

2013



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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 2013.

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 4.

The directors declared an interim dividend of HK\$77 per share totaling HK\$539,000,000 on 12 December 2013 which was paid on 30 December 2013.

Reserves

Details of movements in the reserves of the Group are set out in the consolidated statement of changes in equity on page 9.

Donations

Charitable and other donations made by the Group during the year amounted to approximately HK\$793,000.

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

Directors: Gao Yingxin[#]
Li Jiuzhong[#]
Zhu Yanlai[#]
Chan Sai Ming
Chang Hsin Kang*
Lan Hong Tsung, David*
Lau Hon Chuen*
Zhuo Chengwen[#]

(resigned on 12 August 2013)

[#] 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. Fang Hongguang, Mr. Gao Yingxin and Mr. Lan Hong Tsung, David retire at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

Directors' Interests in Equity or Debt Securities

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 2013 comply with the requirements set out in the Banking (Disclosure) Rules under the Hong Kong Banking Ordinance.

Auditors

At the close of the 2013 annual general meeting held on 28 May 2013, PricewaterhouseCoopers retired as auditor of the Bank upon expiration of its term of office and Ernst & Young ("EY") was appointed as new auditor of the Bank to hold office until the conclusion of the 2014 annual general meeting.

The financial statements for the year 2013 have been audited by EY who will retire and offer themselves for re-appointment at the 2014 annual general meeting.

On behalf of the Board

Zhou Zaiqun

Chairman

Hong Kong, 20 March 2014

Independent Auditors' 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 4 to 180, which comprise the consolidated and company balance sheets as at 31 December 2013, 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.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. Our report is made 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 auditors' judgement, 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 auditors consider internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the Group as at 31 December 2013, 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.

Ernst & Young
Certified Public Accountants
Hong Kong
20 March 2014

Consolidated Income Statement

| For the year ended 31 December | Notes | 2013 HK\$'000 | 2012 HK\$'000 |
|--|-------|------------------|------------------|
| Interest income | | 8,776,796 | 7,710,456 |
| Interest expense | | (4,085,630) | (3,777,643) |
| Net interest income | 6 | 4,691,166 | 3,932,813 |
| Fee and commission income | | 1,075,126 | 822,777 |
| Fee and commission expense | | (66,501) | (67,598) |
| Net fee and commission income | 7 | 1,008,625 | 755,179 |
| Net trading gain | 8 | 97,221 | 147,216 |
| Net (loss)/gain on financial instruments designated at fair value through profit or loss | | (16,193) | 21,959 |
| Net gain on other financial assets | 9 | 52,496 | 16,601 |
| Other operating income | 10 | 75,470 | 57,109 |
| Net operating income before impairment allowances | | 5,908,785 | 4,930,877 |
| Net charge of impairment allowances | 11 | (369,967) | (396,948) |
| Net operating income | | 5,538,818 | 4,533,929 |
| Operating expenses | 12 | (2,352,498) | (1,946,297) |
| Operating profit | | 3,186,320 | 2,587,632 |
| Net gain from fair value adjustments on investment properties | 13 | 169,414 | 178,766 |
| Net gain/(loss) from disposal/revaluation of properties, plant and equipment | 14 | 3,476 | (6,627) |
| Profit before taxation | | 3,359,210 | 2,759,771 |
| Taxation | 15 | (530,553) | (419,813) |
| Profit for the year | | 2,828,657 | 2,339,958 |
| Dividends | 17 | 539,000 | 392,000 |

The notes on pages 12 to 180 are an integral part of these financial statements.

Consolidated Statement of Comprehensive Income

| For the year ended 31 December | Notes | 2013 HK\$'000 | 2012 HK\$'000 |
|--|-------|------------------|------------------|
| Profit for the year | | 2,828,657 | 2,339,958 |
| Items that will not be reclassified subsequently to income statement: | | | |
| Premises: | | | |
| Revaluation of premises | | 794,564 | 1,388,296 |
| Deferred tax | 34 | (119,553) | (218,290) |
| | | 675,011 | 1,170,006 |
| Items that may be reclassified subsequently to income statement: | | | |
| Available-for-sale securities: | | | |
| Change in fair value of available-for-sale securities | | (624,520) | 328,116 |
| Release upon disposal of available-for-sale securities reclassified to income statement | | (31,292) | (11,839) |
| Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities reclassified to income statement | | - | (715) |
| Deferred tax | 34 | 117,817 | (47,000) |
| | | (537,995) | 268,562 |
| Change in fair value of hedging instruments under net investment hedges | | (41,055) | (4,138) |
| Currency translation difference | | 301,150 | 94,637 |
| | | (277,900) | 359,061 |
| Other comprehensive income for the year, net of tax | | 397,111 | 1,529,067 |
| Total comprehensive income for the year | | 3,225,768 | 3,869,025 |

The notes on pages 12 to 180 are an integral part of these financial statements.

Statement of Comprehensive Income

| For the year ended 31 December | Notes | 2013 HK\$'000 | 2012 HK\$'000 |
|--|-------|------------------|------------------|
| Profit for the year | | 2,410,506 | 2,072,764 |
| Items that will not be reclassified subsequently to income statement: | | | |
| Premises: | | | |
| Revaluation of premises | | 775,889 | 1,379,172 |
| Deferred tax | 34 | (114,777) | (217,913) |
| | | 661,112 | 1,161,259 |
| Items that may be reclassified subsequently to income statement: | | | |
| Available-for-sale securities: | | | |
| Change in fair value of available-for-sale securities | | (494,573) | 340,360 |
| Release upon disposal of available-for-sale securities reclassified to income statement | | (22,303) | (10,893) |
| Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities reclassified to income statement | | - | (715) |
| Deferred tax | 34 | 83,082 | (50,297) |
| | | (433,794) | 278,455 |
| Currency translation difference | | 405 | (35) |
| | | (433,389) | 278,420 |
| Other comprehensive income for the year, net of tax | | 227,723 | 1,439,679 |
| Total comprehensive income for the year | | 2,638,229 | 3,512,443 |

The notes on pages 12 to 180 are an integral part of these financial statements.

Consolidated Balance Sheet

| As at 31 December | Notes | 2013 HK\$'000 | 2012 HK\$'000 |
|---|-------|--------------------|--------------------|
| ASSETS | | | |
| Cash and balances with banks and other financial institutions | 20 | 44,739,319 | 40,788,320 |
| Placements with banks and other financial institutions maturing between one and twelve months | | 21,344,000 | 17,308,944 |
| Financial assets at fair value through profit or loss | 21 | 4,164,693 | 5,125,160 |
| Derivative financial instruments | 22 | 508,453 | 764,577 |
| Advances and other accounts | 23 | 155,316,751 | 138,032,685 |
| Investment in securities | 25 | 42,272,143 | 40,989,649 |
| Investment properties | 27 | 1,174,938 | 1,027,083 |
| Properties, plant and equipment | 28 | 6,969,237 | 6,224,995 |
| Deferred tax assets | 34 | 152,831 | 49,727 |
| Other assets | 29 | 3,741,595 | 1,442,298 |
| Total assets | | 280,383,960 | 251,753,438 |
| LIABILITIES | | | |
| Deposits and balances from banks and other financial institutions | | 28,846,029 | 20,262,071 |
| Financial liabilities at fair value through profit or loss | 30 | 4,433,736 | 4,975,073 |
| Derivative financial instruments | 22 | 343,156 | 459,607 |
| Deposits from customers | 31 | 198,160,417 | 185,533,717 |
| Other accounts and provisions | 32 | 15,229,501 | 9,998,985 |
| Current tax liabilities | | 205,587 | 82,384 |
| Deferred tax liabilities | 34 | 865,545 | 828,380 |
| Total liabilities | | 248,083,971 | 222,140,217 |
| EQUITY | | | |
| Share capital | 35 | 700,000 | 700,000 |
| Reserves | 36 | 31,599,989 | 28,913,221 |
| Total equity | | 32,299,989 | 29,613,221 |
| Total liabilities and equity | | 280,383,960 | 251,753,438 |

The notes on pages 12 to 180 are an integral part of these financial statements.

Approved by the Board of Directors on 20 March 2014 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 | 2013 HK\$'000 | 2012 HK\$'000 |
|---|-------|--------------------|--------------------|
| ASSETS | | | |
| Cash and balances with banks and other financial institutions | 20 | 18,840,334 | 21,758,708 |
| Placements with banks and other financial institutions maturing between one and twelve months | | 1,858,262 | 1,579,422 |
| Financial assets at fair value through profit or loss | 21 | 4,164,693 | 5,125,160 |
| Derivative financial instruments | 22 | 410,434 | 649,703 |
| Advances and other accounts | 23 | 98,373,617 | 89,917,821 |
| Investment in securities | 25 | 36,401,978 | 33,899,483 |
| Investment in subsidiaries | 26 | 8,171,067 | 8,171,067 |
| Investment properties | 27 | 1,126,510 | 979,670 |
| Properties, plant and equipment | 28 | 6,191,967 | 5,461,161 |
| Deferred tax assets | 34 | - | 662 |
| Other assets | 29 | 3,532,439 | 1,067,668 |
| Total assets | | 179,071,301 | 168,610,525 |
| LIABILITIES | | | |
| Deposits and balances from banks and other financial institutions | | 7,488,291 | 4,173,831 |
| Financial liabilities at fair value through profit or loss | 30 | 4,433,736 | 4,975,073 |
| Derivative financial instruments | 22 | 248,314 | 376,425 |
| Deposits from customers | 31 | 131,724,586 | 128,178,500 |
| Other accounts and provisions | 32 | 4,222,445 | 2,184,907 |
| Current tax liabilities | | 162,987 | 67,322 |
| Deferred tax liabilities | 34 | 856,737 | 819,491 |
| Total liabilities | | 149,137,096 | 140,775,549 |
| EQUITY | | | |
| Share capital | 35 | 700,000 | 700,000 |
| Reserves | 36 | 29,234,205 | 27,134,976 |
| Total equity | | 29,934,205 | 27,834,976 |
| Total liabilities and equity | | 179,071,301 | 168,610,525 |

The notes on pages 12 to 180 are an integral part of these financial statements.

Approved by the Board of Directors on 20 March 2014 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 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 |

| | 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 2013 | 700,000 | 2,444,517 | 605 | 4,837,228 | 373,164 | 1,547,011 | 707,977 | 19,002,719 | 29,613,221 |
| Profit for the year | - | - | - | - | - | - | - | 2,828,657 | 2,828,657 |
| Other comprehensive income: | | | | | | | | | |
| Premises | - | - | - | 675,011 | - | - | - | - | 675,011 |
| Available-for-sale securities | - | - | - | - | (537,995) | - | - | - | (537,995) |
| Change in fair value of hedging instruments under net investment hedges | - | - | - | - | - | - | (41,055) | - | (41,055) |
| Currency translation difference | - | - | - | 3,500 | (57) | - | 297,707 | - | 301,150 |
| Total comprehensive income | - | - | - | 678,511 | (538,052) | - | 256,652 | 2,828,657 | 3,225,768 |
| Transfer from retained earnings | - | - | - | - | - | 397,969 | - | (397,969) | - |
| Dividends | - | - | - | - | - | - | - | (539,000) | (539,000) |
| At 31 December 2013 | 700,000 | 2,444,517 | 605 | 5,515,739 | (164,888) | 1,944,980 | 964,629 | 20,894,407 | 32,299,989 |

* 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 12 to 180 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 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 |
| 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 |

| | 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 2013 | 700,000 | 2,444,517 | 4,665,171 | 375,089 | 491,984 | (5,532) | 19,163,747 | 27,834,976 |
| Profit for the year | - | - | - | - | - | - | 2,410,506 | 2,410,506 |
| Other comprehensive income: | | | | | | | | |
| Premises | - | - | 661,112 | - | - | - | - | 661,112 |
| Available-for-sale securities | - | - | - | (433,794) | - | - | - | (433,794) |
| Currency translation difference | - | - | - | - | - | 405 | - | 405 |
| Total comprehensive income | - | - | 661,112 | (433,794) | - | 405 | 2,410,506 | 2,638,229 |
| Transfer from retained earnings | - | - | - | - | 98,905 | - | (98,905) | - |
| Dividends | - | - | - | - | - | - | (539,000) | (539,000) |
| At 31 December 2013 | 700,000 | 2,444,517 | 5,326,283 | (58,705) | 590,889 | (5,127) | 20,936,348 | 29,934,205 |

* 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 12 to 180 are an integral part of these financial statements.

Consolidated Cash Flow Statement

| For the year ended 31 December | Notes | 2013 HK\$'000 | 2012 HK\$'000 |
|--|-------|-------------------|--------------------|
| Cash flows from operating activities | | | |
| Operating cash inflow/(outflow) before taxation | 37(a) | 5,927,086 | (6,710,114) |
| Hong Kong profits tax paid | | (354,140) | (505,312) |
| Overseas profits tax paid | | (118,751) | (73,560) |
| Net cash inflow/(outflow) from operating activities | | 5,454,195 | (7,288,986) |
| Cash flows from investing activities | | | |
| Purchase of properties, plant and equipment | 28 | (109,955) | (429,519) |
| Proceeds from disposal of properties, plant and equipment | | 720 | 5,502 |
| Net cash outflow from investing activities | | (109,235) | (424,017) |
| Cash flows from financing activities | | | |
| Dividends paid | | (539,000) | (392,000) |
| Net cash outflow from financing activities | | (539,000) | (392,000) |
| Increase/(decrease) in cash and cash equivalents | | 4,805,960 | (8,105,003) |
| Cash and cash equivalents at 1 January | | 33,701,213 | 41,732,029 |
| Effect of exchange rate changes on cash and cash equivalents | | 501,392 | 74,187 |
| Cash and cash equivalents at 31 December | 37(b) | 39,008,565 | 33,701,213 |

The notes on pages 12 to 180 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. 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, amendments and interpretation already mandatorily effective for accounting periods beginning on 1 January 2013

| 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 |
| 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 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 | No |
| HKFRS 10, 11 and 12 (Amendment) | Transition Guidance | 1 January 2013 | Yes |
| 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 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 affects the presentation of the Group's statement of comprehensive income.
- 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.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation already mandatorily effective for accounting periods beginning on 1 January 2013 (continued)

- HKAS 27 (2011), "Separate Financial Statements". Please refer to the below on HKFRS 10, "Consolidated Financial Statements".
- HKFRS 7 (Amendment), "Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities". The amendments require new disclosures to include information that 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. New disclosure for the adoption of this amended standard is presented in Note 43.
- 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 as 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)

(a) Standards, amendments and interpretation already mandatorily effective for accounting periods beginning on 1 January 2013 (continued)

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 supersede HKAS 27 (Revised), HKAS 28, HKAS 31, HK(SIC)-Int 12 and HK(SIC)-Int 13. 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 HKFRS 10, 11 and 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. The adoption of this amendment does not affect the disclosure of the Group's financial statements.
- 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. It also requires extensive disclosures which allow users of financial statements to assess the methods and inputs used by the entities when developing the fair value measurements. The new disclosure is presented in Note 5.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretation issued that are not yet mandatorily effective and have not been early adopted by the Group in 2013

The following standards, amendments and interpretation have been issued and are mandatory for accounting periods beginning on or after 1 January 2014:

| Standard/Interpretation | Content | Applicable for financial years beginning on/after | Currently relevant to the Group |
|---------------------------------------|---|---|---------------------------------|
| HKAS 19 (2011) (Amendment) | Employee Benefits: Defined Benefit Plans | 1 July 2014 | No |
| HKAS 32 (Amendment) | Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities | 1 January 2014 | Yes |
| HKAS 36 (Amendment) | Impairment of Assets: Recoverable Amount Disclosures for Non-Financial Assets | 1 January 2014 | Yes |
| HKAS 39 (Amendment) | Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting | 1 January 2014 | Yes |
| HKFRS 7 (Amendment) | Financial Instruments: Disclosures – Transition to HKFRS 9 | 1 January 2015 | Yes |
| HKFRS 9 | Financial Instruments | To be determined | Yes |
| HKFRS 10, 12 and HKAS 27 (Amendments) | Investment Entities | 1 January 2014 | No |
| HK(IFRIC) – Int 21 | Levies | 1 January 2014 | Yes |

- 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 adoption of this amendment does not have a material impact on the Group’s financial statements.
- HKAS 36 (Amendment), “Impairment of Assets: Recoverable Amount Disclosures for Non-Financial Assets”. The amendment aligns the disclosure requirements with its original intention which does not intend to disclose at level of cash generating unit. It also requires additional disclosure about the fair value measurement when the recoverable amount of impaired assets is based on fair value less costs of disposal. The adoption of this amendment does not 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 interpretation issued that are not yet mandatorily effective and have not been early adopted by the Group in 2013 (continued)

- HKAS 39 (Amendment), "Financial Instruments: Recognition and Measurement — Novation of Derivatives and Continuation of Hedge Accounting". The amendment introduces a relief to allow hedge accounting to continue in a situation where a derivative, which has been designated as a hedging instrument, is novated to effect clearing with a central counterparty as a result of laws or regulation. The adoption of this amendment does not have a material impact on 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.
- 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. In December 2013, the part related to hedge accounting was further added. 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.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretation issued that are not yet mandatorily effective and have not been early adopted by the Group in 2013 (continued)

(i) Classification and Measurement (continued)

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 the income statement. Once elected to be recognised through other comprehensive income, there will be no reclassification of fair value gains and losses to the income statement.

(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 the income statement. If this requirement creates or enlarges an accounting mismatch in profit or loss, then the whole fair value change is presented in the 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 the income statement but may be transferred within equity.

The standard also 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.

