5,618
IMM VAR for foreign exchange risk	2012	5,122	2,807	6,207	5,432
IMM VAR for interest rate risk	2012	678	260	1,579	559
Stressed VAR for foreign exchange and interest rate risk	2012	14,231	6,075	28,399	12,967
Stressed VAR for foreign exchange risk	2012	6,979	3,860	8,218	7,444
Stressed VAR for interest rate risk	2012	13,653	2,189	22,555	7,474

Note:

1 IMM VAR and stressed VAR measures used for market risk regulatory capital purposes are calculated to a 99% confidence level and use a 10-day holding period. The stressed VAR uses the same methodology as the VAR model and is generated with inputs calibrated to the historical data from a continuous 12-month period of significant financial stress relevant to the Group's portfolio.

The graph below shows the regulatory back-testing result of the Group's market risk under IMM approach.



There were no actual losses exceeding the VAR estimates for the Group in 2012 as shown in the back-testing results.

Unaudited Supplementary Financial Information (continued)

8. Capital requirements for operational risk

	2012	2011
	HK$'000	HK$'000
Capital charge for operational risk	**658,454**	585,678

The Group uses the standardised (operational risk) approach to calculate its operational risk capital charge.

9. Equity exposures in banking book

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

For equity exposures in banking book other than subsidiaries, the Group applies the same accounting treatment and valuation methodologies as detailed in the Notes 2.9(4) and 2.12 to the Financial Statements. If additional investment is made subsequently such that an investee becomes an associate, jointly controlled entity or subsidiary, then the investment is reclassified in accordance with the Group's accounting policies.

Gains or losses related to equity exposures are summarised below:

	2012	2011
	HK$'000	HK$'000
Realised gains/(losses) from sales	**463**	(51)
Unrealised gains on revaluation recognised in reserves but not through profit or loss	**44,956**	32,572
Unrealised gains included in supplementary capital	**20,230**	14,657

Management of Risks

The Overview

The principal types of risk inherent in the business of the Group are credit risk, interest rate risk, market risk, liquidity risk, operational risk, reputation risk, legal and compliance risk, and strategic risk. The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits.

Risk Management Structure

The Bank's Board of Directors (the "Board") holds the ultimate responsibility for the Group's overall risk management. It determines the risk management strategies and the risk management structure.

To achieve the Group's goals in risk management, the Board sets up the Risk Management Committee, which comprises of independent non-executive directors, to oversee the Group's various types of risks and approve the high-level risk management policies.

According to the risk management strategies established by the Board, risk management policies and controls are devised and reviewed regularly by relevant departments and respective management committees chaired by the Chief Executive (the "CE").

The Risk Management Units develop policies and procedures for identifying, measuring, monitoring and controlling credit risk, market risk, operational risk, reputation risk, legal and compliance risk, interest rate risk, liquidity risk and strategic risk; to set appropriate risk limits; and to continually monitor risks.

The Auditing Department conducts independent reviews on the adequacy and effectiveness of risk management policies and controls to ensure that the Group is operating according to the established policies, procedures and limits.

Independence is crucial to effective risk management. To ensure the independence of the Risk Management Department and the Auditing Department, they report directly to the Risk Management Committee and the Audit Committee respectively. Both committees are specialised committees set up by the Board and all members are directors of the Bank.

Management of Risks (continued)

Risk Management Structure (continued)

(i) Credit risk management

Details of management of credit risk are set out in Note 4 to the Financial Statements.

(ii) Liquidity risk management

Details of liquidity risk management are set out in Note 4 to the Financial Statements.

(iii) Market risk management

Details of market risk management are set out in Note 4 to the Financial Statements.

(iv) Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, staff and information technology system, or from external events. The risk is inherent in every aspect of business operations and confronted by the Group in its day-to-day operational activities.

The Group has implemented the “Three Lines of Defence” for its operational risk management. All departments or functional units as the first line of defence are the first parties responsible for operational risk management, and carry out the duties and functions of self risk control in the process of business operation through self assessment, self checking, self correction and self development. The Operational Risk, legal and Compliance Division (“OLD”) together with certain specialist functional units in relation to operational risk management within the Group, including the Human Resources Division, Business Planning & Optimization Division, Corporate Services Division, Financial Management Division and Accounting Division (collectively known as “Specialist functional units”), are the second line of defence. They are responsible for assessing and monitoring the operational risk conditions in the first line of defence, and providing them with guidance. The OLD, being independent from the business units, is responsible for assisting the Management in managing the Group’s operational risk, including the establishment and review of the operational risk management policy and framework, designing the operational risk management tools and reporting mechanism, and assessing and reporting the overall operational risk position to the Management and RMC. Specialist functional units are required to carry out their managerial duties of the second line defence with respect to some specific aspects of operational risk and its related issues. Besides taking charge of operational risk management in their own units, these units are also required to provide other units with professional advice/training in respect of certain operational risk categories and to lead the Group-wide operational risk management. Auditing Department is the third line of defence which provides independent assessment to the robustness and adequacy of the operational risk management framework and is required to conduct periodic audit of the operational risk management activities of various departments or functional units within the Group regarding their compliance and effectiveness and to put forward recommendations for remedial actions.

Management of Risks (continued)

Risk Management Structure (continued)

(iv) Operational risk management (continued)

The Group has put in place an effective internal control process which requires the establishment of policies and control procedures for all the key activities. The Group adheres to the fundamental principle of proper segregation of duties and authorisation. The Group adopts various operational risk management tools or methodologies such as key risk indicators, self-assessment, operational risk events reporting and review to identify, assess, monitor and control the risks inherent in business activities and products, as well as purchase of insurance to mitigate unforeseeable operational risks. Business continuity plans are established to support business operations in the event of an emergency or disaster. Adequate backup facilities are maintained and periodic drills are conducted.

(v) Reputation risk management

Reputation risk is the risk that negative publicity about the Group's business practices, whether genuine or not, will cause a potential decline in the customer base, or lead to costly litigation or revenue decrease. Reputation risk is inherent in other types of risk and every aspect of business operation and covers a wide spectrum of issues.

In order to mitigate reputation risk, the Group has formulated and duly followed its the Reputation Risk Management Policy. The policy aims to prevent and manage reputation risk proactively at an early stage when an incident occurs. Since reputation risk is often caused by various types of operational and strategic issues that negatively impact the trust and perception of the company, all operational and key risks identified are assessed through the established Key Control Self-Assessment framework, including risk assessment tools, to evaluate the severity of their impact on the Group, including the damage to reputation.

In addition, the Group has put in place a comprehensive framework to continuously monitor reputation risk incidents in the financial industry. This continuous monitoring enables the Group to effectively manage, control and mitigate any potential adverse impact from an incident. The Group also adopts robust disclosure practices to keep our stakeholders informed at all times, which we believe help to build confidence in our Group and establish a strong public image.

(vi) Legal and compliance risk management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operations or financial conditions of the Group. Compliance risk is the risk of legal or regulatory sanctions, financial losses or losses in reputation a bank may suffer as a result of its failure to comply with all applicable laws and regulations. Legal and compliance risks are managed by the OLD. All legal matters are handled by the OLD. The OLD is responsible for legal risk management of the Group. As part of the Group's corporate governance framework, the policy for the management of legal and compliance risk is approved by the RMC as delegated by the Board.

(vii) Strategic risk management

Strategic risk generally refers to the risks that may induce some current or future negative impacts on the earnings, capital, reputation or market position of the Group because of poor business decisions, improper implementation of decisional strategies and lack of response to the market. The Group has developed its Strategic Risk Management Policy that defines the responsibilities of the Board and the Management when implementing its desired strategies.

Corporate Governance

The Group strives to achieve high standards of corporate governance and has followed the module on "Corporate Governance of Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual (CG-1) issued by the Hong Kong Monetary Authority.