(iii) Hedge accounting

The requirements related to hedge accounting relaxes the requirements for assessing hedge effectiveness which more risk management strategies would be eligible for hedge accounting. It also relaxes the rules on using purchased options and non-derivative financial instruments as hedging instruments and allows greater flexibility on the hedged items. Corresponding disclosures about risk management activity for applying hedge accounting are also introduced.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretation issued that are not yet mandatorily effective and have not been early adopted by the Group in 2013 (continued)

It is expected that the final part on impairment of financial assets will be pronounced in 2014. HKAS 39 will be replaced by HKFRS 9 in its entirety. The previous mandatory effective date of HKFRS 9 was removed and the new mandatory effective date will be determined upon the entire completion of HKFRS 9. Early adoption of HKFRS 9 is permitted but the part of classification and measurement and hedge accounting must be applied at the same time. The accounting for own credit risk can be early adopted in isolation without applying the other HKFRS 9 requirements at the same time. The Group is considering the financial impact of the standard and the timing of its application.

- HK(IFRIC) – Int 21, “Levies”. The interpretation addresses how an entity should account for liabilities to pay levies imposed by governments, other than income taxes, in its financial statements. For a levy that is triggered upon reaching a minimum threshold, no liability should be anticipated before the specified minimum threshold is reached. The adoption of this amendment does not have a material impact on the Group's financial statements.

(c) Improvements to HKFRSs

“Improvements to HKFRSs” contains numerous amendments to HKFRSs 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 HKFRSs. The amendments are either effective and adopted for annual periods beginning on or after 1 January 2013 or will be effective on or after 1 July 2014. The adoption of these improvements does not have a material impact on the Group's financial statements.

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 entities controlled by the Group. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. 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)

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 cash flow hedges and 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 option pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

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 of hedged items. These criteria should be met before a hedge can be qualified to be accounted for under hedge accounting.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.6 Hedge accounting (continued)

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 the income statement upon disposal of the foreign operation as part of the gain or loss on disposal.

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.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

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.

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 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 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.

For a financial asset reclassified from the available-for-sale category, the fair value carrying amount at the date of reclassification becomes its new amortised cost and any previous gain or loss on that asset that has been recognised in other comprehensive income is amortised to profit or loss over the remaining life of the investment using the effective interest method. Any difference between the new amortised cost and the maturity amount is also amortised over the remaining life of the financial asset using the effective interest method. If the financial asset is subsequently determined to be impaired, the amount recorded in other comprehensive income is reclassified to profit or loss immediately.

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 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 guarantee contracts 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 guarantee contracts 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 expires.

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 in 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 Fair value measurement

The Group measures its premises and investment properties and certain financial instruments at fair value at the end of each reporting period. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in its principal market or the most advantageous market accessible by the Group at the measurement date.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

If the market for assets or liabilities is not active, the Group uses valuation techniques, 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, that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

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 security 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.

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)

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.

(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 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.

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 an 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 the 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 (i.e. transaction price) of the land amounted to substantially all of the fair value of the land as if it were freehold.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.18 Leases (continued)

(2) Finance leases (continued)

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 (i) that party controls, jointly controls or has significant influence over the Group; (ii) is a member of the same financial reporting group, such as parents, subsidiaries and fellow subsidiaries; (iii) is an associate or a joint venture of the Group or parent reporting group; (iv) is a key management personnel of the Group or parents, (v) the party is subject to common control with the Group; and (vi) and entity in which a person identified in (iv) controls. 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 2013 are shown in Note 23.

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 2013 are shown in Note 25.

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 such as option pricing models. To the extent practical, the models use observable data. In addition, valuation adjustments may be adopted if factors such as credit risk are not considered in the valuation models. Management judgement and estimates are required for the selection of appropriate valuation parameters, assumptions and modeling techniques. Further details will be discussed in Note 5.

Carrying amounts of derivative financial instruments as at 31 December 2013 are shown in Note 22.

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 2013 are shown in Note 25.

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 processes 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 business processes and ensures various risks are properly managed and controlled in the course of conducting business. The Group has a robust 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 updated to reflect changes in markets and business strategies. Various groups of risk takers assume their respective responsibilities for risk management.

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 its committees, has the primary responsibility for the formulation of risk management strategies and for ensuring that the Group has an effective risk management system to implement these strategies.

The Risk Management Committee, a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, approving high-level risk-related policies and monitoring their implementation, reviewing and approving significant or high risk exposures or transactions. The Risk Management Committee 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 promote an appropriate internal control environment.

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

Product development and risk monitoring

To ensure the effectiveness of risk assessment and monitoring, the Group has a comprehensive product development and risk monitoring system where roles and responsibilities of all related units are clearly defined and proper due diligence processes on product development are in place.

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 product management units shall work closely with relevant risk evaluating divisions to identify and assess the risks of new products. Risk evaluating divisions shall conduct independent review on the risk assessment results and the corresponding risk management measures. Products can only be launched upon completion of the product due diligence process to the satisfaction of all risk evaluating divisions.

A prudent approach is adopted 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 arising from a customer or counterparty that 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 the lending, trade finance and 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 updated to cope with changes in 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, a management committee authorised by the Chief Executive, 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 defence. 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 Credit and Loans Management Committee, Chief Executive and Risk Management Committee. NCB (China) sets up independent risk monitoring teams to monitor credit risk, and submits 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 Chief Executive. Based on management needs, the Chief Executive can further delegate to the subordinates within the limits authorised by the Board of Directors. The Group sets the limits of credit approval authority according to business nature, internal rating, level of transaction risk and 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.

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 advances 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 probability of default) and facility ratings (in terms of loss given default) are assigned to credit applications for non-retail exposures to support credit approval. Retail internal rating systems are deployed in the risk assessment of retail credit transactions, including small business retail exposures, residential mortgage loans and 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, reporting and analysis of credit risk information. For non-retail exposures, more frequent rating review and closer monitoring are required for higher-risk 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 employs a credit master scale for internal rating purpose that can be mapped to Standard & Poor's external ratings. The credit master scale for internal rating is in compliance with the Banking (Capital) Rules under the Hong Kong Banking Ordinance on internal rating structure..

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

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

In the year of 2013, the Group continues to adopt loan grading criteria which divide credit assets into 5 categories with reference to HKMA's guidelines, as below:

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Credit risk measurement and control (continued)

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 applied for 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 or customer to cover all settlement risks arising from the Group's market 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 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 assesses the guarantor's financial condition, credit history and ability to meet obligations.

As at 31 December 2013 and 2012, the Group did not hold any collateral that it was permitted to sell or re-pledge in the absence of default by the borrower.

(A) Credit exposures

The maximum exposure is the worst case scenario of 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 on 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 49. 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 62 to 65. 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, 14.94% (2012: 15.79%) is covered by collateral as at 31 December 2013.

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 | |
|-----------------------|--------------------|-----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Advances to customers | | |
| Personal | | |
| - Mortgages | 19,071,015 | 17,143,632 |
| - Credit cards | 454,882 | - |
| - Others | 7,201,697 | 4,858,417 |
| Corporate | | |
| - Commercial loans | 108,469,101 | 103,158,279 |
| - Trade finance | 8,345,348 | 5,992,781 |
| | 143,542,043 | 131,153,109 |
| Trade bills | 13,242,636 | 8,069,618 |
| Total | 156,784,679 | 139,222,727 |

| | The Bank | |
|-----------------------|-------------------|-----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Advances to customers | | |
| Personal | | |
| - Mortgages | 10,468,766 | 11,326,989 |
| - Others | 6,053,509 | 4,324,775 |
| Corporate | | |
| - Commercial loans | 66,166,653 | 64,479,702 |
| - Trade finance | 6,902,201 | 4,931,864 |
| | 89,591,129 | 85,063,330 |
| Trade bills | 9,458,019 | 5,504,118 |
| Total | 99,049,148 | 90,567,448 |

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 principal payment or interest;
- 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 | | |
|-----------------------|-------------|--------------------|-------------------------|
| | 2013 | | |
| | Pass | Special mention | Substandard or below |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Advances to customers | | | |
| Personal | | | |
| - Mortgages | 18,699,997 | 23,672 | 1,958 |
| - Credit cards | 445,096 | - | - |
| - Others | 7,111,627 | 3,798 | 1,697 |
| Corporate | | | |
| - Commercial loans | 104,860,954 | 2,953,206 | 12,863 |
| - Trade finance | 8,193,494 | 87,262 | - |
| | 139,311,168 | 3,067,938 | 16,518 |
| Trade bills | 13,242,636 | - | - |
| Total | 152,553,804 | 3,067,938 | 16,518 |

| | The Group | | |
|-----------------------|-------------|--------------------|-------------------------|
| | 2012 | | |
| | Pass | Special mention | Substandard or below |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Advances to customers | | | |
| Personal | | | |
| - Mortgages | 16,895,662 | 23,523 | 2,066 |
| - Others | 4,792,158 | 8,453 | 1,607 |
| Corporate | | | |
| - Commercial loans | 100,427,042 | 2,145,488 | 72 |
| - Trade finance | 5,686,815 | 240,980 | - |
| | 127,801,677 | 2,418,444 | 3,745 |
| Trade bills | 8,069,618 | - | - |
| Total | 135,871,295 | 2,418,444 | 3,745 |

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 | | |
|-----------------------|------------|--------------------|-------------------------|
| | 2013 | | |
| | Pass | Special mention | Substandard or below |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Advances to customers | | | |
| Personal | | | |
| - Mortgages | 10,345,633 | 4,093 | 1,285 |
| - Others | 5,986,849 | 3,155 | 1,697 |
| Corporate | | | |
| - Commercial loans | 64,167,947 | 1,728,339 | 12,863 |
| - Trade finance | 6,810,267 | 54,863 | - |
| | 87,310,696 | 1,790,450 | 15,845 |
| Trade bills | 9,458,019 | - | - |
| Total | 96,768,715 | 1,790,450 | 15,845 |

| | The Bank | | |
|-----------------------|------------|--------------------|-------------------------|
| | 2012 | | |
| | Pass | Special mention | Substandard or below |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Advances to customers | | | |
| Personal | | | |
| - Mortgages | 11,230,412 | 2,421 | 1,300 |
| - Others | 4,282,075 | 8,453 | 1,607 |
| Corporate | | | |
| - Commercial loans | 62,857,999 | 1,321,210 | 72 |
| - Trade finance | 4,693,834 | 198,501 | - |
| | 83,064,320 | 1,530,585 | 2,979 |
| Trade bills | 5,504,118 | - | - |
| Total | 88,568,438 | 1,530,585 | 2,979 |

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 and do not overdue, 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 | | | | | |
|-----------------------|---|---|--|---------------------------------|----------|
| 2013 | | | | | |
| | 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 | 312,480 | 92 | - | 5,475 | 318,047 |
| - Credit cards | 9,243 | 543 | - | - | 9,786 |
| - Others | 69,397 | 1,174 | 5,117 | - | 75,688 |
| Corporate | | | | | |
| - Commercial loans | 288,300 | 6,221 | 2,178 | 1,042 | 297,741 |
| - Trade finance | 9,882 | - | 477 | - | 10,359 |
| Total | 689,302 | 8,030 | 7,772 | 6,517 | 711,621 |

| 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 |

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 | | | | | |
|-----------------------|---|---|--|---------------------------------|----------|
| 2013 | | | | | |
| | 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 | 117,425 | 92 | - | 238 | 117,755 |
| - Others | 54,407 | 1,174 | - | - | 55,581 |
| Corporate | | | | | |
| - Commercial loans | 125,212 | 6,221 | 2,178 | - | 133,611 |
| - Trade finance | 9,882 | - | 477 | - | 10,359 |
| Total | 306,926 | 7,487 | 2,655 | 238 | 317,306 |

| The Bank | | | | | |
|-----------------------|---|---|--|---------------------------------|----------|
| 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 | 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 |

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 | | | |
|---|----------------------------|--|----------------------------|--|
| | 2013 | | 2012 | |
| | Gross advances HK\$'000 | Market value of collateral HK\$'000 | Gross advances HK\$'000 | Market value of collateral HK\$'000 |
| Advances to customers | | | | |
| Personal | | | | |
| - Mortgages | 27,341 | 30,941 | 18,111 | 19,217 |
| - Others | 8,887 | 5,702 | 4,747 | 5,586 |
| Corporate | | | | |
| - Commercial loans | 344,337 | 109,922 | 379,812 | 157,993 |
| - Trade finance | 54,233 | 57,575 | 61,582 | 83,399 |
| Total | 434,798 | 204,140 | 464,252 | 266,195 |
| Loan impairment allowances made in respect of such advances | <u>280,913</u> | | <u>220,593</u> | |

| | The Bank | | | |
|---|----------------------------|--|----------------------------|--|
| | 2013 | | 2012 | |
| | Gross advances HK\$'000 | Market value of collateral HK\$'000 | Gross advances HK\$'000 | Market value of collateral HK\$'000 |
| Advances to customers | | | | |
| Personal | | | | |
| - Others | 6,227 | 3,412 | 777 | - |
| Corporate | | | | |
| - Commercial loans | 123,893 | 42,303 | 97,220 | 76,219 |
| - Trade finance | 26,712 | 8,177 | 36,125 | 17,017 |
| Total | 156,832 | 53,892 | 134,122 | 93,236 |
| Loan impairment allowances made in respect of such advances | <u>79,556</u> | | <u>58,444</u> | |

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

As at 31 December 2013 and 2012, there were no impaired trade bills.

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 | |
|---|----------------|----------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Current market value of collateral held against the covered portion of such advances to customers | 204,140 | 266,195 |
| Covered portion of such advances to customers | 153,690 | 177,725 |
| Uncovered portion of such advances to customers | 281,108 | 286,527 |

| | The Bank | |
|---|----------------|----------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Current market value of collateral held against the covered portion of such advances to customers | 53,892 | 93,236 |
| Covered portion of such advances to customers | 48,739 | 51,233 |
| Uncovered portion of such advances to customers | 108,093 | 82,889 |

Classified or impaired advances to customers are analysed as follows:

| | The Group | |
|---|----------------|----------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Gross classified or impaired advances to customers | 485,811 | 483,659 |
| Gross classified or impaired advances to customers as a percentage of gross advances to customers | 0.34% | 0.37% |
| Individually assessed loan impairment allowances made in respect of such advances | 280,913 | 220,593 |

| | The Bank | |
|---|----------------|----------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Gross classified or impaired advances to customers | 192,199 | 147,240 |
| Gross classified or impaired advances to customers as a percentage of gross advances to customers | 0.21% | 0.17% |
| Individually assessed loan impairment allowances made in respect of such advances | 79,556 | 58,444 |

Classified or impaired advances to customers 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 | | | |
|---|--------------------|--|--------------------|--|
| | 2013 | | 2012 | |
| | Amount HK\$'000 | % of gross advances to customers | Amount HK\$'000 | % of gross advances to customers |
| Gross advances to customers which have been overdue for: | | | | |
| - six months or less but over three months | 197,953 | 0.14% | 37,443 | 0.03% |
| - one year or less but over six months | 67,182 | 0.04% | 101,388 | 0.08% |
| - over one year | 126,102 | 0.09% | 125,587 | 0.09% |
| Advances overdue for over three months | 391,237 | 0.27% | 264,418 | 0.20% |
| Individually assessed loan impairment allowances made in respect of such advances | 266,765 | | 121,444 | |

| | The Bank | | | |
|---|--------------------|--|--------------------|--|
| | 2013 | | 2012 | |
| | Amount HK\$'000 | % of gross advances to customers | Amount HK\$'000 | % of gross advances to customers |
| Gross advances to customers which have been overdue for: | | | | |
| - six months or less but over three months | 41,010 | 0.05% | 23,086 | 0.03% |
| - one year or less but over six months | 48,844 | 0.05% | 9,707 | 0.01% |
| - over one year | 49,067 | 0.06% | 25,591 | 0.03% |
| Advances overdue for over three months | 138,921 | 0.16% | 58,384 | 0.07% |
| Individually assessed loan impairment allowances made in respect of such advances | 68,315 | | 21,359 | |

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 | |
|---|------------------|-----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Current market value of collateral held against the covered portion of such advances to customers | 201,240 | 611,086 |
| Covered portion of such advances to customers | 145,200 | 150,371 |
| Uncovered portion of such advances to customers | 246,037 | 114,047 |

| | The Bank | |
|---|-----------------|-----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Current market value of collateral held against the covered portion of such advances to customers | 50,439 | 430,151 |
| Covered portion of such advances to customers | 41,597 | 20,753 |
| Uncovered portion of such advances to customers | 97,324 | 37,631 |

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 2013 and 2012, there were no trade bills 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 | | | |
|--|--------------------|--|--------------------|--|
| | 2013 | | 2012 | |
| | Amount HK\$'000 | % of gross advances to customers | Amount HK\$'000 | % of gross advances to customers |
| Rescheduled advances to customers net of amounts included in "Advances overdue for more than three months" | 6,288 | 0.00% | 11,039 | 0.01% |

| | The Bank | | | |
|--|--------------------|--|--------------------|--|
| | 2013 | | 2012 | |
| | Amount HK\$'000 | % of gross advances to customers | Amount HK\$'000 | % of gross advances to customers |
| Rescheduled advances to customers net of amounts included in "Advances overdue for more than three months" | 6,288 | 0.01% | 11,039 | 0.01% |

As at 31 December 2013 and 2012, there were no rescheduled advances to banks and other financial institutions.