Board of Directors and the Management

The Board is responsible for setting objectives and formulating long term strategies as well as managing the Group's overall business. It currently comprises ten Directors with a variety of different experience and professionalism. Among them, two are Executive Directors, while the remaining eight are Non-executive Directors. Of the eight Non-executive Directors, three are Independent Non-executive Directors whose indispensable function is to provide independent scrutiny. The Board meets regularly and four board meetings were held in the year with an average attendance rate of 95.24%. The Management, led by the Chief Executive, is responsible for formulating and implementing detailed programmes to effect the approved strategies and policies, and providing detailed reports on the Group's performance to the Board on a regular basis to enable the Board to discharge its responsibilities effectively. In order to focus its attention on strategic and material issues that have significant impact on the Group's finances and long-term development, the Board has set up four committees to oversee the major areas of the Group. Details of the committees are given below:

Executive Committee

The Executive Committee has been delegated with power directly from the Board to handle matters which require the Board's review during the adjournment of the Board. Its responsibilities include:

- approving policies, implementing plans and management measures to effect the group-wide development strategies and business plans approved by the Board;
- reviewing the progress on implementation of the strategies and business plans;
- recommending strategic proposals to the Board for its consideration and approval; and
- approving the Group's rules and regulations according to the policies imposed by the supervisory authorities and the holding company.

The members of Executive Committee during the year were Mr. Fang Hongguang (Chairman), Mr. Chan Sai Ming[1] and Mr. Yuen Wai Keung[2]. All of them were Executive Directors of the Bank.

Notes:

1. Appointed as Executive Director and member of the Executive Committee of the Bank with effect from 22 May 2012.
2. Resigned as Executive Director and member of the Executive Committee of the Bank with effect from 1 May 2012.

Corporate Governance (continued)

Audit Committee

The Committee assists the Board in fulfilling its oversight role over the Group in the following areas:

- integrity of financial statements and the financial reporting process;
- internal control system;
- performance of internal audit functions and internal auditors;
- appointment of external auditors and evaluation of external auditors' qualifications, independence and performance;
- periodic review and annual audit of the Group's financial statements;
- compliance with applicable accounting standards and legal and regulatory requirements on financial disclosures; and
- enhancement of the corporate governance framework .

The members of Audit Committee during the year were Mr. Lau Hon Chuen (Chairman), Mr. Lan Hong Tsung David and Mr. Zhuo Chengwen. All were Non-executive Directors of the Bank. Among them, Mr. Lau Hon Chuen and Mr. Lan Hong Tsung David were Independent Non-executive Directors.

Risk Management Committee

The Risk Management Committee assists the Board in performing the duties in respect of the risk management of the Bank in, among others, the following areas:

- formulation of the risk appetite and risk management strategy of the Bank and determination of the Bank's risk profile;
- identification, assessment and management of material risks faced by the Bank; and
- approving high level risk management related policies.

The members of the Risk Management Committee during the year were Mr. Li Jiuzhong (Chairman), Mr. Fang Hongguang, Mr. Zhuo Chengwen, Mr. Chang Hsin Kang, Mr. Lau Hon Chuen, Mr. Chan Sai Ming[1] and Mr. Yuen Wai Keung[2]. All were Directors of the Bank. Among them, Mr. Chang Hsin Kang and Mr. Lau Hon Chuen were Independent Non-executive Directors.

Notes:

1. Appointed as Executive Director and member of the Risk Management Committee of the Bank with effect from 22 May 2012.
2. Resigned as Executive Director and ceased to be member of the Risk Management Committee of the Bank with effect from 1 May 2012.

Corporate Governance (continued)

Nomination and Remuneration Committee

The Nomination and Remuneration Committee comprises three members, including one Non-executive Director, Mr. Zhuo Chengwen, and two Independent Non-executive Director, namely Mr. Lau Hon Chuen and Mr. Lan Hong Tsung David. It was chaired by Mr. Zhuo Chengwen, a Non-executive Director of the Board. The Independent Non-executive Directors represent 66.7% of the Committee members.

The Nomination and Remuneration Committee assists the Board in performing the duties in respect of the Group in the following areas:

- remuneration strategy and incentive framework of the Group;
- selection and nomination of Directors, Board Committee members and certain senior executives as designated by the Board from time to time;
- structure, size and composition (including skills, experience and knowledge) of Board and Board Committee members;
- remuneration of Directors, Board Committee members, designated senior management and key personnel; and
- effectiveness of the Board and Board Committees.

Key tasks performed by the Nomination and Remuneration Committee during 2012 included the approval, review and propose to the Board on the following according to the responsibilities and authorities:

- formulation, review and amendment on major human resources and remuneration policies, including the review and revision of the "Remuneration and Incentive Policy" and the "Deferred Variable Remuneration Policy" ; as well as the review of "Senior Management", "Key Personnel", "Key Employee Group" and "Risk Control Personnel" as delineated in the "Guideline on a Sound Remuneration System" published by Hong Kong Monetary Authority;
- performance appraisal of the designated senior management and key personnel for year 2011;
- proposal on bonus for year 2011 and salary adjustment for year 2012 of the designated senior management and key personnel;
- key performance indicators of the designated senior management and key personnel for year 2012;
- appointment/resignation of designated senior management ;
- election of directors for 2012;
- Directors' independency report for 2012;
- self-evaluation report of the Nomination and Remuneration Committee for 2011;
- consideration of the matters relating to the adjustment and appointment of the directors of Nanyang Commercial Bank (China);

There were two Nomination and Remuneration Committee meetings held during 2012. The attendance rate of the three directors is 100%.

Corporate Governance (continued)

Remuneration and Incentive Mechanism

The Remuneration and Incentive Mechanism of the Group is based on the principles of "effective motivation" and "sound remuneration management". It links remuneration with performance and risk factors closely. It serves to encourage staff to enhance their performance, and at the same time, to strengthen their awareness of risk so as to achieve sound remuneration management.

The Remuneration and Incentive Policy of the Group is applicable to Nanyang Commercial Bank Limited and all of its subsidiaries (including the branches and institutions in and out of Hong Kong).

- **"Senior Management" and "Key Personnel"**

  The following groups of employees have been identified as the "Senior Management" and "Key Personnel" as defined in the HKMA's "Guideline on a Sound Remuneration System":

  - "Senior Management": The senior executives designated by the Board who are responsible for oversight of the firm-wide strategy or material business lines, including Chief Executive and Deputy General Managers.

  - "Key Personnel": The employees whose individual business activities involve the assumption of material risk which may have significant impact on risk exposure, or whose individual responsibilities are directly and materially linked to the risk management, or those who have direct influence to the profit, including heads of material business lines, Head of Trading, as well as Head of risk control functions.

- **Determination of the Remuneration Policy**

  To fulfill the above-mentioned principles and to facilitate effective risk management within the framework of the Remuneration Policy of the Group, Human Resources Division is responsible for proposing the Remuneration Policy of the Group and will seek consultation of the risk control units including risk management, financial management and compliance if necessary, in order to balance the needs for staff motivations, sound remuneration and prudent risk management. The proposed Remuneration Policy will be submitted to the Nomination and Remuneration Committee for review and thereafter to the Board of Directors for approval. The Nomination and Remuneration Committee and the Board of Directors will seek opinions from other Board Committees (e.g. Risk Management Committee, Audit Committee, etc.) where they consider necessary under the circumstances.

Corporate Governance (continued)

Remuneration and Incentive Mechanism (continued)

- **Key Features of the Remuneration and Incentive Mechanism**

1. Performance Management Mechanism

To reflect the "performance-driven" corporate culture, the Group has put in place a performance management mechanism to formalise the performance management at the levels of the Group, units and individuals. The annual targets of the Group will be cascaded down under the framework of balanced scorecard whereby the performance of the Senior Management and different units (including business units, risk control units and other units) would be assessed from the perspectives of financial, customer, building blocks/key tasks, human capital, risk management and compliance. For individual staff at different levels, annual targets of the Group will be tied to their job requirements through the performance management mechanism. Performance of individuals will be appraised on their achievement against targets, their contribution towards performance of their units and fulfilment of risk management duties and compliance. Not only is target accomplishment taken into account, but the risk exposure involved during the course of work could also be evaluated and managed, ensuring security and normal operation of the Group. Core values are also assessed to facilitate the attainment of them.