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 following analysis of the gross advances to customers by industry sector is based on the categories with reference to the Completion Instructions for the HKMA return of loans and advances.

| | The Group | | | | | |
|---|----------------|---|------------------------|-----------|---|---|
| | 2013 | | | | | |
| | 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 | 2,216,959 | 49.42% | - | - | - | 9,953 |
| - Property investment | 12,296,487 | 86.23% | 15,573 | 58,529 | 1,150 | 124,766 |
| - Financial concerns | 2,819,772 | 13.24% | - | - | - | 8,427 |
| - Stockbrokers | 266,540 | 0.53% | - | - | - | 643 |
| - Wholesale and retail trade | 10,133,696 | 32.83% | 67,961 | 109,124 | 19,731 | 79,617 |
| - Manufacturing | 4,580,945 | 37.58% | 39,580 | 43,157 | 24,498 | 43,219 |
| - Transport and transport equipment | 3,944,329 | 13.50% | 713 | 2,855 | 167 | 34,125 |
| - Recreational activities | 61,579 | - | - | - | - | 159 |
| - Information technology | 2,051,533 | 1.76% | 2,298 | 2,298 | 649 | 5,388 |
| - Others | 10,931,760 | 48.71% | 19,871 | 26,902 | 8,016 | 70,296 |
| Individuals | | | | | | |
| - Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | 565,821 | 100.00% | 3,178 | 14,067 | - | 302 |
| - Loans for purchase of other residential properties | 9,902,944 | 99.91% | 1,153 | 103,688 | - | 3,820 |
| - Others | 4,807,678 | 47.61% | 3,886 | 45,691 | 771 | 4,769 |
| Total loans for use in Hong Kong | 64,580,043 | 55.38% | 154,213 | 406,311 | 54,982 | 385,484 |
| Trade finance | 8,345,348 | 26.31% | 54,710 | 64,592 | 34,580 | 60,959 |
| Loans for use outside Hong Kong | 70,616,652 | 41.43% | 276,888 | 654,409 | 191,351 | 740,572 |
| Gross advances to customers | 143,542,043 | 46.83% | 485,811 | 1,125,312 | 280,913 | 1,187,015 |

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 | | | | |
|---|----------------------------|--|---------------------------------------|---------------------|--|--|
| | | 2012 | | | | |
| | Gross advances HK\$'000 | % Covered by collateral or other security | Classified or impaired HK\$'000 | Overdue HK\$'000 | Individually assessed impairment allowances HK\$'000 | Collectively assessed impairment allowances 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 Bank | | | | | |
|---|----------------|---|------------------------|----------|---|---|
| | 2013 | | | | | |
| | 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 | 2,216,959 | 49.42% | - | - | - | 9,953 |
| - Property investment | 12,296,487 | 86.23% | 15,573 | 58,529 | 1,150 | 124,766 |
| - Financial concerns | 2,819,772 | 13.24% | - | - | - | 8,427 |
| - Stockbrokers | 266,540 | 0.53% | - | - | - | 643 |
| - Wholesale and retail trade | 10,133,696 | 32.83% | 67,961 | 109,124 | 19,731 | 79,617 |
| - Manufacturing | 4,580,945 | 37.58% | 39,580 | 43,157 | 24,498 | 43,219 |
| - Transport and transport equipment | 3,910,573 | 13.49% | 713 | 2,855 | 167 | 33,755 |
| - Recreational activities | 61,579 | - | - | - | - | 159 |
| - Information technology | 2,051,533 | 1.76% | 2,298 | 2,298 | 649 | 5,388 |
| - Others | 10,931,759 | 48.71% | 19,871 | 26,902 | 8,016 | 70,296 |
| Individuals | | | | | | |
| - Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | 565,821 | 100.00% | 3,178 | 14,067 | - | 302 |
| - Loans for purchase of other residential properties | 9,902,944 | 99.91% | 1,153 | 103,688 | - | 3,820 |
| - Others | 4,807,678 | 47.61% | 3,886 | 45,691 | 771 | 4,769 |
| Total loans for use in Hong Kong | 64,546,286 | 55.40% | 154,213 | 406,311 | 54,982 | 385,114 |
| Trade finance | 6,902,201 | 28.82% | 27,189 | 37,071 | 16,296 | 45,249 |
| Loans for use outside Hong Kong | 18,142,642 | 20.73% | 10,797 | 11,168 | 8,278 | 165,612 |
| Gross advances to customers | 89,591,129 | 46.33% | 192,199 | 454,550 | 79,556 | 595,975 |

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 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 | | | |
|--------------------------------------|---------------------------|--|---------------------------|--|
| | 2013 | | 2012 | |
| | 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 investment | 1,954 | 738 | 29,103 | 99 |
| - Financial concerns | - | - | 11,267 | - |
| - Stockbrokers | 36 | - | 257 | - |
| - Wholesale and retail trade | 11,310 | 7,449 | 22,910 | 4,337 |
| - Manufacturing | 7,211 | 2,841 | 11,775 | 1,766 |
| - Transport and transport equipment | 210 | - | 41,032 | - |
| - Recreational activities | - | - | 485 | - |
| - Information technology | 70 | - | 3,045 | - |
| - Others | 8,679 | 2,152 | 11,112 | 605 |
| Individuals | | | | |
| - Others | 9,467 | 6,747 | - | - |
| Total loans for use in Hong Kong | 38,937 | 19,927 | 130,986 | 6,807 |
| Trade finance | 11,337 | 2,556 | 53,548 | 2,649 |
| Loans for use outside Hong Kong | 383,201 | 137,691 | 231,122 | 378 |
| Gross advances to customers | 433,475 | 160,174 | 415,656 | 9,834 |

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 | | | |
|--------------------------------------|---------------------------|--|---------------------------|--|
| | 2013 | | 2012 | |
| | 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 investment | 1,954 | 738 | 29,103 | 99 |
| - Financial concerns | - | - | 11,267 | - |
| - Stockbrokers | 36 | - | 257 | - |
| - Wholesale and retail trade | 11,310 | 7,449 | 22,910 | 4,337 |
| - Manufacturing | 7,211 | 2,841 | 11,775 | 1,766 |
| - Transport and transport equipment | 77 | - | 40,950 | - |
| - Recreational activities | - | - | 485 | - |
| - Information technology | 70 | - | 3,045 | - |
| - Others | 8,679 | 2,152 | 11,112 | 605 |
| Individuals | | | | |
| - Others | 9,467 | 6,747 | - | - |
| Total loans for use in Hong Kong | 38,804 | 19,927 | 130,904 | 6,807 |
| Trade finance | 5,688 | 2,556 | 35,630 | 2,649 |
| Loans for use outside Hong Kong | 10,243 | - | 58,653 | - |
| Gross advances to customers | 54,735 | 22,483 | 225,187 | 9,456 |

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. For an advance to customer guaranteed by a party situated in a country different from the customer, the risk will be transferred to the country of the guarantor.

Gross advances to customers

| | The Group | |
|-------------------|--------------------|--------------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 71,198,417 | 67,584,057 |
| Mainland of China | 66,923,361 | 58,393,561 |
| Others | 5,420,265 | 5,175,491 |
| | 143,542,043 | 131,153,109 |

| | The Bank | |
|-------------------|-------------------|-------------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 66,697,103 | 63,543,928 |
| Mainland of China | 18,605,455 | 17,048,232 |
| Others | 4,288,571 | 4,471,170 |
| | 89,591,129 | 85,063,330 |

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

| | The Group | |
|-------------------|------------------|-----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 463,692 | 480,016 |
| Mainland of China | 633,469 | 430,812 |
| Others | 89,854 | 58,621 |
| | 1,187,015 | 969,449 |

| | The Bank | |
|-------------------|-----------------|-----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 406,112 | 429,488 |
| Mainland of China | 155,014 | 130,398 |
| Others | 34,849 | 31,297 |
| | 595,975 | 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)

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

Overdue advances

| | The Group | |
|-------------------|------------------|----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 422,834 | 472,042 |
| Mainland of China | 659,877 | 433,690 |
| Others | 42,601 | 3,608 |
| | 1,125,312 | 909,340 |

| | The Bank | |
|-------------------|----------------|----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 399,093 | 405,112 |
| Mainland of China | 43,917 | 40,430 |
| Others | 11,540 | - |
| | 454,550 | 445,542 |

Individually assessed loan impairment allowances in respect of the overdue advances

| | The Group | |
|-------------------|----------------|----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 50,989 | 93,005 |
| Mainland of China | 217,507 | 123,297 |
| Others | 4,377 | - |
| | 272,873 | 216,302 |

| | The Bank | |
|-------------------|---------------|---------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 46,567 | 35,992 |
| Mainland of China | 21,953 | 18,161 |
| Others | 4,257 | - |
| | 72,777 | 54,153 |

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 | |
|-------------------|---------------|--------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 8,155 | 3,916 |
| Mainland of China | 3,632 | 1,690 |
| Others | 238 | 11 |
| | 12,025 | 5,617 |

| | The Bank | |
|-------------------|--------------|--------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 8,016 | 3,713 |
| Mainland of China | 35 | 496 |
| Others | 57 | - |
| | 8,108 | 4,209 |

Classified or impaired advances

| | The Group | |
|-------------------|----------------|----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 154,186 | 180,495 |
| Mainland of China | 324,675 | 303,164 |
| Others | 6,950 | - |
| | 485,811 | 483,659 |

| | The Bank | |
|-------------------|----------------|----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 148,681 | 120,531 |
| Mainland of China | 36,707 | 26,709 |
| Others | 6,811 | - |
| | 192,199 | 147,240 |

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 | |
|-------------------|----------------|----------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 57,768 | 95,512 |
| Mainland of China | 218,768 | 125,081 |
| Others | 4,377 | - |
| | 280,913 | 220,593 |

| | The Bank | |
|-------------------|---------------|---------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 53,345 | 38,498 |
| Mainland of China | 21,954 | 19,946 |
| Others | 4,257 | - |
| | 79,556 | 58,444 |

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

| | The Group | |
|-------------------|--------------|------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 2,298 | 193 |
| Mainland of China | 39 | 392 |
| | 2,337 | 585 |

| | The Bank | |
|-----------|--------------|------------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Hong Kong | 2,297 | 108 |
| | 2,297 | 108 |

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 | | The Bank | |
|------------------------|------------------|-----------------|-----------------|-----------------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Industrial properties | 2,790 | 4,644 | 2,790 | 4,644 |
| Residential properties | 19,494 | 12,198 | 15,300 | 12,198 |
| | 22,284 | 16,842 | 18,090 | 16,842 |

The estimated market value of repossessed assets held by the Group and the Bank as at 31 December 2013 amounted to HK\$38,822,000 (2012: HK\$24,229,000) and HK\$34,250,000 (2012: HK\$21,581,000) respectively. They comprise properties in respect of which the Group and the Bank has 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 | | |
|--|-----------------------|---------------------------|---------------------|-------------------|
| | | 2013 | | |
| | Aaa to A3 HK\$'000 | Lower than A3 HK\$'000 | Unrated HK\$'000 | Total HK\$'000 |
| Central banks | 17,068,323 | - | - | 17,068,323 |
| Banks and other financial institutions | 15,178,049 | 20,416,998 | 12,536,250 | 48,131,297 |
| | 32,246,372 | 20,416,998 | 12,536,250 | 65,199,620 |

| | | The Group | | |
|--|-----------------------|---------------------------|---------------------|-------------------|
| | | 2012 | | |
| | Aaa to A3 HK\$'000 | Lower than A3 HK\$'000 | Unrated HK\$'000 | Total 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 Bank | | |
|--|-----------------------|---------------------------|---------------------|-------------------|
| | | 2013 | | |
| | Aaa to A3 HK\$'000 | Lower than A3 HK\$'000 | Unrated HK\$'000 | Total HK\$'000 |
| Central banks | 853,838 | - | - | 853,838 |
| Banks and other financial institutions | 6,302,846 | 8,051,195 | 4,899,332 | 19,253,373 |
| | 7,156,684 | 8,051,195 | 4,899,332 | 20,107,211 |

| | | The Bank | | |
|--|-----------------------|---------------------------|---------------------|-------------------|
| | | 2012 | | |
| | Aaa to A3 HK\$'000 | Lower than A3 HK\$'000 | Unrated HK\$'000 | Total 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 |

As at 31 December 2013 and 2012, there were no overdue or impaired balances and placements with banks and other financial institutions.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities and certificates of deposit

The following tables present an analysis of the carrying value of debt securities and certificates of deposit by issue rating.

In the absence of such issue ratings, the ratings designated for the issuers are reported.

| | The Group | | | | | |
|---|-----------|------------|------------|---------------|-----------|------------|
| | 2013 | | | | | |
| | 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 | 895,932 | 18,002,312 | 15,328,029 | 445,839 | 5,266,560 | 39,938,672 |
| Held-to-maturity securities | - | 585,144 | - | 298 | - | 585,442 |
| Loans and receivables | - | - | 1,008,897 | - | 675,167 | 1,684,064 |
| Financial assets at fair value through profit or loss | 624 | 3,665,412 | 498,657 | - | - | 4,164,693 |
| Total | 896,556 | 22,252,868 | 16,835,583 | 446,137 | 5,941,727 | 46,372,871 |
| | 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 Bank | | | | | |
| | 2013 | | | | | |
| | 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 | 895,932 | 14,633,726 | 14,733,437 | 445,839 | 3,944,717 | 34,653,651 |
| Held-to-maturity securities | - | - | - | 298 | - | 298 |
| Loans and receivables | - | - | 1,008,897 | - | 675,167 | 1,684,064 |
| Financial assets at fair value through profit or loss | 624 | 3,665,412 | 498,657 | - | - | 4,164,693 |
| Total | 896,556 | 18,299,138 | 16,240,991 | 446,137 | 4,619,884 | 40,502,706 |
| | 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 |

As at 31 December 2013 and 2012, there were no impaired or overdue debt securities and certificates of deposit.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk

Market risk refers to the risk of loss arising from 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 moderate 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 management measures.

In accordance with the Group's corporate governance principles in respect of risk management, the Board and Risk Management Committee, the Management and functional units perform their duties and responsibilities to manage the Group's market risk. The risk management units are responsible for assisting the Management to monitor the market risk profile and compliance of management policies and limits of the Group to ensure that aggregate 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. NCB (China) 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 are approved by Risk Management Committee, Asset and Liability Management Committee or the 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 Risk Management Committee and the 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 exposure¹ 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 | 2013 | 1,294 | 1,294 | 2,982 | 2,196 |
| | 2012 | 2,095 | 1,188 | 2,814 | 2,232 |
| VAR for foreign exchange risk | 2013 | 1,191 | 1,191 | 3,047 | 2,196 |
| | 2012 | 2,007 | 1,150 | 2,774 | 2,171 |
| VAR for interest risk | 2013 | 502 | 117 | 635 | 268 |
| | 2012 | 256 | 148 | 534 | 251 |

Notes:

- 1 Structural FX positions have been excluded. In 2013, all general market risk exposure are presented on the Group basis, comparative amounts are presented on the same basis accordingly.

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 especially 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 swaps) 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 | | | | | | |
|---|--------------------|-------------------|-------------------|------------------|----------------|----------------|------------------|
| | 2013 | | | | | | |
| | Renminbi | US Dollars | HK Dollars | Euro | Japanese Yen | Pound Sterling | Others |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Assets | | | | | | | |
| Cash and balances with banks and other financial institutions | 37,895,965 | 3,302,233 | 3,031,355 | 287,594 | 76,650 | 43,356 | 102,166 |
| Placements with banks and other financial institutions maturing between one and twelve months | 20,497,328 | 846,672 | - | - | - | - | - |
| Financial assets at fair value through profit or loss | - | 498,657 | 3,666,036 | - | - | - | - |
| Derivative financial instruments | 95,469 | 15,990 | 396,994 | - | - | - | - |
| Advances and other accounts | 46,507,717 | 43,888,535 | 64,276,248 | 391,263 | 34,633 | 11,410 | 206,945 |
| Investment in securities | | | | | | | |
| - Available-for-sale securities | 14,477,805 | 6,151,826 | 11,191,446 | 780,426 | - | - | 7,401,134 |
| - Held-to-maturity securities | 585,144 | - | 298 | - | - | - | - |
| - Loans and receivables | 833,378 | 850,686 | - | - | - | - | - |
| Investment properties | 48,428 | - | 1,126,510 | - | - | - | - |
| Properties, plant and equipment | 777,270 | 3,467 | 6,188,500 | - | - | - | - |
| Other assets (including deferred tax assets) | 309,581 | 49,808 | 3,532,919 | 399 | 7 | 6 | 1,706 |
| Total assets | 122,028,085 | 55,607,874 | 93,410,306 | 1,459,682 | 111,290 | 54,772 | 7,711,951 |
| Liabilities | | | | | | | |
| Deposits and balances from banks and other financial institutions | 17,115,023 | 9,846,139 | 1,340,154 | 72,617 | 4,195 | 3,290 | 464,611 |
| Financial liabilities at fair value through profit or loss | - | - | 4,433,736 | - | - | - | - |
| Derivative financial instruments | 92,363 | 59,342 | 191,451 | - | - | - | - |
| Deposits from customers | 82,735,748 | 30,587,345 | 75,681,802 | 2,254,533 | 211,583 | 922,912 | 5,766,494 |
| Other accounts and provisions (including current and deferred tax liabilities) | 10,488,966 | 1,026,354 | 4,607,189 | 57,944 | 32,756 | 1,391 | 86,033 |
| Total liabilities | 110,432,100 | 41,519,180 | 86,254,332 | 2,385,094 | 248,534 | 927,593 | 6,317,138 |
| Net on-balance sheet position | 11,595,985 | 14,088,694 | 7,155,974 | (925,412) | (137,244) | (872,821) | 1,394,813 |
| Off-balance sheet net notional position* | (4,137,873) | (12,082,047) | 15,842,217 | 929,725 | 138,070 | 873,190 | (1,347,921) |
| Contingent liabilities and commitments | 58,871,709 | 30,613,919 | 20,015,614 | 566,451 | 54,213 | 8,978 | 15,232 |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