2. Risk Adjustment of Remuneration

To put the principle of aligning performance and remuneration with risk into practice, based on "The Risk Adjustment Method for Group Bonus Funding Mechanics" of BOCHK, the key risk modifiers of the bank have been incorporated into the performance management mechanism of the Group. The size of the Variable Remuneration Pool of the Group is calculated according to the risk adjusted performance results approved by the Board of BOCHK and is subject to its discretion. This method ensures the Group to fix the Group's Variable Remuneration Pool after considering risk exposures and changes and to maintain effective risk management through the remuneration mechanism.

"The Risk Adjustment Method for Group Bonus Funding Mechanics" of BOCHK was reviewed this year. With professional advices sought from the Risk Committee of BOCHK, the enhancement was approved by its Board after review carried out by its Nomination and Remuneration Committee. The framework of using credit risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk, compliance risk and reputation risk was maintained. To be more scientific and objective, more quantitative measures were introduced based on BOCHK's latest risk management profile.

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Corporate Governance (continued)

Remuneration and Incentive Mechanism (continued)

- **Key Features of the Remuneration and Incentive Mechanism (continued)**

3. Performance-based and Risk-adjusted Remuneration Management

The remuneration of staff is composed of "fixed remuneration" and "variable remuneration". The proportion of one to the other for individual staff members depends on job grades, roles, responsibilities and functions of the staff with the prerequisite that balance has to be struck between the fixed and variable portion. Generally speaking, the higher the job grades and/or the greater the responsibilities, the higher will be the proportion of variable remuneration so as to encourage the staff to follow the philosophy of prudent risk management and sound long-term financial stability.

Every year, the Group will conduct periodic review on the fixed remuneration of the staff with reference to various factors like remuneration strategy, market pay trend and staff salary level, and will determine the remuneration based on the affordability of the Group as well as the performance of the Group, units and individuals. As mentioned above, performance assessment criteria include quantitative and qualitative factors, as well as financial and non-financial indicators.

According to the Group Bonus Funding Mechanics of BOCHK, the size of the Variable Remuneration Pool of the Group is determined by the Board of BOCHK on the basis of the financial performance of the Group and the achievement of non-financial strategic business targets under the long-term development of the BOCHK Group. Thorough consideration is also made to the risk factors in the determination process. The size of the Pool is reached based on pre-defined formulaic calculations but the Board of BOCHK can make discretionary adjustment to it if deemed appropriate under prevailing circumstances. When the BOCHK group's performance is relatively weak (e.g. failed to meet the threshold performance level), no variable remuneration will be paid out that year in principle, however, the Board of BOCHK reserves the rights to exercise its discretion.

As far as individual units and individual staff are concerned, allocation of the variable remuneration is closely linked to the performance of the units, and that of each individual staff as well as the unit he/she is attaching to, and the assessment of which should include risk modifiers. The performance and remuneration arrangement of risk control personnel are determined by the achievement of their core job responsibilities, independent from the business they oversee; for front-line risk controllers, a matrix reporting and performance management system is applied to ensure the suitability of performance-based remuneration. Within the acceptable risk level of the Group, the better the performance of the unit and the individual staff, the higher will be the variable remuneration for the individual staff.

Corporate Governance (continued)

Remuneration and Incentive Mechanism (continued)

- **Key Features of the Remuneration and Incentive Mechanism (continued)**

4. Linking the payout of the variable remuneration with the time horizon of the risk to reflect the long-term value creation of the Group

To work out the principle of aligning remuneration with the time horizon of risk and to ensure that sufficient time is allowed to ascertain the associated risk and its impact before the actual payout, payout of the variable remuneration of staff is required to be deferred in cash if such amount reaches certain prescribed threshold. The Group adopts a progressive approach towards deferral. The longer the time horizon of risk in the activities conducted by the staff, the higher the job grade or the higher amount of the variable remuneration, the higher will be the proportion of deferral. Deferral period lasts for 3 years.

The vesting of the deferred variable remuneration is linked with the long term value creation of the Group. The vesting conditions are linked to the yearly performance (financial and non-financial) of the BOCHK Group in the next 3 years to the effect that the variable remuneration could only be vested to such extent as set for the relevant year in that 3-year period subject to the condition that the BOCHK Group's performance has met the threshold requirement in the corresponding year. In case of material revision of the original estimates of the performance of the Group or individual units, or if a staff is found to commit fraud, or found to be of malfeasance or in violation of internal control policies, the unvested portion of the deferred variable remuneration of the relevant staff will be clawed back.