| | The Group | | | | | | |
|---|-------------------|-------------------|-------------------|------------------|------------------|----------------|------------------|
| | 2012 | | | | | | |
| | Renminbi | US Dollars | HK Dollars | Euro | Japanese Yen | Pound Sterling | Others |
| | 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 |
| Placements with banks and other financial institutions maturing between one and twelve months | 14,226,915 | 2,272,850 | 809,179 | - | - | - | - |
| Financial assets at fair value through profit or loss | - | 772,821 | 4,272,358 | - | - | - | 79,981 |
| Derivative financial instruments | 113,918 | 3,910 | 646,749 | - | - | - | - |
| Advances and other accounts | 41,284,919 | 31,387,484 | 64,596,843 | 377,712 | 84,599 | 12,113 | 289,015 |
| 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 |
| - Held-to-maturity securities | 884,701 | 464,743 | 1,146 | - | - | - | 120,936 |
| - Loans and receivables | 1,157,262 | - | - | - | - | - | - |
| Investment properties | 47,413 | - | 979,670 | - | - | - | - |
| Properties, plant and equipment | 763,834 | 4,276 | 5,456,885 | - | - | - | - |
| Other assets (including deferred tax assets) | 238,635 | 223,760 | 1,024,881 | 6 | 2,554 | 4 | 2,185 |
| Total assets | 97,966,255 | 44,704,196 | 97,253,589 | 1,591,826 | 1,661,750 | 640,554 | 7,935,268 |
| 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 |
| Financial liabilities at fair value through profit or loss | - | - | 4,975,073 | - | - | - | - |
| Derivative financial instruments | 82,226 | 115,283 | 262,098 | - | - | - | - |
| Deposits from customers | 66,697,901 | 31,214,436 | 77,772,653 | 2,083,241 | 153,534 | 741,624 | 6,870,328 |
| 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 |
| Total liabilities | 86,280,425 | 39,394,153 | 86,306,539 | 2,153,294 | 253,211 | 751,215 | 7,001,380 |
| Net on-balance sheet position | 11,685,830 | 5,310,043 | 10,947,050 | (561,468) | 1,408,539 | (110,661) | 933,888 |
| Off-balance sheet net notional position* | (4,489,727) | (3,248,672) | 9,701,784 | 567,903 | (1,406,739) | 114,453 | (846,095) |
| Contingent liabilities and commitments | 36,717,979 | 25,800,962 | 24,774,429 | 645,012 | 120,838 | - | 9,875 |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

| | The Bank | | | | | | |
|---|-------------------|---------------------|-------------------|------------------|------------------|------------------|--------------------|
| | 2013 | | | | | | |
| | Renminbi | US Dollars | HK Dollars | Euro | Japanese Yen | Pound Sterling | Others |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Assets | | | | | | | |
| Cash and balances with banks and other financial institutions | 13,761,499 | 2,100,851 | 2,594,300 | 235,431 | 47,250 | 17,418 | 83,585 |
| Placements with banks and other financial institutions maturing between one and twelve months | - | 1,858,262 | - | - | - | - | - |
| Financial assets at fair value through profit or loss | - | 498,657 | 3,666,036 | - | - | - | - |
| Derivative financial instruments | - | 13,440 | 396,994 | - | - | - | - |
| Advances and other accounts | 2,395,627 | 33,962,136 | 61,418,574 | 344,292 | 34,633 | 11,410 | 206,945 |
| Investment in securities | | | | | | | |
| - Available-for-sale securities | 9,192,784 | 6,151,826 | 11,191,446 | 780,426 | - | - | 7,401,134 |
| - Held-to-maturity securities | - | - | 298 | - | - | - | - |
| - Loans and receivables | 833,378 | 850,686 | - | - | - | - | - |
| Investment in subsidiaries | 3,030,038 | - | 5,141,029 | - | - | - | - |
| Investment properties | - | - | 1,126,510 | - | - | - | - |
| Properties, plant and equipment | - | 3,467 | 6,188,500 | - | - | - | - |
| Other assets | 550 | 2,859 | 3,526,912 | 399 | 7 | 6 | 1,706 |
| Total assets | 29,213,876 | 45,442,184 | 95,250,599 | 1,360,548 | 81,890 | 28,834 | 7,693,370 |
| Liabilities | | | | | | | |
| Deposits and balances from banks and other financial institutions | 2,140,690 | 3,358,178 | 1,399,295 | 100,521 | 7,539 | 7,822 | 474,246 |
| Financial liabilities at fair value through profit or loss | - | - | 4,433,736 | - | - | - | - |
| Derivative financial instruments | - | 56,863 | 191,451 | - | - | - | - |
| Deposits from customers | 25,779,819 | 24,834,671 | 72,183,662 | 2,101,770 | 181,948 | 893,395 | 5,749,321 |
| Other accounts and provisions (including current and deferred tax liabilities) | 108,830 | 457,151 | 4,555,742 | 8,242 | 29,666 | 1,301 | 81,237 |
| Total liabilities | 28,029,339 | 28,706,863 | 82,763,886 | 2,210,533 | 219,153 | 902,518 | 6,304,804 |
| Net on-balance sheet position | 1,184,537 | 16,735,321 | 12,486,713 | (849,985) | (137,263) | (873,684) | 1,388,566 |
| Off-balance sheet net notional position* | 1,655,076 | (14,852,193) | 12,889,029 | 854,243 | 138,070 | 873,190 | (1,342,053) |
| Contingent liabilities and commitments | 259,936 | 10,495,869 | 19,684,741 | 183,512 | 24,371 | 1,015 | 699 |

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 |
| | 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 |
| Placements with banks and other financial institutions maturing between one and twelve months | - | 770,243 | 809,179 | - | - | - | - |
| Financial assets at fair value through profit or loss | - | 772,821 | 4,272,358 | - | - | - | 79,981 |
| Derivative financial instruments | - | 2,954 | 646,749 | - | - | - | - |
| Advances and other accounts | 3,219,627 | 23,639,146 | 62,322,872 | 354,192 | 80,856 | 12,113 | 289,015 |
| 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 |
| - Held-to-maturity securities | - | 464,743 | 1,146 | - | - | - | 120,936 |
| - Loans and receivables | 1,157,262 | - | - | - | - | - | - |
| Investment in subsidiaries | 3,030,038 | - | 5,141,029 | - | - | - | - |
| Investment properties | - | - | 979,670 | - | - | - | - |
| Properties, plant and equipment | - | 4,276 | 5,456,885 | - | - | - | - |
| Other assets (including deferred tax assets) | 48,219 | 844 | 1,017,063 | 6 | 9 | 4 | 2,185 |
| Total assets | 22,974,984 | 34,346,538 | 99,635,174 | 1,499,727 | 1,613,604 | 614,058 | 7,926,440 |
| 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 |
| Financial liabilities at fair value through profit or loss | - | - | 4,975,073 | - | - | - | - |
| Derivative financial instruments | - | 114,327 | 262,098 | - | - | - | - |
| Deposits from customers | 17,594,501 | 26,480,371 | 74,571,116 | 1,919,414 | 138,846 | 709,223 | 6,765,029 |
| 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 |
| Total liabilities | 18,064,162 | 29,919,139 | 83,022,142 | 1,957,737 | 177,757 | 723,703 | 6,910,909 |
| Net on-balance sheet position | 4,910,822 | 4,427,399 | 16,613,032 | (458,010) | 1,435,847 | (109,645) | 1,015,531 |
| Off-balance sheet net notional position* | (1,852,324) | (2,480,964) | 6,508,735 | 464,424 | (1,434,003) | 114,453 | (927,414) |
| Contingent liabilities and commitments | 57,113 | 7,033,803 | 24,414,935 | 145,028 | 37,858 | - | 9,875 |

* 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)

(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 structures 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 resulting 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 cash flows of assets and liabilities.

The Group's risk management framework also applies to interest rate risk management. Asset and Liability Management Committee exercises its oversight of interest rate risk in accordance with "Banking Book Interest Rate Risk Management Policy" approved by Risk Management Committee. Financial Management Division is responsible for interest rate risk management. With the cooperation of the Treasury Division, Financial Management Division assists the Asset and Liability Management Committee to perform day-to-day interest rate risk management. Its roles include, but are not limited to, the formulation of management policies, selection of methodologies, setting of risk indicators and limits, assessment of target balance sheet, monitoring of the compliance with policies and limits, and submission of interest rate risk management reports to the Management and Risk Management Committee, etc.

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, repricing gap limits, basis risk, duration, price value of a basis point (PVBP), net interest income sensitivity ratio (NII), economic value sensitivity ratio (EV), etc. The indicators and limits are classified into three levels, which are approved by the Risk Management Committee, Asset and Liability Management Committee and Deputy General Manager of Middle-office 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, the relevant departments are required to go through a risk assessment process, which includes the 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 Risk Management Committee for approval.

NII and 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 the projected net interest income for the year. The latter assesses the impact of interest rate movement on economic value (i.e. the net 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 the Risk Management Committee on these two indicators to monitor and control the Group's banking book interest rate risk.

The Group uses scenario analyses and stress tests to assess the banking book interest rate risk that the Group would face under adverse circumstances. Scenario analyses and stress tests 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)

The Group is principally exposed to HKD, USD and RMB in terms of interest rate risk. As at 31 December 2013, 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:

| Scenarios | 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 | |
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Up 100 basis points parallel shift in HKD yield curves | 232,271 | 210,914 | 198,455 | 177,966 | (53,388) | (55,265) | (53,388) | (55,265) |
| Up 100 basis points parallel shift in USD yield curves | (30,024) | (23,706) | (35,681) | (22,928) | (100,832) | (170,405) | (100,832) | (170,405) |
| Up 100 basis points parallel shift in RMB yield curves | (12,059) | (225) | (74,957) | (25,985) | (263,101) | (238,843) | (154,352) | (76,116) |

The overall positive impact on Group's net interest income of the above currencies has slightly increased when compared with 2012 and is mainly because of the widened short term positive gaps in HKD but most of the impacts on HKD is offset by the widened of short term negative gaps in USD and RMB. Reserves would have been reduced because of the expected reduction in valuation of available-for-sale portfolio due to a parallel shift up of 100 basis point in the yield curve (simulated scenario). The reduction of reserves is decreased compared with 2012 because the duration of USD available-for-sale portfolio is shortened.

The Group uses more severe assumptions when conducting stress test, including a change in the correlation between interest rates of relevant currencies, parallel movement of interest rates, and that 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 | | | | | | |
|---|--------------------|-------------------|-------------------|-------------------|------------------|-----------------------------|--------------------|
| | 2013 | | | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 | 43,239,550 | - | - | - | - | 1,499,769 | 44,739,319 |
| Placements with banks and other financial institutions maturing between one and twelve months | - | 10,324,490 | 11,019,510 | - | - | - | 21,344,000 |
| Financial assets at fair value through profit or loss | 296,487 | 704,859 | 2,901,993 | 261,354 | - | - | 4,164,693 |
| Derivative financial instruments | - | - | - | - | - | 508,453 | 508,453 |
| Advances and other accounts | 95,905,202 | 24,502,236 | 29,683,287 | 5,037,156 | 183,445 | 5,425 | 155,316,751 |
| Investment in securities | | | | | | | |
| - Available-for-sale securities | 4,121,084 | 7,615,224 | 10,198,263 | 16,543,097 | 1,461,004 | 63,965 | 40,002,637 |
| - Held-to-maturity securities | 298 | - | 585,144 | - | - | - | 585,442 |
| - Loans and receivables | 105,185 | 661,988 | 916,891 | - | - | - | 1,684,064 |
| Investment properties | - | - | - | - | - | 1,174,938 | 1,174,938 |
| Properties, plant and equipment | - | - | - | - | - | 6,969,237 | 6,969,237 |
| Other assets (including deferred tax assets) | 770 | - | - | - | - | 3,893,656 | 3,894,426 |
| Total assets | 143,668,576 | 43,808,797 | 55,305,088 | 21,841,607 | 1,644,449 | 14,115,443 | 280,383,960 |
| Liabilities | | | | | | | |
| Deposits and balances from banks and other financial institutions | 15,176,539 | 3,306,414 | 8,778,777 | - | - | 1,584,299 | 28,846,029 |
| Financial liabilities at fair value through profit or loss | 701,490 | 1,727,292 | 2,004,954 | - | - | - | 4,433,736 |
| Derivative financial instruments | - | - | - | - | - | 343,156 | 343,156 |
| Deposits from customers | 111,858,553 | 29,530,001 | 38,410,496 | 9,873,053 | 39,057 | 8,449,257 | 198,160,417 |
| Other accounts and provisions (including current and deferred tax liabilities) | 2,966,037 | 2,588,722 | 4,105,753 | 397,216 | - | 6,242,905 | 16,300,633 |
| Total liabilities | 130,702,619 | 37,152,429 | 53,299,980 | 10,270,269 | 39,057 | 16,619,617 | 248,083,971 |
| Interest sensitivity gap | 12,965,957 | 6,656,368 | 2,005,108 | 11,571,338 | 1,605,392 | (2,504,174) | 32,299,989 |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

| | The Group | | | | | | |
|---|--------------------|-------------------|-------------------|-------------------|------------------|-----------------------------|--------------------|
| | 2012 | | | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 Bank | | | | | | |
|---|-------------------|-------------------|-------------------|-------------------|------------------|-----------------------------|--------------------|
| | 2013 | | | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 | 17,632,879 | - | - | - | - | 1,207,455 | 18,840,334 |
| Placements with banks and other financial institutions maturing between one and twelve months | - | 1,527,931 | 330,331 | - | - | - | 1,858,262 |
| Financial assets at fair value through profit or loss | 296,487 | 704,859 | 2,901,993 | 261,354 | - | - | 4,164,693 |
| Derivative financial instruments | - | - | - | - | - | 410,434 | 410,434 |
| Advances and other accounts | 75,387,024 | 13,990,291 | 7,150,346 | 1,834,237 | 6,284 | 5,435 | 98,373,617 |
| Investment in securities | | | | | | | |
| - Available-for-sale securities | 4,121,084 | 7,562,793 | 9,824,754 | 11,684,016 | 1,461,004 | 63,965 | 34,717,616 |
| - Held-to-maturity securities | 298 | - | - | - | - | - | 298 |
| - Loans and receivables | 105,185 | 661,988 | 916,891 | - | - | - | 1,684,064 |
| Investment in subsidiaries | - | - | - | - | - | 8,171,067 | 8,171,067 |
| Investment properties | - | - | - | - | - | 1,126,510 | 1,126,510 |
| Properties, plant and equipment | - | - | - | - | - | 6,191,967 | 6,191,967 |
| Other assets | - | - | - | - | - | 3,532,439 | 3,532,439 |
| Total assets | 97,542,957 | 24,447,862 | 21,124,315 | 13,779,607 | 1,467,288 | 20,709,272 | 179,071,301 |
| Liabilities | | | | | | | |
| Deposits and balances of banks and other financial institutions | 4,198,955 | 561,061 | 1,096,468 | - | - | 1,631,807 | 7,488,291 |
| Financial liabilities at fair value through profit or loss | 701,490 | 1,727,292 | 2,004,954 | - | - | - | 4,433,736 |
| Derivative financial instruments | - | - | - | - | - | 248,314 | 248,314 |
| Deposits from customers | 86,849,459 | 18,627,211 | 16,800,148 | 993,900 | - | 8,453,868 | 131,724,586 |
| Other accounts and provisions (including current and deferred tax liabilities) | 438,109 | - | - | - | - | 4,804,060 | 5,242,169 |
| Total liabilities | 92,188,013 | 20,915,564 | 19,901,570 | 993,900 | - | 15,138,049 | 149,137,096 |
| Interest sensitivity gap | 5,354,944 | 3,532,298 | 1,222,745 | 12,785,707 | 1,467,288 | 5,571,223 | 29,934,205 |

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 to 3 months | 3 to 12 months | 1 to 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)

4.3 Liquidity Risk

Liquidity risk is the risk that banks fail to provide sufficient funds to grow assets or pay due obligations, and need to bear an unacceptable loss. The Group follows sound liquidity risk appetite, to provide stable, reliable and adequate sources of cash to meet liquidity needs under normal circumstances or stressed scenarios; and to 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- 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 the 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 which provides adequate funds in support of normal business needs and ensure its ability to raise 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 among different entities within the Group, and to restrict their 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.

Risk Management Committee is the decision-making authority of liquidity risk management, and assumes the ultimate responsibility of liquidity risk management. As authorised by Risk Management Committee, Asset and Liability Management Committee 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 Risk Management Committee. Financial Management Division is responsible for overseeing the Group's liquidity risk. It cooperates with the Treasury Division to assist the Asset and Liability Management Committee 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, loan-to-deposit ratio, Maximum Cumulative Cash Outflow ("MCO") and liquidity buffer asset portfolio. 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 crisis, general market crisis and combined 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 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 has embarked on refining the behaviour 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 which are implemented in 2013. In cash flow analysis under normal circumstances, refinements have been made to assumptions relating to on-balance sheet items (such as customer deposits) and off-balance sheet items (such as loan commitments). According to various characteristics of the assets, liabilities and off-balance sheet items, the Group forecasts the future cash flow based on contractual maturity date and the assumptions of customer behaviour and balance sheet changes. The Group establishes MCO indicator which predicts the future 30 days maximum cumulative net cash outflow in normal situations based on the above assumptions, to assess if the Group has sufficient financing capacity to meet the cash flow gap in order to achieve the objective of continuing operation. As at 31 December 2013, before taking the cash inflow through the sale of outstanding marketable securities into consideration, the Bank's 30 day cumulative cash flow was a net cash inflow, amounting to HK\$4,658 million, and was in compliant with the internal limit requirements.

In liquidity stress test, a new combined scenario which is a combination of institution specific and general market crisis has been set up to assess the Group's capability to withstand a more severe liquidity crisis, with a more stringent set of assumptions being adopted. Stress test assumptions include the run-off rate of retail, wholesale and interbank deposits; drawdown rate of loan commitments and trade-related contingent liabilities; delinquency ratio and rollover rate of customer loan; and haircut of interbank placement and marketable securities. As at 31 December 2013, the Group was able to maintain a positive cash flow under the three stressed scenarios, indicating the Group has the ability to meet financing needs under stressed conditions. In addition, the Group has a policy in place to maintain an asset buffer portfolio which includes high quality marketable securities to ensure funding needs even under stressed scenarios. The contingency funding plan is established which 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.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

In certain derivative contracts, counterparties have the right to request the Group for additional collateral if they have credit concerns on the Group's creditworthiness.

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 Risk Management Committee 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

| | <u>2013</u> | <u>2012</u> |
|-------------------------|----------------------|---------------|
| Average liquidity ratio | <u>47.80%</u> | <u>44.46%</u> |

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 | | | | | | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | 2013 | | | | | | |
| | On demand | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | Over 5 years | Indefinite |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Assets | | | | | | | |
| Cash and balances with banks and other financial institutions | 19,625,303 | 12,929,170 | - | - | - | - | 12,184,846 |
| Placements with banks and other financial institutions maturing between one and twelve months | - | - | 10,324,490 | 11,019,510 | - | - | - |
| Financial assets at fair value through profit or loss | | | | | | | |
| - held for trading | - | 296,487 | 704,859 | 2,664,066 | 624 | - | - |
| - designated at fair value through profit or loss | - | - | - | 240,097 | 258,560 | - | - |
| Derivative financial instruments | 345,025 | 55,479 | 16,455 | 90,390 | 1,104 | - | - |
| Advances and other accounts | | | | | | | |
| - advances to customers | 5,317,238 | 8,893,638 | 12,414,991 | 39,468,912 | 46,982,868 | 28,731,200 | 265,268 |
| - trade bills | 1,078 | 2,482,327 | 4,693,586 | 6,065,645 | - | - | - |
| Investment in securities | | | | | | | |
| - available-for-sale | | | | | | | |
| - certificates of deposit | - | 6,064 | 899,663 | 6,044,492 | 726,666 | - | - |
| - debt securities | - | 2,482,919 | 2,569,203 | 5,167,277 | 20,598,317 | 1,444,071 | - |
| - held-to-maturity | - | - | - | 585,144 | 298 | - | - |
| - loans and receivables | - | 105,185 | 661,988 | 916,891 | - | - | - |
| - debt securities | - | - | - | - | - | - | 63,965 |
| - equity securities | - | - | - | - | - | - | - |
| Investment properties | - | - | - | - | - | - | 1,174,938 |
| Properties, plant and equipment | - | - | - | - | - | - | 6,969,237 |
| Other assets (including deferred tax assets) | 152,748 | 3,519,657 | 13,437 | 90,958 | 76,003 | 380 | 41,243 |
| Total assets | 25,441,392 | 30,770,926 | 32,298,672 | 72,353,382 | 68,644,440 | 30,175,651 | 20,699,497 |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

| | The Group | | | | | | | |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|---------------|------------|--------------------|
| | 2013 | | | | | | | |
| | On demand | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 | 2,303,726 | 14,457,112 | 3,306,414 | 8,778,777 | - | - | - | 28,846,029 |
| Financial liabilities at fair value through profit or loss | - | 701,490 | 1,727,292 | 2,004,954 | - | - | - | 4,433,736 |
| Derivative financial instruments | 94,553 | 85,890 | 34,974 | 70,803 | 56,936 | - | - | 343,156 |
| Deposits from customers | 72,261,365 | 45,965,432 | 29,462,615 | 38,560,815 | 11,871,133 | 39,057 | - | 198,160,417 |
| Other accounts and provisions (including current and deferred tax liabilities) | 2,755,008 | 4,962,292 | 2,901,823 | 4,361,272 | 1,309,372 | 10,866 | - | 16,300,633 |
| Total liabilities | 77,414,652 | 66,172,216 | 37,433,118 | 53,776,621 | 13,237,441 | 49,923 | - | 248,083,971 |
| Net liquidity gap | (51,973,260) | (35,401,290) | (5,134,446) | 18,576,761 | 55,406,999 | 30,125,728 | 20,699,497 | 32,299,989 |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

| | (Restated) | | | | | | | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|--------------------|
| | The Group | | | | | | | |
| | 2012 | | | | | | | |
| | On demand | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 | 13,734,264 | - | - | - | - | 9,964,681 | 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 | | | | | | | | |
| – held for trading | | | | | | | | |
| – debt securities | - | 299,495 | 1,773,822 | 2,198,420 | 621 | - | - | 4,272,358 |
| – designated at fair value through profit or loss | | | | | | | | |
| – debt securities | - | - | - | 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 | | | | | | | | |
| – available-for-sale | | | | | | | | |
| – certificates of deposit | - | 400,657 | 40,564 | 4,003,596 | 1,125,146 | - | - | 5,569,963 |
| – debt securities | - | 1,595,169 | 5,577,764 | 7,310,513 | 15,315,817 | 2,935,489 | - | 32,734,752 |
| – held-to-maturity | | | | | | | | |
| – certificates of deposit | - | 464,743 | - | - | - | - | - | 464,743 |
| – debt securities | - | 127,773 | 312,631 | - | 566,379 | - | - | 1,006,783 |
| – loans and receivables | | | | | | | | |
| – debt securities | - | - | 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) | 362,059 | 1,043,080 | 10,792 | 25,907 | 29,765 | - | 20,422 | 1,492,025 |
| Total assets | 24,146,117 | 25,359,621 | 32,523,837 | 61,422,663 | 62,876,530 | 27,852,118 | 17,572,552 | 251,753,438 |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

| | (Restated) | | | | | | | |
|--|-------------------|-------------------|-------------------|-------------------|------------------|---------------|------------|--------------------|
| | The Group | | | | | | | |
| | 2012 | | | | | | | |
| | On demand | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 | - | 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 | (47,748,350) | (29,799,055) | (6,607,831) | 14,008,570 | 54,379,269 | 27,808,066 | 17,572,552 | 29,613,221 |

Certain comparative amounts have been reclassified to conform with the current year's presentation.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

| | The Bank | | | | | | | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|--------------------|
| | 2013 | | | | | | | |
| | On demand | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 | 15,427,036 | 3,413,298 | - | - | - | - | - | 18,840,334 |
| Placements with banks and other financial institutions maturing between one and twelve months | - | - | 1,527,931 | 330,331 | - | - | - | 1,858,262 |
| Financial assets at fair value through profit or loss | | | | | | | | |
| – held for trading | | | | | | | | |
| – debt securities | - | 296,487 | 704,859 | 2,664,066 | 624 | - | - | 3,666,036 |
| – designated at fair value through profit or loss | | | | | | | | |
| – debt securities | - | - | - | 240,097 | 258,560 | - | - | 498,657 |
| Derivative financial instruments | 345,025 | 41,713 | 2,712 | 20,638 | 346 | - | - | 410,434 |
| Advances and other accounts | | | | | | | | |
| – advances to customers | 4,796,737 | 7,448,303 | 7,460,242 | 15,953,432 | 37,099,624 | 16,047,873 | 109,387 | 88,915,598 |
| – trade bills | 1,078 | 1,544,684 | 3,152,502 | 4,759,755 | - | - | - | 9,458,019 |
| Investment in securities | | | | | | | | |
| – available-for-sale | | | | | | | | |
| – certificates of deposit | - | 6,064 | 899,663 | 6,044,492 | 726,666 | - | - | 7,676,885 |
| – debt securities | - | 2,482,919 | 2,516,773 | 4,793,767 | 15,739,236 | 1,444,071 | - | 26,976,766 |
| – held-to-maturity | | | | | | | | |
| – debt securities | - | - | - | - | 298 | - | - | 298 |
| – loans and receivables | | | | | | | | |
| – debt securities | - | 105,185 | 661,988 | 916,891 | - | - | - | 1,684,064 |
| – equity securities | - | - | - | - | - | - | 63,965 | 63,965 |
| Investment in subsidiaries | - | - | - | - | - | - | 8,171,067 | 8,171,067 |
| Investment properties | - | - | - | - | - | - | 1,126,510 | 1,126,510 |
| Properties, plant and equipment | - | - | - | - | - | - | 6,191,967 | 6,191,967 |
| Other assets | 17,129 | 3,482,064 | 845 | 2,305 | 360 | - | 29,736 | 3,532,439 |
| Total assets | 20,587,005 | 18,820,717 | 16,927,515 | 35,725,774 | 53,825,714 | 17,491,944 | 15,692,632 | 179,071,301 |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

| | The Bank | | | | | | |
|--|-------------------|-------------------|-------------------|-------------------|------------------|--------------|------------|
| | 2013 | | | | | | |
| | On demand | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | Over 5 years | Indefinite |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Liabilities | | | | | | | |
| Deposits and balances from banks and other financial institutions | 2,421,609 | 3,409,153 | 561,061 | 1,096,468 | - | - | - |
| Financial liabilities at fair value through profit or loss | - | 701,490 | 1,727,292 | 2,004,954 | - | - | - |
| Derivative financial instruments | 94,553 | 68,659 | 11,159 | 17,512 | 56,431 | - | - |
| Deposits from customers | 57,481,019 | 37,739,386 | 18,559,824 | 16,950,467 | 993,890 | - | - |
| Other accounts and provisions (including current and deferred tax liabilities) | 1,146,948 | 2,996,225 | 89,274 | 120,325 | 889,397 | - | - |
| Total liabilities | 61,144,129 | 44,914,913 | 20,948,610 | 20,189,726 | 1,939,718 | - | - |
| Net liquidity gap | (40,557,124) | (26,094,196) | (4,021,095) | 15,536,048 | 51,885,996 | 17,491,944 | 15,692,632 |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

| | (Restated) | | | | | | | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|--------------------|
| | The Bank | | | | | | | |
| | 2012 | | | | | | | |
| | On demand | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 | 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 | | | | | | | | |
| – held for trading | | | | | | | | |
| – debt securities | - | 299,495 | 1,773,822 | 2,198,420 | 621 | - | - | 4,272,358 |
| – designated at fair value through profit or loss | | | | | | | | |
| – debt securities | - | - | - | 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 | | | | | | | | |
| – available-for-sale | | | | | | | | |
| – certificates of deposit | - | 400,657 | 40,564 | 4,003,596 | 1,125,146 | - | - | 5,569,963 |
| – debt securities | - | 1,595,169 | 5,384,410 | 6,525,438 | 10,745,474 | 2,278,796 | - | 26,529,287 |
| – held-to-maturity | | | | | | | | |
| – certificates of deposit | - | 464,743 | - | - | - | - | - | 464,743 |
| – debt securities | - | - | 121,186 | - | 896 | - | - | 122,082 |
| – loans and receivables | | | | | | | | |
| – debt securities | - | - | 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) | 22,051 | 1,026,350 | 21 | 1,538 | 995 | - | 17,375 | 1,068,330 |
| Total assets | 20,111,247 | 17,589,649 | 19,893,090 | 28,746,893 | 48,174,621 | 19,305,440 | 14,789,585 | 168,610,525 |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

| | (Restated) | | | | | | |
|--|-------------------|-------------------|-------------------|-------------------|----------------|--------------|------------|
| | The Bank | | | | | | |
| | 2012 | | | | | | |
| | On demand | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | Over 5 years | Indefinite |
| | 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 | - | - | - |
| Financial liabilities at fair value through profit or loss | - | 1,419,971 | 2,092,893 | 1,462,209 | - | - | - |
| Derivative financial instruments | 205,008 | 5,812 | 23,158 | 36,924 | 105,523 | - | - |
| Deposits from customers | 56,526,767 | 35,084,235 | 19,922,283 | 16,577,888 | 67,327 | - | - |
| Other accounts and provisions (including current and deferred tax liabilities) | 1,536,694 | 573,405 | 73,848 | 118,513 | 769,260 | - | - |
| Total liabilities | 60,133,589 | 38,294,642 | 22,254,221 | 19,150,987 | 942,110 | - | - |
| Net liquidity gap | (40,022,342) | (20,704,993) | (2,361,131) | 9,595,906 | 47,232,511 | 19,305,440 | 14,789,585 |

Certain comparative amounts have been reclassified to conform with the current year's presentation.

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 | | | | |
|---|--------------------|-------------------|-------------------|-------------------|-----------------|
| | 2013 | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | Over 5 years |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Financial liabilities | | | | | |
| Deposits and balances from banks and other financial institutions | 16,778,992 | 3,341,129 | 8,942,010 | - | - |
| Financial liabilities at fair value through profit or loss | 701,500 | 1,727,500 | 2,006,500 | - | - |
| Deposits from customers | 118,257,428 | 29,568,037 | 39,248,181 | 13,029,817 | 51,735 |
| Other financial liabilities | 7,599,320 | 2,657,072 | 4,241,374 | 411,167 | 10,867 |
| Total financial liabilities | 143,337,240 | 37,293,738 | 54,438,065 | 13,440,984 | 62,602 |

| | The Group | | | | |
|---|--------------------|-------------------|-------------------|------------------|-----------------|
| | 2012 | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | Over 5 years |
| | 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 | - | - |
| Financial liabilities at fair value through profit or loss | 1,420,000 | 2,093,000 | 1,462,500 | - | - |
| Deposits from customers | 112,549,463 | 30,259,278 | 35,805,901 | 8,603,246 | 52,637 |
| Other financial liabilities | 4,517,866 | 1,809,154 | 3,377,424 | 33,300 | 6,150 |
| Total financial liabilities | 126,782,222 | 39,153,517 | 47,732,366 | 8,636,546 | 58,787 |

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 | | | | | |
|--|--------------------|-------------------|-------------------|------------------|-----------------|--------------------|
| | 2013 | | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 | 5,831,713 | 563,102 | 1,097,739 | - | - | 7,492,554 |
| Financial liabilities at fair value through profit or loss | 701,500 | 1,727,500 | 2,006,500 | - | - | 4,435,500 |
| Deposits from customers | 95,238,323 | 18,603,469 | 17,118,139 | 1,044,047 | - | 132,003,978 |
| Other financial liabilities | 4,141,243 | 2,006 | 427 | - | - | 4,143,676 |
| Total financial liabilities | 105,912,779 | 20,896,077 | 20,222,805 | 1,044,047 | - | 148,075,708 |

| | The Bank | | | | | |
|--|------------------|------------------|-------------------|-----------------|-----------------|-------------|
| | 2012 | | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 |

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;
- Interest rate contracts: interest rate swaps;
- Commodity contracts: bullion margin contracts, commodity swaps; and
- Equity contracts: exchange traded equity options.

The tables below summarise the cashflows of Group and the Bank as at 31 December for derivative financial liabilities that will be settled on a net basis by remaining contractual maturities.

| | The Group | | | | |
|-------------------------|------------------|------------------|-------------------|-----------------|-----------------|
| | 2013 | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | Over 5 years |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts | (93,034) | - | - | - | - |
| Interest rate contracts | (4,523) | (15,139) | (67,761) | (30,561) | - |
| Commodity contracts | (1,311) | (37) | - | - | - |
| | (98,868) | (15,176) | (67,761) | (30,561) | - |
| | (212,366) | | | | |

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

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 | | | | | |
|-------------------------|------------------|------------------|-------------------|-----------------|-----------------|
| 2013 | | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | Over 5 years |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts | (93,034) | - | - | - | - |
| Interest rate contracts | (246) | (5,900) | (26,400) | (30,037) | - |
| Commodity contracts | (1,311) | - | - | - | - |
| | (94,591) | (5,900) | (26,400) | (30,037) | - |

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

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, cross currency interest rate swaps, bullion swaps and OTC equity options.

The tables below summarise the cashflows of the Group and the Bank as at 31 December for all derivative financial instruments that will be settled on a gross basis by remaining contractual maturities.

| The Group | | | | | |
|--------------------------|---------------------|--------------------|--------------------|------------------|---------------------|
| 2013 | | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts: | | | | | |
| - Outflow | (23,897,683) | (4,397,226) | (9,657,460) | (179,071) | (38,131,440) |
| - Inflow | 23,866,437 | 4,369,915 | 9,679,171 | 180,102 | 38,095,625 |
| Total outflow | (23,897,683) | (4,397,226) | (9,657,460) | (179,071) | (38,131,440) |
| Total inflow | 23,866,437 | 4,369,915 | 9,679,171 | 180,102 | 38,095,625 |

| The Group | | | | | |
|--------------------------|---------------------|--------------------|---------------------|-----------------|---------------------|
| 2012 | | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 |

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 | | | | |
|--------------------------|---------------------|------------------|--------------------|-----------------|---------------------|
| | 2013 | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts: | | | | | |
| - Outflow | (20,456,849) | (625,212) | (2,253,894) | (42,785) | (23,378,740) |
| - Inflow | 20,430,976 | 616,475 | 2,265,259 | 43,549 | 23,356,259 |
| Total outflow | (20,456,849) | (625,212) | (2,253,894) | (42,785) | (23,378,740) |
| Total inflow | 20,430,976 | 616,475 | 2,265,259 | 43,549 | 23,356,259 |

| | The Bank | | | | |
|--------------------------|--------------------|--------------------|--------------------|-----------------|---------------------|
| | 2012 | | | | |
| | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 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 |

(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 2013 that the Group and the Bank commit to extend credit to customers and other facilities amounted to HK\$76,884,033,000 (2012: HK\$64,207,586,000) and HK\$26,338,710,000 (2012: HK\$27,481,060,000) respectively. Those loan commitments can be drawn within one year.