Business Review

Amid the volatile financial environment at the start of 2012, the Group embarked on a year-long strategy to "make steady progress, build on our strengths, maintain balanced growth and promote seamless cooperation between the divisions". The Group also aimed to explore further opportunities to expand its core businesses and encourage new business areas. To meet these goals, we strengthened communication, enhanced management systems and introduced new procedures across the Group. As a result, our core businesses grew steadily and our operating result has improved this year.

Financial Highlights

For the year ended 31 December 2012, the Group's net operating income before impairment allowances was HKD4,931 million, representing a growth of 16.01% compared to the previous year. Net interest income increased by 19.73% to HKD3,933 million, non-interest income increased by 3.34% to HKD998 million, of which net fee income was down by 4.43%. Excluding the recovery of Lehman Brothers minibonds and other investment-related products, the Group's profit after tax was HKD2,334 million for the year ended 31 December 2012, representing an increase of 16.64% compared with the previous year. Return on equity and return on assets were 8.37% and 0.95% respectively, representing year-on-year respective increases of 0.14 percentage points and 0.02 percentage points; net interest margin was 1.63%, an increase of 0.07 basis points compared to last year. Our classified or impaired loan ratio was 0.37%, an increase of 0.23 percentage points compared to the end of the previous year

Business review

As at 31 December 2012, the total balance of loans amounted to HKD131,153 million, an increase of HKD11,309 million or 9.44% compared to a year earlier; and total balance of deposits expanded 6.34% to HKD185,534 million.

More deposits attracted to secure funding sources. 2012 saw fierce competition for foundation deposits with numerous product launches in the market. While the competition for HKD- and USD-deposits was intense, the main industry focus was on capturing market share of the rapidly-growing RMB-deposits. This was evidenced by interest rate rises in the first half of the year to higher than 3% for the first time in the local market. In view of the aggressive market competition, the Group proactively introduced several new promotions for deposits of various types and tenors tailored to suit different customer segments. In addition, we successfully linked our "NCB Wealth Management" incentive plan with our RMB business to expand our deposit base. The Group also adjusted its capital structure and implemented a strategy to attract medium- and long-term deposits in phases. These measures helped us ride out the rising cost of funding by enhancing stability in our core deposits and relieved any potential pressure arising from short-term deposits with high interest rates. In 2012, our liquidity ratio improved and the market share of our deposits remained stable.

Business Review (continued)

Business structure adjusted to increase total income. In response to the ongoing low interest rate environment, one of our key goals this year was to increase total income by making timely adjustments to our business structure to allocate more resources to develop and promote our core businesses. For corporate banking business, we reviewed and raised our loan pricing levels in line with market rates. The proportion of corporate loans which generate higher profit margins was increased, in particular through the credit facilities offered to SMEs and micro-sized companies. In addition, through cross-border collaboration, we targeted large-sum RMB loan extension and cross-border trade financing opportunities with favourable interest spreads. In personal banking, we accelerated the expansion of our residential mortgage business by responding promptly to local residential market changes and adopting a policy-oriented approach. We focused on providing all-round tailored solutions for quality customers and those maintaining long-term banking relationship with us, while exploring new opportunities to serve the needs of high-value customers. Our continuous product innovation also included new ranges of personal loans and advances being launched. In our securities business, investment seminars and the latest market analysis were provided to customers to help build their confidence in our professional investment and wealth management services. As well as reviewing our fee structure, we also vigorously developed other wealth management businesses such as life insurance and funds distribution. During the year, fee income from funds distribution recorded a year-on-year increase of 52.55%, which partially offset the impact caused by the decrease of income from our securities business. As at 31 December 2012, the Group's net interest margin stood at 1.63%, representing an increase of 0.07 percentage point(s) compared with the end of last year, despite a decline in the non-interest income share of the Group's total income from 22.72% to 20.24% during the year, within which our net fee income recorded a year-on-year decrease of 4.43%.