Financial guarantees and other financial facilities

Financial guarantees and other financial facilities of the Group and the Bank as at 31 December 2013 amounting to HK\$33,262,083,000 (2012: HK\$23,861,509,000) and HK\$4,311,433,000 (2012: HK\$4,217,552,000) respectively are maturing no later than one 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 Asset and Liability Management Committee 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 Banking (Capital) (Amendment) Rules 2012 and the Banking (Capital) (Amendment) Rules 2013 came into operation on 1 January 2013 and 30 June 2013 respectively. The rules mainly addressed the revision to both the minimum capital ratio requirement (in terms of expanding the existing capital adequacy ratio into three ratios, namely, a Common Equity Tier 1 capital ratio, a Tier 1 capital ratio and a Total capital ratio) and the definition of regulatory capital. In addition, the rules included the enhancements to the counterparty credit risk framework and amendments on the capital treatment for certain trade financing activities and securities financing transactions. The Group has followed the rules to calculate capital adequacy ratio.

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 Asset and Liability Management Committee 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 the majority of its non-securitisation exposures. A small residual credit exposures was remained under standardised (credit risk) ("STC") approach. The Group has adopted standardised Credit Valuation Adjustment (CVA) method to calculate the counterparty CVA capital charges for OTC derivative contracts and securities financing transactions under both banking book and trading book.

The Group continues to adopt the internal models ("IMM") approach to calculate general market risk capital charge for foreign exchange and interest rate exposures and, with the approvals of HKMA, exclude its structural FX positions arising from overseas branches and NCB (China) 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 capital charge for operational risk.

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 2013. 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 or not adequately captured under Pillar I, and therefore minimum Common Equity Tier 1 capital ratio, minimum Tier 1 capital ratio and the minimum Total capital ratio are determined. The Group considers this ICAAP process as an on-going process for capital management and periodically reviews and adjusts its capital structure where appropriate 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 Asset and Liability Management Committee. 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 maintains adequate capital and appropriate capital structure which align with our business development needs thereby achieving an optimal balance among risk, return and capital adequacy.

As a result of the adoption of Banking (Capital) (Amendment) Rules 2012 and Banking (Capital) (Amendment) Rules 2013 since 1 January 2013 and 30 June 2013 respectively, the capital disclosures for 2013 are not directly comparable to those of 2012.

(A) Basis of regulatory consolidation

The consolidation basis for regulatory purposes comprises the positions of the Bank and certain subsidiaries specified by the HKMA 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)

4. Financial risk management (continued)

4.4 Capital Management (continued)

(A) Basis of regulatory consolidation (continued)

Subsidiaries which are included within the accounting scope of consolidation but not included within the regulatory scope of consolidation are set out below:

| Name of company | 2013 | |
|--|--------------|--------------|
| | Total assets | Total equity |
| | HK\$'000 | HK\$'000 |
| Nanyang Commercial Bank Trustee Limited | 16,869 | 16,510 |
| Kwong Li Nam Investment Agency Limited | 4,168 | 4,029 |
| Nanyang Commercial Bank (Nominees) Limited | 1,483 | 1,483 |

There are no subsidiaries which are included within the regulatory scope of consolidation but not included within the accounting scope of consolidation as at 31 December 2013.

There are also no subsidiaries which are included within both the accounting scope of consolidation and the regulatory scope of consolidation but the methods of consolidation differ as at 31 December 2013.

The principal activities of the above subsidiaries are set out in "Note 26 – Investment in subsidiaries" on page 151.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital Management (continued)

(B) Capital ratio

| | <u>2013</u> |
|------------------------|---------------|
| CET1 capital ratio | <u>13.53%</u> |
| Tier 1 capital ratio | <u>13.53%</u> |
| Total capital ratio | <u>15.80%</u> |
| | <u>2012</u> |
| Capital adequacy ratio | <u>15.89%</u> |
| Core capital ratio | <u>15.08%</u> |

(C) Components of capital base after deductions

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

| | <u>2013</u> |
|--|--------------------|
| | <u>HK\$'000</u> |
| CET1 capital: instruments and reserves | |
| Directly issued qualifying CET1 capital instruments plus any related share premium | 3,144,517 |
| Retained earnings | 20,879,091 |
| Disclosed reserves | <u>8,260,460</u> |
| CET1 capital before regulatory deductions | <u>32,284,068</u> |
| CET1 capital: regulatory deductions | |
| Deferred tax assets net of deferred tax liabilities | (152,418) |
| Gains and losses due to changes in own credit risk on fair valued liabilities | (677) |
| Cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) | (6,422,662) |
| Regulatory reserve for general banking risks | <u>(1,944,980)</u> |
| Total regulatory deductions to CET1 capital | <u>(8,520,737)</u> |
| CET1 capital | <u>23,763,331</u> |
| Tier 1 capital | <u>23,763,331</u> |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital Management (continued)

(C) Components of capital base after deductions (continued)

| | <u>2013</u> |
|--|--------------------------|
| | <u>HK\$'000</u> |
| Tier 2 capital: instruments and provisions | |
| Collective impairment allowances and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital | <u>1,099,587</u> |
| Tier 2 capital before regulatory deductions | <u>1,099,587</u> |
| Tier 2 capital: regulatory deductions | |
| Add back of cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) eligible for inclusion in Tier 2 capital | <u>2,890,198</u> |
| Total regulatory deductions to Tier 2 capital | <u>2,890,198</u> |
| Tier 2 capital | <u>3,989,785</u> |
| Total capital | <u>27,753,116</u> |

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital Management (continued)

(C) Components of capital base after deductions (continued)

| | 2012 |
|--|--------------------------|
| | HK\$'000 |
| Core capital: | |
| Paid up ordinary share capital | 700,000 |
| Reserves | 19,217,120 |
| Profit and loss account | 2,140,665 |
| | <u>22,057,785</u> |
| Deductions from core capital | <u>(29,786)</u> |
| Core capital | <u>22,027,999</u> |
| Supplementary capital: | |
| Fair value gains arising from holdings of available-for-sale securities | 193,952 |
| Fair value gains arising from holdings of securities designated at fair value through profit or loss | 20,569 |
| Collective loan impairment allowances | 78,719 |
| Regulatory reserve | 124,468 |
| Surplus provisions | 796,494 |
| | <u>1,214,202</u> |
| Deductions from supplementary capital | <u>(29,787)</u> |
| Supplementary capital | <u>1,184,415</u> |
| Total capital base after deductions | <u><u>23,212,414</u></u> |

To comply with the Banking (Disclosure) Rules, a section "Regulatory Disclosures" is available on the Bank's website at www.ncb.com.hk and includes the following consolidated information of the Bank:

- A detailed breakdown of the capital base and regulatory deductions, using the standard template as specified by the HKMA.
- A reconciliation of capital components to the balance sheet, using the standard template as specified by the HKMA.
- A description of the main features and the full terms and conditions of the issued capital instruments.

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy as defined in HKFRS 13, "Fair value measurement". The categorisation are determined with reference to the observability and significance of the inputs used in the valuation methods and based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1: based on quoted prices (unadjusted) in active markets for identical assets or liabilities. This category includes debt instruments issued by certain governments and certain exchange-traded derivative contracts. As properties are unique in nature and not identical with another, they are not categorised in this level.
- Level 2: based on valuation techniques for which the lowest level input that is significant to the fair value measurement is observable, either directly or indirectly. This category includes majority of the OTC derivative contracts, debt securities and certificate of deposits with quote from pricing services providers. It also includes residential properties and shops with insignificant adjustments made to observable market inputs.
- Level 3: based on valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable. This category includes equity investment and certificate of deposits with significant unobservable components. It also includes offices and shops with significant adjustments made to observable market inputs.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by reassessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

5.1 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 valuation from front line businesses and all other significant fair value measurements. Significant valuation issues are reported to the Management.

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.1 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 mostly observable and obtainable from open market.

The technique used to calculate the fair value of the following financial instruments is as below:

Debt securities and certificates of deposit

The fair value of these instruments is determined by obtaining quoted market prices from dealer or independent pricing service vendors, or using discounted cash flow technique. Discounted cash flow model is a valuation technique that measures present value using estimated expected future cash flows from the instruments and then discounts these flows using a discount rate or discount margin that reflects the credit spreads required by the market for instruments with similar risk. These inputs are observable or can be corroborated by observable or unobservable market data.

Asset backed securities

For this class of instruments, external prices are obtained from independent third parties.

Derivatives

Over-the-counter derivative contracts include forward, swap and option contracts on foreign exchange, interest rate, equity or commodity. The fair value of these contracts are mainly measured using valuation techniques such as discounted cash flow models and option pricing models. The inputs can be observable or unobservable market data. Observable inputs include interest rate, foreign exchange rates, equity and stock prices, commodity prices and volatilities.

Credit valuation adjustments (CVA) and debit valuation adjustments (DVA) are applied to the Group's over-the-counter derivatives. These adjustments reflect interest rates, expectations of counterparty creditworthiness and the Group's own credit spread respectively. They are determined for each counterparty and are dependent on expected future values of exposures, default probabilities and recovery rates.

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(A) Fair value hierarchy

| The Group | | | |
|--|--------------|-----------|------------|
| 2013 | | | |
| 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 (Note 21) | | | |
| - Trading securities | | | |
| - Debt securities | - 3,666,036 | - | 3,666,036 |
| - Financial assets designated at fair value through profit or loss | | | |
| - Debt securities | - 498,657 | - | 498,657 |
| Derivative financial instruments (Note 22) | 345,027 | 163,426 | 508,453 |
| Available-for-sale securities (Note 25) | | | |
| - Debt securities | - 32,261,787 | - | 32,261,787 |
| - Certificates of deposit | - 5,540,037 | 2,136,848 | 7,676,885 |
| - Equity securities | - | 63,965 | 63,965 |
| Financial liabilities | | | |
| Financial liabilities at fair value through profit or loss (Note 30) | | | |
| - Trading liabilities | - 4,433,736 | - | 4,433,736 |
| Derivative financial instruments (Note 22) | 94,553 | 248,603 | 343,156 |

| 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 (Note 21) | | | |
| - 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 (Note 22) | 501,902 | 262,675 | 764,577 |
| Available-for-sale securities (Note 25) | | | |
| - Debt securities | 1,468,168 | 31,266,584 | 32,734,752 |
| - Certificates of deposit | - 5,569,963 | - | 5,569,963 |
| - Equity securities | - | 56,146 | 56,146 |
| Financial liabilities | | | |
| Financial liabilities at fair value through profit or loss (Note 30) | | | |
| - Trading liabilities | - 4,975,073 | - | 4,975,073 |
| Derivative financial instruments (Note 22) | 205,008 | 254,599 | 459,607 |

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(A) Fair value hierarchy (continued)

| The Bank | | | |
|--|--------------|-----------|------------|
| 2013 | | | |
| 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 (Note 21) | | | |
| - Trading securities | | | |
| - Debt securities | - 3,666,036 | - | 3,666,036 |
| - Financial assets designated at fair value through profit or loss | | | |
| - Debt securities | - 498,657 | - | 498,657 |
| Derivative financial instruments (Note 22) | 345,027 | 65,407 | 410,434 |
| Available-for-sale securities (Note 25) | | | |
| - Debt securities | - 26,976,766 | - | 26,976,766 |
| - Certificates of deposit | - 5,540,037 | 2,136,848 | 7,676,885 |
| - Equity securities | - | 63,965 | 63,965 |
| Financial liabilities | | | |
| Financial liabilities at fair value through profit or loss (Note 30) | | | |
| - Trading liabilities | - 4,433,736 | - | 4,433,736 |
| Derivative financial instruments (Note 22) | 94,553 | 153,761 | 248,314 |

| 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 (Note 21) | | | |
| - 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 (Note 22) | 501,902 | 147,801 | 649,703 |
| Available-for-sale securities (Note 25) | | | |
| - Debt securities | 1,468,168 | 25,061,119 | 26,529,287 |
| - Certificates of deposit | - 5,569,963 | - | 5,569,963 |
| - Equity securities | - | 56,146 | 56,146 |
| Financial liabilities | | | |
| Financial liabilities at fair value through profit or loss (Note 30) | | | |
| - Trading liabilities | - 4,975,073 | - | 4,975,073 |
| Derivative financial instruments (Note 22) | 205,008 | 171,417 | 376,425 |

During the year 2013 and 2012, there were no financial asset and liability transfers between level 1 and level 2 for the Group and the Bank.

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items

| The Group and the Bank | |
|--|----------------------|
| 2013 | |
| Financial assets | |
| Available-for-sale securities | |
| Certificates of deposit | Equity securities |
| HK\$'000 | HK\$'000 |
| At 1 January 2013 | - |
| Gains | 56,146 |
| - Other comprehensive income | 7,819 |
| Purchases | - |
| Transfers into level 3 | - |
| At 31 December 2013 | 63,965 |
| Total unrealised gain for the year included in income statement for financial assets held as at 31 December 2013 | - |

| 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 | 43,899 |
| Gains | 12,384 |
| - Other comprehensive income | (137) |
| Sales | - |
| At 31 December 2012 | 56,146 |
| Total unrealised gain for the year included in income statement for financial assets held as at 31 December 2012 | - |

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items (continued)

As at 31 December 2013 and 2012, financial instruments categorised as level 3 are mainly comprised of certificates of deposit and unlisted equity securities.

Certificates of deposit were transferred into level 3 in the year of 2013 due to change of valuation observability. The Group has established internal control procedures to control the Group's exposure to such financial instruments.

The fair values of unlisted available-for-sale equity securities are determined with reference to multiples of comparable listed companies, such as average of the price/earning ratios of comparables or net asset value, if appropriate comparables are not available. The fair value is positively correlated to the price/earning ratios of appropriate comparables or net asset values. Had the net asset value of the underlying equity investments increased/(decreased) by 5%, the Group's other comprehensive income would have increased/(decreased) by HK\$3,198,000.

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.2 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

Substantially all the financial assets and liabilities mature within one year from the balance sheet date and their carrying value approximates fair value.

Advances to customers

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

Held-to-maturity securities

The fair value of held-to-maturity securities is determined by using the same approach as those debt securities and certificates of deposit and asset backed securities measured at fair value as described in Note 5.1.

Loans and receivables

The fair value for loans and receivables is determined by obtaining quoted market price from dealer and independent pricing service vendors or using discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity.

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)

5. Fair values of assets and liabilities (continued)

5.2 Financial instruments not measured at fair value (continued)

The following tables set out the carrying values and fair values of the financial instruments not measured at fair value, except for the above with their carrying values being approximation of fair values.

| | The Group | | | |
|---------------------------------------|----------------------------|------------------------|----------------------------|------------------------|
| | 2013 | | 2012 | |
| | Carrying value HK\$'000 | Fair value HK\$'000 | Carrying value HK\$'000 | Fair value HK\$'000 |
| Financial assets | | | | |
| Held-to-maturity securities (Note 25) | | | | |
| - Debt securities | 585,442 | 583,975 | 1,006,783 | 1,012,465 |
| - Certificates of deposit | - | - | 464,743 | 465,004 |
| Loans and receivables (Note 25) | 1,684,064 | 1,679,326 | 1,157,262 | 1,155,860 |

| | The Bank | | | |
|---------------------------------------|----------------------------|------------------------|----------------------------|------------------------|
| | 2013 | | 2012 | |
| | Carrying value HK\$'000 | Fair value HK\$'000 | Carrying value HK\$'000 | Fair value HK\$'000 |
| Financial assets | | | | |
| Held-to-maturity securities (Note 25) | | | | |
| - Debt securities | 298 | 295 | 122,082 | 121,998 |
| - Certificates of deposit | - | - | 464,743 | 465,004 |
| Loans and receivables (Note 25) | 1,684,064 | 1,679,326 | 1,157,262 | 1,155,860 |

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.2 Financial instruments not measured at fair value (continued)

The following table shows the fair value hierarchy for financial instruments with fair values disclosed.

| The Group | | | |
|-----------------------------|-------------|----------|-----------|
| 2013 | | | |
| Level 1 | Level 2 | Level 3 | Total |
| HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Financial assets | | | |
| Held-to-maturity securities | | | |
| - Debt securities | - 583,680 | 295 | 583,975 |
| Loans and receivables | - 1,679,326 | - | 1,679,326 |

| The Bank | | | |
|-----------------------------|-------------|----------|-----------|
| 2013 | | | |
| Level 1 | Level 2 | Level 3 | Total |
| HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Financial assets | | | |
| Held-to-maturity securities | | | |
| - Debt securities | - | 295 | 295 |
| Loans and receivables | - 1,679,326 | - | 1,679,326 |

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.3 Non-financial instruments measured at fair value

The Group uses valuation techniques or quoted market prices in active market to determine the fair value of non-financial instruments.

Investment properties and premises

The Group's properties can be divided into investment properties and premises. All of the Group's investment properties and premises were revalued as at 31 December 2013. The valuations were carried out by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited, who have among their staff Fellow and Members of the Hong Kong Institute of Surveyors with recent experience in the locations and categories of properties being valued. The Management had discussion with the surveyors on the valuation methods, valuation assumptions and valuation results when the valuation is performed at each interim and annual reporting date. There has been no change in valuation methods during the year ended 31 December 2013.