Business scope expanded with focus on cross-border collaboration. During the year, the Group made considerable breakthroughs in cross-border business cooperation which gave new momentum to business development. The progress supported by the platform of "NCB Wealth Management" was significant. Early in 2012, we jointly launched with NCB (China) the "NCB Wealth Express Card", a brand new UnionPay debit card offering special debit card functions. By connecting customers' accounts in Hong Kong and the Mainland, the new card provides greater flexibility in cross-border financial management and features a hassle-free auto-sweeping function. In line with the opening-up of the Mainland financial sector by the Mainland regulatory authorities, we also partnered during the year with the Guangdong Branch and Suzhou Branch of Bank of China to set up directions and principles covering a wide range of business areas and laying a solid foundation for our cross-border cooperation.

Business Review (continued)

Overall capacity increased to enhance development efficiency. Faced with intense competition in the banking industry, we were able to sustain growth by consistently upgrading our service network and distribution channels, streamlining our procedures and introducing new value-added services. In terms of deploying and integrating our network resources, we opened a new branch in Kowloon Bay early this year, and completed internal restructuring and renovation projects in some of our branches. All of these initiatives were aimed at creating a refreshing banking environment and enhancing customer experiences. To support the global development strategy of Bank of China, our San Francisco Branch completed a computer system upgrade project and equipped itself for the launch of its new Internet Banking and RMB businesses. **For our marketing strategies,** we optimised our system that allows customers to receive innovative customised banking service and product information anytime, anywhere. We have also introduced a forum for our professional service teams in securities, funds and life insurance to share sales experiences with each other and strengthened the cooperation between our teams of financial planning managers and investment product specialists to enhance their sales efforts. Higher sales efficiency and effectiveness was achieved. **In optimising our workflow management,** we further refined our sales procedures and systems for investment products subject to stringent regulatory requirements, such as life insurance and investment, to ensure regulatory compliance by frontline staff in their sales procedures. By leveraging the service platform of “NCB Wealth Management”, we provided a number of value-added services to our customers and assisted them in reviewing their asset portfolio so as to offer them the banking and investment products that best meet their needs.

Risk management

The Group adopted a prudent and compliant approach in developing and conducting its business to proactively prevent and mitigate risks. In response to changing market conditions and increasingly rigid regulatory requirements, during the year the Group consistently enhanced its credit control measures by reviewing relevant risk control systems, optimising credit approval procedures, strengthening the management of loans after drawdown and monitoring of loan utilisation. The Group further improved its risk management by implementing internal risk ratings, conducting regular stress tests, enhancing credit approval and monitoring systems, strengthening compliance inspection procedures in line with the requirements of the Hong Kong Monetary Authority and other regulatory authorities, in particular with regard to the internal and external audit procedures and anti-money laundering policies. Our business divisions stayed vigilant to money-laundering risks, fully complied with laws and regulations and throughout the year our risk ratios remained at sound levels

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Business Review (continued)

Corporate social responsibility

The Group is at all times committed to its corporate social responsibilities. In May 2012, we sponsored five teachers from Yangpeng School in the Mainland to take part in a training programme at Hepingli No.1 Primary School in Dongcheng District, Beijing. The Group also continued to support the school with scholarships and bursaries. To convey the message of caring, our volunteers participated in a number of charitable and social service activities, including visit to elderly living alone, flag-selling for fund raising, and “TREATS Journey to Integration 2012” which encourages caring and equality in society. For the second consecutive year, our volunteers helped low-income families to understand basic financial skills by taking part in the Financial Education Workshops organised jointly by the Hong Kong Association of Banks and the Hong Kong Council of Social Service. As part of our efforts to enrich the cultural life of the community, we sponsored the drama performance “I Have a Date with Autumn” organised by Hong Kong Repertory Theatre.

Prospects and Outlook

Looking forward, the global economy is gradually picking up in 2013 but still with lots of uncertainties. China’s domestic economy will continue to grow, albeit at a slower pace. We are cautiously optimistic about the economic prospect of Hong Kong where opportunities and challenges are both anticipated. The Group will continue to strive for balanced and sustainable growth by improving the efficiency of its service network and by continuing to support the growth of its core SME, RMB and cross-border financial services.