Valuation methods and inputs used in Level 2 fair value measurements

The fair value of properties classified as Level 2 is determined using either the market comparison approach by reference to recent sales price of comparable properties or the income capitalisation approach by reference to market rent and capitalisation rate, with appropriate adjustments to reflect the differences between the comparable properties and the subject properties. These adjustments are considered as insignificant to the entire measurement.

The Group's properties are located in Hong Kong and major cities in the PRC where the property markets are considered active and transparent. Sales price, market rent and capitalisation rate of comparable properties are generally observable either directly or indirectly in these markets.

Information about Level 3 fair value measurements

The fair values of all of the Group's properties classified as Level 3 are determined using either the market comparison approach or the income capitalisation approach, adjusted for a premium or a discount specific to the features of the Group's properties compared to the comparable properties.

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.3 Non-financial instruments measured at fair value (continued)

Investment properties and premises (continued)

The valuation methods and significant unobservable inputs used in the fair value measurement of the Group's properties classified as Level 3 are as follows:

| | Valuation method | Significant unobservable inputs | Weighted average | Relationship of unobservable inputs to fair value |
|------------------|--|---|------------------|--|
| Other properties | Market comparison approach or income capitalisation approach | Premium/ (discount) on features of the property compared to comparable properties | -8.4% | The higher the premium, the higher the fair value. The higher the discount, the lower the fair value |

Premium / (discount) on features of the property are determined after taken into account various factors, such as time for market movement, location, accessibility, building age / condition, floor level, size, layout etc, with reference to their differences in features with comparable properties.

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.3 Non-financial instruments measured at fair value (continued)

(A) Fair value hierarchy

| The Group | | | | |
|---|----------|-----------|-----------|-----------|
| 2013 | | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Non-financial assets | | | | |
| Investment properties (Note 27) | - | 27,000 | 1,147,938 | 1,174,938 |
| Properties, plant and equipment (Note 28) | | | | |
| - Premises | - | 1,931,868 | 4,677,510 | 6,609,378 |
| | | | | |
| The Bank | | | | |
| 2013 | | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Non-financial assets | | | | |
| Investment properties (Note 27) | - | 27,000 | 1,099,510 | 1,126,510 |
| Properties, plant and equipment (Note 28) | | | | |
| - Premises | - | 1,889,585 | 4,231,196 | 6,120,781 |

During the year 2013, there were no non-financial asset transfers between level 1 and level 2 for the Group and the Bank.

Notes to the Financial Statements (continued)

5. Fair values of assets and liabilities (continued)

5.3 Non-financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items

| | The Group | |
|--|-----------------------|---------------------------------|
| | 2013 | |
| | Non-financial assets | |
| | Investment properties | Properties, plant and equipment |
| | Premises | |
| | HK\$'000 | HK\$'000 |
| At 1 January 2013 | 1,001,279 | 4,094,219 |
| Gains | | |
| - Income statement | | |
| - Net gain from fair value adjustments on investment properties | 166,363 | - |
| - Net gain from revaluation of properties, plant and equipment | - | 8,085 |
| - Other comprehensive income | | |
| - Revaluation of premises | - | 582,352 |
| Depreciation | - | (57,416) |
| Additions | - | 16,560 |
| Reclassification | (21,050) | 21,050 |
| Exchange difference | 1,346 | 12,660 |
| At 31 December 2013 | 1,147,938 | 4,677,510 |
| Total unrealised gain for the year included in income statement for non-financial assets held as at 31 December 2013 | | |
| - Net gain from fair value adjustments on investment properties | 166,363 | - |
| - Net gain from revaluation of properties, plant and equipment | - | 8,085 |
| | 166,363 | 8,085 |

| | The Bank | |
|--|-----------------------|---------------------------------|
| | 2013 | |
| | Non-financial assets | |
| | Investment properties | Properties, plant and equipment |
| | Premises | |
| | HK\$'000 | HK\$'000 |
| At 1 January 2013 | 955,670 | 3,665,303 |
| Gains | | |
| - Income statement | | |
| - Net gain from fair value adjustments on investment properties | 164,890 | - |
| - Other comprehensive income | | |
| - Revaluation of premises | - | 568,212 |
| Depreciation | - | (39,691) |
| Additions | - | 16,322 |
| Reclassification | (21,050) | 21,050 |
| At 31 December 2013 | 1,099,510 | 4,231,196 |
| Total unrealised gain for the year included in income statement for non-financial assets held as at 31 December 2013 | | |
| - Net gain from fair value adjustments on investment properties | 164,890 | - |

Notes to the Financial Statements (continued)

6. Net interest income

| | 2013 HK\$'000 | 2012 HK\$'000 |
|---|--------------------|------------------|
| Interest income | | |
| Due from banks and other financial institutions | 2,256,247 | 2,329,108 |
| Advances to customers | 5,294,805 | 4,355,000 |
| Listed investments | 327,562 | 319,579 |
| Unlisted investments | 881,056 | 680,723 |
| Others | 17,126 | 26,046 |
| | 8,776,796 | 7,710,456 |
| Interest expense | | |
| Due to banks and other financial institutions | (779,789) | (601,733) |
| Deposits from customers | (3,068,188) | (3,014,699) |
| Others | (237,653) | (161,211) |
| | (4,085,630) | (3,777,643) |
| Net interest income | 4,691,166 | 3,932,813 |

Included within interest income is HK\$2,594,000 (2012: HK\$8,079,000) of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2013.

Included within interest income and interest expense are HK\$8,732,588,000 (2012: HK\$7,653,870,000) and HK\$4,080,742,000 (2012: HK\$3,763,585,000), for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

Notes to the Financial Statements (continued)

7. Net fee and commission income

| | 2013 HK\$'000 | 2012 HK\$'000 |
|--|------------------|------------------|
| Fee and commission income | | |
| Loan commissions | 240,188 | 183,902 |
| Bills commissions | 218,959 | 150,725 |
| Securities brokerage | 194,970 | 164,207 |
| Funds distribution | 118,762 | 72,126 |
| Insurance | 101,524 | 77,018 |
| Payment services | 72,189 | 74,734 |
| Safe deposit box | 21,800 | 21,688 |
| Credit card business | 5,004 | 761 |
| Trust and custody services | 1,389 | 109 |
| Currency exchange | 534 | 600 |
| Others | 99,807 | 76,907 |
| | 1,075,126 | 822,777 |
| Fee and commission expense | | |
| Securities brokerage | (27,549) | (26,224) |
| Payment services | (6,539) | (6,604) |
| Credit card business | (914) | (78) |
| Others | (31,499) | (34,692) |
| | (66,501) | (67,598) |
| Net fee and commission income | 1,008,625 | 755,179 |
| Of which arise from | | |
| - financial assets or financial liabilities not at fair value through profit or loss | | |
| - Fee and commission income | 219,867 | 193,677 |
| - Fee and commission expense | (2,954) | (1,584) |
| | 216,913 | 192,093 |
| - trust and other fiduciary activities | | |
| - Fee and commission income | 13,071 | 12,262 |
| - Fee and commission expense | (1,202) | (1,183) |
| | 11,869 | 11,079 |

8. Net trading gain

| | 2013 HK\$'000 | 2012 HK\$'000 |
|--|------------------|------------------|
| Net gain/(loss) from: | | |
| - foreign exchange and foreign exchange products | (5,065) | 131,080 |
| - interest rate instruments | 102,286 | 16,136 |
| | 97,221 | 147,216 |

Notes to the Financial Statements (continued)

9. Net gain on other financial assets

| | 2013 HK\$'000 | 2012 HK\$'000 |
|---|------------------|------------------|
| Net gain from disposal of available-for-sale securities | 31,292 | 11,839 |
| Others | 21,204 | 4,762 |
| | 52,496 | 16,601 |

10. Other operating income

| | 2013 HK\$'000 | 2012 HK\$'000 |
|---|------------------|------------------|
| Dividend income from investment in securities | | |
| - unlisted investments | 7,975 | 6,940 |
| Gross rental income from investment properties | 45,545 | 40,881 |
| Less: Outgoings in respect of investment properties | (2,906) | (2,066) |
| Others | 24,856 | 11,354 |
| | 75,470 | 57,109 |

Included in the "Outgoings in respect of investment properties" is HK\$163,000 (2012: HK\$177,000) of direct operating expenses related to investment properties that were not let during the year.

Contingent rent included in the "Gross rental income from investment properties" amounted to HK\$346,000 during the year (2012: HK\$112,000).

11. Net charge of impairment allowances

| | 2013 HK\$'000 | 2012 HK\$'000 |
|--|------------------|------------------|
| Advances to customers | | |
| Individually assessed | | |
| - new allowances | (222,187) | (155,261) |
| - releases | 11,572 | 5,185 |
| - recoveries | 51,936 | 13,523 |
| Net charge of individually assessed loan impairment allowances (Note 24) | (158,679) | (136,553) |
| Collectively assessed | | |
| - new allowances | (211,288) | (260,395) |
| Net charge of collectively assessed loan impairment allowances (Note 24) | (211,288) | (260,395) |
| Net charge of impairment allowances | (369,967) | (396,948) |

Notes to the Financial Statements (continued)

12. Operating expenses

| | 2013 HK\$'000 | 2012 HK\$'000 |
|--|------------------|------------------|
| Staff costs (including directors' emoluments) | | |
| - salaries and other costs | 1,064,036 | 904,165 |
| - pension cost | 127,780 | 109,887 |
| | 1,191,816 | 1,014,052 |
| Premises and equipment expenses (excluding depreciation) | | |
| - rental of premises | 242,896 | 211,026 |
| - information technology | 156,632 | 111,466 |
| - others | 53,375 | 47,921 |
| | 452,903 | 370,413 |
| Depreciation (Note 28) | 206,956 | 166,939 |
| Auditor's remuneration | | |
| - audit services | 5,727 | 7,377 |
| - non-audit services | 199 | 671 |
| Other operating expenses | 494,897 | 386,845 |
| | 2,352,498 | 1,946,297 |

13. Net gain from fair value adjustments on investment properties

| | 2013 HK\$'000 | 2012 HK\$'000 |
|---|------------------|------------------|
| Net gain from fair value adjustments on investment properties (Note 27) | 169,414 | 178,766 |

14. Net gain/(loss) from disposal/revaluation of properties, plant and equipment

| | 2013 HK\$'000 | 2012 HK\$'000 |
|--|------------------|------------------|
| Net loss from disposal of premises | - | (995) |
| Net loss from disposal of other fixed assets | (4,609) | (3,894) |
| Net gain/(loss) from revaluation of premises (Note 28) | 8,085 | (1,738) |
| | 3,476 | (6,627) |

Notes to the Financial Statements (continued)

15. Taxation

Taxation in the income statement represents:

| | 2013 HK\$'000 | 2012 HK\$'000 |
|---|------------------|------------------|
| Current tax | | |
| Hong Kong profits tax | | |
| - current year taxation | 439,500 | 365,036 |
| - over-provision in prior years | (6,254) | (7,942) |
| | 433,246 | 357,094 |
| Overseas taxation | | |
| - current year taxation | 179,858 | 71,372 |
| - (over)/under-provision in prior years | (17,010) | 2,863 |
| | 596,094 | 431,329 |
| Deferred tax | | |
| Origination and reversal of temporary differences (Note 34) | (65,541) | (11,516) |
| | 530,553 | 419,813 |

Hong Kong profits tax has been provided at the rate of 16.5% (2012: 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:

| | 2013 HK\$'000 | 2012 HK\$'000 |
|---|------------------|------------------|
| Profit before taxation | 3,359,210 | 2,759,771 |
| Calculated at a taxation rate of 16.5% (2012: 16.5%) | 554,270 | 455,362 |
| Effect of different taxation rates in other countries | 23,684 | 18,893 |
| Income not subject to taxation | (76,226) | (70,295) |
| Expenses not deductible for taxation purposes | 20,050 | 13,482 |
| Tax losses not recognised | 1 | 298 |
| Utilisation of previously unrecognised tax losses | (385) | - |
| Over-provision in prior years | (23,264) | (5,079) |
| Foreign withholding tax | 32,423 | 7,152 |
| Taxation charge | 530,553 | 419,813 |
| Effective tax rate | 15.79% | 15.21% |

Notes to the Financial Statements (continued)

16. Profit attributable to the equity holders of the Bank

The consolidated profit attributable to the equity holders of the Bank for the year ended 31 December 2013 includes a profit of HK\$2,410,506,000 (2012: HK\$2,072,764,000) which has been dealt with in the financial statements of the Bank.

17. Dividends

| | 2013 | | 2012 | |
|-----------------------|-------------------|-------------------|-------------------|-------------------|
| | Per share HK\$ | Total HK\$'000 | Per share HK\$ | Total HK\$'000 |
| Interim dividend paid | 77 | 539,000 | 56 | 392,000 |

On 12 December 2013, the Board declared an interim dividend of HK\$77 per ordinary share for 2013 amounting to HK\$539,000,000.

18. Retirement benefit costs

The principal defined contribution schemes for the Group's employees are ORSO schemes exempted under the MPF Schemes Ordinance and the BOC-Prudential Easy Choice MPF Scheme. Under the ORSO schemes, employees make monthly contributions to the ORSO schemes 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.

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 schemes for the year ended 31 December 2013 amounted to approximately HK\$37,267,000 (2012: approximately HK\$36,771,000), after a deduction of forfeited contributions of approximately HK\$358,000 (2012: approximately HK\$318,000). For the MPF Scheme, the Group contributed approximately HK\$5,976,000 (2012: approximately HK\$5,375,000) for the year ended 31 December 2013.

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:

| | 2013 | 2012 |
|------------------|-----------------|----------|
| | HK\$'000 | HK\$'000 |
| Fees | 6,045 | 6,515 |
| Other emoluments | 8,063 | 10,426 |
| | 14,108 | 16,941 |

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

| | 2013 | | | | | |
|-----------------------|--------------------------|----------------------|-------------------|--------------------------|----------------------|-------------------|
| | Senior Management | | | Key Personnel | | |
| | Non-deferred HK\$'000 | Deferred HK\$'000 | Total HK\$'000 | Non-deferred HK\$'000 | Deferred HK\$'000 | Total HK\$'000 |
| Fixed remuneration | | | | | | |
| Cash | 10,005 | - | 10,005 | 5,552 | - | 5,552 |
| Variable remuneration | | | | | | |
| Cash | 3,939 | 531 | 4,470 | 2,068 | - | 2,068 |
| Total | 13,944 | 531 | 14,475 | 7,620 | - | 7,620 |

| | 2012 | | | | | |
|-----------------------|--------------------------|----------------------|-------------------|--------------------------|----------------------|-------------------|
| | Senior Management | | | Key Personnel | | |
| | Non-deferred HK\$'000 | Deferred HK\$'000 | Total HK\$'000 | Non-deferred HK\$'000 | Deferred HK\$'000 | Total 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 |

The remuneration above includes 4 (2012: 5) members of Senior Management and 4 (2012: 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

| | 2013 | | 2012 | |
|---|-------------------------------|---------------------------|-------------------------------|---------------------------|
| | Senior Management HK\$'000 | Key Personnel HK\$'000 | Senior Management HK\$'000 | Key Personnel HK\$'000 |
| Deferred remuneration | | | | |
| Vested | 253 | - | 90 | - |
| Unvested | 948 | - | 670 | - |
| | 1,201 | - | 760 | - |
| At 1 January | 670 | - | 260 | - |
| Awarded | 531 | - | 500 | - |
| Paid out | (253) | - | (90) | - |
| Reduced through performance adjustments | - | - | - | - |
| At 31 December | 948 | - | 670 | - |

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 heads of material business lines, Head of Treasury, as well as Head of Risk Management Department.