Definitions

In this Annual Report, unless the context otherwise requires, the following terms shall have the meanings set out below:

Terms	Meanings
"ABS"	Asset-backed securities
"ALCO"	the Asset and Liability Management Committee
"Associates"	has the meaning ascribed to "associates" in the Listing Rules
"Board of BOCHK (Holdings)"	the Board of Directors of BOCHK (Holdings)
"BOC"	Bank of China Limited, a joint stock commercial bank with limited liability established under the laws of the PRC, the H shares and A shares of which are listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange respectively
"BOC (BVI)"	BOC Hong Kong (BVI) Limited, a company incorporated under the laws of the British Virgin Islands and a wholly-owned subsidiary of BOCHKG
"BOCHK"	Bank of China (Hong Kong) Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of the BOCHK (Holdings)
"BOCHKG"	BOC Hong Kong (Group) Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of BOC
"BOCI-Prudential Manager"	BOCI-Prudential Asset Management Limited, a company incorporated under the laws of Hong Kong
"BOCI-Prudential Trustee"	BOCI-Prudential Trustee Limited, a company incorporated under the laws of Hong Kong
"CAR"	Capital Adequacy Ratio, computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules

Definitions (continued)

Terms	Meanings
“CE”	Chief Executive
“CIC”	China Investment Corporation
“CRM”	Credit Risk Mitigation
“Central Huijin”	Central Huijin Investment Ltd.
“EAD”	Exposure at Default
“ECAI(s)”	External Credit Assessment Institution(s)
“FIRB”	Foundation Internal Ratings-Based
“Fitch”	Fitch Ratings
“FMD”	Financial Management Division
“HKAS(s)”	Hong Kong Accounting Standard(s)
“HKFRS(s)”	Hong Kong Financial Reporting Standard(s)
“HKICPA”	Hong Kong Institute of Certified Public Accountants
“HK(IFRIC)-Int”	Hong Kong (IFRIC) Interpretation

Definitions (continued)

Terms	Meanings
“HKMA”	Hong Kong Monetary Authority
“HK(SIC)-Int”	Hong Kong (SIC) Interpretation
“Hong Kong”	Hong Kong Special Administrative Region
“ICAAP”	Internal Capital Adequacy Assessment Process
“IRB”	Internal Ratings-Based
“LGD”	Loss Given Default
“Listing Rules”	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
“Mainland” or “Mainland China”	the mainland of the PRC
“MBS”	Mortgage-backed securities
“Moody’s”	Moody’s Investors Service
“MPF”	Mandatory Provident Fund
“MPF Schemes Ordinance”	the Mandatory Provident Fund Schemes Ordinance, Chapter 485 of the Laws of Hong Kong, as amended
“NCB (China)”	Nanyang Commercial Bank (China), Limited, a company incorporated under the laws of the PRC and a wholly-owned subsidiary of the Bank
“ORSO schemes”	the Occupational Retirement Schemes under Occupational Retirement Schemes Ordinance, Chapter 426 of the Laws of Hong Kong
“PD”	Probability of Default

Definitions (continued)

Terms	Meanings
"PRC"	the People's Republic of China
"RMB" or "Renminbi"	Renminbi, the lawful currency of the PRC
"RMC"	Risk Management Committee
"Share Option Scheme"	the Share Option Scheme conditionally approved and adopted by the shareholders of BOCHK (Holdings) on 10 July 2002
"Sharesave Plan"	the Sharesave Plan conditionally approved and adopted by the shareholders of BOCHK (Holdings) on 10 July 2002
"SME(s)"	Small and medium-sized enterprise(s)
"STC"	Standardised (Credit Risk)
"STM"	Standardised (Market Risk)
"Standard & Poor's"	Standard & Poor's Ratings Services
"Stock Exchange" or "Hong Kong Stock Exchange" or "Stock Exchange of Hong Kong"	The Stock Exchange of Hong Kong Limited
"US"	the United States of America
"VAR"	Value at Risk