20. Cash and balances with banks and other financial institutions

| | The Group | | The Bank | |
|--|-------------------|-------------------|-------------------|-------------------|
| | 2013 HK\$'000 | 2012 HK\$'000 | 2013 HK\$'000 | 2012 HK\$'000 |
| Cash | 883,699 | 651,229 | 591,385 | 383,218 |
| Balances with central banks | 17,068,323 | 13,139,030 | 853,838 | 35,306 |
| Balances with banks and other financial institutions | 13,858,127 | 13,263,797 | 13,981,814 | 13,026,968 |
| Placements with banks and other financial institutions maturing within one month | 12,929,170 | 13,734,264 | 3,413,297 | 8,313,216 |
| | 44,739,319 | 40,788,320 | 18,840,334 | 21,758,708 |

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 | |
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| At fair value | | | | | | |
| Debt securities | | | | | | |
| - Listed in Hong Kong | - | - | 260,730 | 264,125 | 260,730 | 264,125 |
| - Listed outside Hong Kong | - | - | 237,927 | 508,696 | 237,927 | 508,696 |
| | - | - | 498,657 | 772,821 | 498,657 | 772,821 |
| - Unlisted | 3,666,036 | 4,272,358 | - | 79,981 | 3,666,036 | 4,352,339 |
| Total | 3,666,036 | 4,272,358 | 498,657 | 852,802 | 4,164,693 | 5,125,160 |

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

| | The Group and the Bank | |
|-------------------------|------------------------|-----------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Sovereigns | 3,665,412 | 4,271,737 |
| Public sector entities* | 624 | 621 |
| Corporate entities | 498,657 | 852,802 |
| | 4,164,693 | 5,125,160 |

* Included financial assets at fair value through profit or loss of HK\$624,000 (2012: HK\$621,000) 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 | |
|---|------------------------|-----------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Treasury bills | 3,665,412 | 4,271,737 |
| Other financial assets at fair value through profit or loss | 499,281 | 853,423 |
| | 4,164,693 | 5,125,160 |

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, precious metal and equity 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 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 and requirement 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. There are limits to control the notional amount of exposure arising from derivative transactions, and the maximum tenor of the deal is set. 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 | | |
|--------------------------|-------------------|---|-------------------|
| | 2013 | | |
| | Trading | Not qualified for hedge accounting | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts | | | |
| Spot and forwards | 13,620,622 | - | 13,620,622 |
| Swaps | 27,813,930 | - | 27,813,930 |
| Foreign currency options | | | |
| - Options purchased | 22,156 | - | 22,156 |
| - Options written | 22,156 | - | 22,156 |
| | 41,478,864 | - | 41,478,864 |
| Interest rate contracts | | | |
| Swaps | 43,343,986 | 464,465 | 43,808,451 |
| Commodity contracts | 211,761 | - | 211,761 |
| Other contracts | 3,837 | - | 3,837 |
| Total | 85,038,448 | 464,465 | 85,502,913 |

Not qualified for hedge accounting: derivative contracts 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 | | |
|--------------------------|-------------------|--|-------------------|
| | 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 |
| | <u>43,175,193</u> | <u>-</u> | <u>43,175,193</u> |
| Interest rate contracts | | | |
| Swaps | <u>35,851,341</u> | <u>720,082</u> | <u>36,571,423</u> |
| Commodity contracts | <u>142,395</u> | <u>-</u> | <u>142,395</u> |
| Equity contracts | <u>47,104</u> | <u>-</u> | <u>47,104</u> |
| Other contracts | <u>4,496</u> | <u>-</u> | <u>4,496</u> |
| Total | <u>79,220,529</u> | <u>720,082</u> | <u>79,940,611</u> |

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

| | The Bank | | |
|-------------------------|-------------------|--|-------------------|
| | 2013 | | |
| | Trading | Not qualified for hedge accounting | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts | | | |
| Spot and forwards | 7,097,789 | - | 7,097,789 |
| Swaps | 19,584,063 | - | 19,584,063 |
| Foreign currency option | | | |
| - Options purchased | 22,156 | - | 22,156 |
| - Options written | 22,156 | - | 22,156 |
| | <u>26,726,164</u> | <u>-</u> | <u>26,726,164</u> |
| Interest rate contracts | | | |
| Swaps | <u>1,272,262</u> | <u>464,465</u> | <u>1,736,727</u> |
| Commodity contracts | <u>188,037</u> | <u>-</u> | <u>188,037</u> |
| Other contracts | <u>3,837</u> | <u>-</u> | <u>3,837</u> |
| Total | <u>28,190,300</u> | <u>464,465</u> | <u>28,654,765</u> |

| | 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 |
| | <u>30,726,039</u> | <u>-</u> | <u>30,726,039</u> |
| Interest rate contracts | | | |
| Swaps | <u>2,133,652</u> | <u>720,082</u> | <u>2,853,734</u> |
| Commodity contracts | <u>92,496</u> | <u>-</u> | <u>92,496</u> |
| Equity contracts | <u>9,636</u> | <u>-</u> | <u>9,636</u> |
| Other contracts | <u>4,496</u> | <u>-</u> | <u>4,496</u> |
| Total | <u>32,966,319</u> | <u>720,082</u> | <u>33,686,401</u> |

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 | | | | | | |
|-------------------------|------------------------------------|----------|------------------------|------------------------------------|----------|-----------|
| 2013 | | | | | | |
| 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 | 411,547 | - | 411,547 | (110,301) | - | (110,301) |
| Swaps | 26,554 | - | 26,554 | (112,844) | - | (112,844) |
| Foreign currency option | | | | | | |
| - Options purchased | 71 | - | 71 | - | - | - |
| - Options written | - | - | - | (71) | - | (71) |
| | 438,172 | - | 438,172 | (223,216) | - | (223,216) |
| Interest rate contracts | | | | | | |
| Swaps | 56,854 | - | 56,854 | (79,837) | (38,748) | (118,585) |
| Commodity contracts | 13,425 | - | 13,425 | (1,355) | - | (1,355) |
| Other contracts | 2 | - | 2 | - | - | - |
| Total | 508,453 | - | 508,453 | (304,408) | (38,748) | (343,156) |

| 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) |

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

| The Bank | | | | | | |
|-------------------------|------------------------------------|----------|------------------------|------------------------------------|-----------------|------------------|
| 2013 | | | | | | |
| 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 | HK\$'000 |
| Exchange rate contracts | | | | | | |
| Spot and forwards | 380,320 | - | 380,320 | (95,705) | - | (95,705) |
| Swaps | 16,672 | - | 16,672 | (89,292) | - | (89,292) |
| Foreign currency option | | | | | | |
| - Options purchased | 71 | - | 71 | - | - | - |
| - Options written | - | - | (71) | - | - | (71) |
| | 397,063 | - | 397,063 | (185,068) | - | (185,068) |
| Interest rate contracts | | | | | | |
| Swaps | - | - | (23,187) | (38,748) | - | (61,935) |
| Commodity contracts | | | | | | |
| | 13,369 | - | 13,369 | (1,311) | - | (1,311) |
| Other contracts | | | | | | |
| | 2 | - | 2 | - | - | - |
| Total | 410,434 | - | 410,434 | (209,566) | (38,748) | (248,314) |

| The Bank | | | | | | |
|-------------------------|------------------------------------|----------|------------------------|------------------------------------|-----------------|------------------|
| 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 | 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) |

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

The tables below give the contract/notional amounts, credit risk-weighted amounts and fair values of derivatives after taking into account the effect of valid bilateral netting agreements and are prepared with reference to the Completion Instructions for the HKMA return of capital adequacy ratio.

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.

| | The Group | | |
|-------------------------|---------------------------------|-----------------------------------|----------------|
| | 2013 | | |
| | Contract/ notional amount | Credit risk-weighted amount | Fair value |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts | | | |
| Spot and forwards | 9,598,359 | 196,207 | 79,702 |
| Swaps | 26,059,621 | 88,727 | 23,878 |
| | 35,657,980 | 284,934 | 103,580 |
| Interest rate contracts | | | |
| Swaps | 43,808,451 | 35,998 | 29,667 |
| Total | 79,466,431 | 320,932 | 133,247 |

| | The Group | | |
|-------------------------|---------------------------------|-----------------------------------|----------------|
| | 2012 | | |
| | Contract/ notional amount | Credit risk-weighted amount | Fair value |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts | | | |
| Spot and forwards | 17,422,349 | 174,157 | 66,483 |
| Swaps | 17,864,217 | 77,605 | 137,925 |
| | 35,286,566 | 251,762 | 204,408 |
| Interest rate contracts | | | |
| Swaps | 36,571,423 | 31,045 | 24,385 |
| Commodity contracts | 49,899 | 2,809 | 69 |
| Equity contracts | 37,467 | 1,173 | 127 |
| Total | 71,945,355 | 286,789 | 228,989 |

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

| | The Bank | | |
|-------------------------|---------------------------------|-----------------------------------|---------------|
| | 2013 | | |
| | Contract/ notional amount | Credit risk-weighted amount | Fair value |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts | | | |
| Spot and forwards | 3,075,526 | 97,974 | 48,613 |
| Swaps | 17,967,167 | 52,614 | 14,967 |
| | <u>21,042,693</u> | <u>150,588</u> | <u>63,580</u> |
| Interest rate contracts | | | |
| Swaps | 1,736,727 | 2,334 | - |
| Total | <u>22,779,420</u> | <u>152,922</u> | <u>63,580</u> |

| | The Bank | | |
|-------------------------|---------------------------------|-----------------------------------|----------------|
| | 2012 | | |
| | Contract/ notional amount | Credit risk-weighted amount | Fair value |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| Exchange rate contracts | | | |
| Spot and forwards | 10,330,935 | 80,560 | 31,722 |
| Swaps | 13,011,854 | 54,064 | 115,804 |
| | <u>23,342,789</u> | <u>134,624</u> | <u>147,526</u> |
| Interest rate contracts | | | |
| Swaps | 2,853,734 | 2,548 | - |
| Total | <u>26,196,523</u> | <u>137,172</u> | <u>147,526</u> |

There is no effect of valid bilateral netting agreement for the fair values in the Group and the Bank.

Notes to the Financial Statements (continued)

23. Advances and other accounts

| | The Group | | The Bank | |
|------------------------------|-------------|-------------|------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Personal loans and advances | 26,727,594 | 22,002,049 | 16,522,275 | 15,651,764 |
| Corporate loans and advances | 116,814,449 | 109,151,060 | 73,068,854 | 69,411,566 |
| Advances to customers* | 143,542,043 | 131,153,109 | 89,591,129 | 85,063,330 |
| Loan impairment allowances | | | | |
| - Individually assessed | (280,913) | (220,593) | (79,556) | (58,444) |
| - Collectively assessed | (1,187,015) | (969,449) | (595,975) | (591,183) |
| | 142,074,115 | 129,963,067 | 88,915,598 | 84,413,703 |
| Trade bills | 13,242,636 | 8,069,618 | 9,458,019 | 5,504,118 |
| Total | 155,316,751 | 138,032,685 | 98,373,617 | 89,917,821 |

As at 31 December 2013, advances to customers of the Group and the Bank included accrued interest of HK\$326,587,000 (2012: HK\$522,723,000) and HK\$142,721,000 (2012: HK\$303,115,000) respectively.

As at 31 December 2013 and 2012, no impairment allowance was made in respect of trade bills.

* Included advances to customers of the Group and the Bank denominated in HK dollars of HK\$64,930,071,000 (2012: HK\$65,256,992,000) and HK\$62,071,556,000 (2012: HK\$62,941,947,000) and US dollars equivalent to HK\$34,374,429,000 (2012: HK\$27,860,495,000) and HK\$24,686,906,000 (2012: HK\$20,197,752,000) respectively.

24. Loan impairment allowances

| | The Group | | | The Bank | | |
|--|-----------------------|-----------|-----------|----------|-----------|----------|
| | 2013 | | | | | |
| | Individual assessment | | | | | |
| | Personal | Corporate | Total | Personal | Corporate | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| At 1 January 2013 | 8,305 | 212,288 | 220,593 | 788 | 57,656 | 58,444 |
| Charged to income statement | 3,645 | 155,034 | 158,679 | 2,783 | 26,475 | 29,258 |
| Loans written off during the year as uncollectible | - | (153,427) | (153,427) | - | (15,736) | (15,736) |
| Recoveries | 1,493 | 50,443 | 51,936 | 106 | 8,321 | 8,427 |
| Unwind of discount on impairment allowances | (371) | (2,223) | (2,594) | - | (846) | (846) |
| Exchange difference | 127 | 5,599 | 5,726 | - | 9 | 9 |
| At 31 December 2013 | 13,199 | 267,714 | 280,913 | 3,677 | 75,879 | 79,556 |

Notes to the Financial Statements (continued)

24. Loan impairment allowances (continued)

| | The Group | | | The Bank | | |
|---|-----------------------|-----------------------|-------------------|----------------------|-----------------------|-------------------|
| | 2013 | | | | | |
| | Collective assessment | | | | | |
| | Personal HK\$'000 | Corporate HK\$'000 | Total HK\$'000 | Personal HK\$'000 | Corporate HK\$'000 | Total HK\$'000 |
| At 1 January 2013 | 47,201 | 922,248 | 969,449 | 6,396 | 584,787 | 591,183 |
| Charged to income statement | 36,935 | 174,353 | 211,288 | 9,367 | 2,102 | 11,469 |
| Loans written off during the year as uncollectible | (6,747) | - | (6,747) | (6,747) | - | (6,747) |
| Exchange difference | 456 | 12,569 | 13,025 | - | 70 | 70 |
| At 31 December 2013 | 77,845 | 1,109,170 | 1,187,015 | 9,016 | 586,959 | 595,975 |

| | The Group | | | The Bank | | |
|---|-----------------------|-----------------------|-------------------|----------------------|-----------------------|-------------------|
| | 2012 | | | | | |
| | Individual assessment | | | | | |
| | Personal HK\$'000 | Corporate HK\$'000 | Total HK\$'000 | Personal HK\$'000 | Corporate HK\$'000 | Total 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 |

| | The Group | | | The Bank | | |
|---|-----------------------|-----------------------|-------------------|----------------------|-----------------------|-------------------|
| | 2012 | | | | | |
| | Collective assessment | | | | | |
| | Personal HK\$'000 | Corporate HK\$'000 | Total HK\$'000 | Personal HK\$'000 | Corporate HK\$'000 | Total 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 |

Notes to the Financial Statements (continued)

25. Investment in securities

| | The Group | | The Bank | |
|--|-------------------|-------------------|-------------------|-------------------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| (a) Available-for-sale securities | | | | |
| Debt securities, at fair value | | | | |
| - Listed in Hong Kong | 3,479,005 | 3,125,220 | 3,479,005 | 3,125,220 |
| - Listed outside Hong Kong | 4,580,287 | 5,058,760 | 4,580,287 | 5,058,760 |
| | 8,059,292 | 8,183,980 | 8,059,292 | 8,183,980 |
| - Unlisted | 24,202,495 | 24,550,772 | 18,917,474 | 18,345,307 |
| | 32,261,787 | 32,734,752 | 26,976,766 | 26,529,287 |
| Certificates of deposit, at fair value | | | | |
| - Listed outside Hong Kong | 260,416 | 304,946 | 260,416 | 304,946 |
| - Unlisted | 7,416,469 | 5,265,017 | 7,416,469 | 5,265,017 |
| | 7,676,885 | 5,569,963 | 7,676,885 | 5,569,963 |
| Equity securities, at fair value | | | | |
| - Unlisted | 63,965 | 56,146 | 63,965 | 56,146 |
| | 40,002,637 | 38,360,861 | 34,717,616 | 32,155,396 |
| (b) Held-to-maturity securities | | | | |
| Debt securities, at amortised cost | | | | |
| - Unlisted | 585,442 | 1,006,783 | 298 | 122,082 |
| Certificates of deposit, at amortised cost | | | | |
| - Unlisted | - | 464,743 | - | 464,743 |
| | 585,442 | 1,471,526 | 298 | 586,825 |
| (c) Loans and receivables | | | | |
| Unlisted, at amortised cost | 1,684,064 | 1,157,262 | 1,684,064 | 1,157,262 |
| Total | 42,272,143 | 40,989,649 | 36,401,978 | 33,899,483 |

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

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

| | The Group | | | |
|--|--------------------------------------|------------------------------------|--------------------------|------------|
| | 2013 | | | |
| | Available- for-sale securities | Held-to- maturity securities | Loans and receivables | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Sovereigns | 9,942,492 | 585,144 | - | 10,527,636 |
| Public sector entities* | 604,814 | - | - | 604,814 |
| Banks and other financial institutions | 20,094,280 | 298 | 850,686 | 20,945,264 |
| Corporate entities | 9,361,051 | - | 833,378 | 10,194,429 |
| | 40,002,637 | 585,442 | 1,684,064 | 42,272,143 |

| | 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 |

* Included available-for-sale securities of HK\$604,814,000 (2012: HK\$506,992,000) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

| | The Bank | | | |
|--|--------------------------------------|------------------------------------|--------------------------|------------|
| | 2013 | | | |
| | Available- for-sale securities | Held-to- maturity securities | Loans and receivables | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Sovereigns | 6,511,281 | - | - | 6,511,281 |
| Public sector entities** | 604,814 | - | - | 604,814 |
| Banks and other financial institutions | 20,031,071 | 298 | 850,686 | 20,882,055 |
| Corporate entities | 7,570,450 | - | 833,378 | 8,403,828 |
| | 34,717,616 | 298 | 1,684,064 | 36,401,978 |

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 |
| Sovereigns | 9,953,382 | - | - |
| Public sector entities** | 506,992 | - | - |
| Banks and other financial institutions | 16,454,503 | 465,639 | - |
| Corporate entities | 5,240,519 | 121,186 | 1,157,262 |
| | <u>32,155,396</u> | <u>586,825</u> | <u>1,157,262</u> |
| | | | <u>33,899,483</u> |

** Included available-for-sale securities of HK\$604,814,000 (2012: HK\$506,992,000) 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 | | |
|-------------------------------------|--------------------------------------|------------------------------------|--------------------------|
| | 2013 | | |
| | Available- for-sale securities | Held-to- maturity securities | Loans and receivables |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| At 1 January 2013 | 38,360,861 | 1,471,526 | 1,157,262 |
| Additions | 56,982,757 | - | 2,305,726 |
| Disposals, redemptions and maturity | (54,005,892) | (908,005) | (1,828,041) |
| Amortisation | (32,171) | (5,142) | 6,548 |
| Change in fair value | (624,520) | - | - |
| Exchange difference | (678,398) | 27,063 | 42,569 |
| At 31 December 2013 | <u>40,002,637</u> | <u>585,442</u> | <u>1,684,064</u> |

| | 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 | <u>38,360,861</u> | <u>1,471,526</u> | <u>1,157,262</u> |

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

| | The Bank | | |
|-------------------------------------|--|--|--------------------------------------|
| | 2013 | | |
| | Available- for-sale securities HK\$'000 | Held-to- maturity securities HK\$'000 | Loans and receivables HK\$'000 |
| At 1 January 2013 | 32,155,396 | 586,825 | 1,157,262 |
| Additions | 55,415,150 | - | 2,305,726 |
| Disposals, redemptions and maturity | (51,671,550) | (587,798) | (1,828,041) |
| Amortisation | (2,920) | 74 | 6,548 |
| Change in fair value | (494,573) | - | - |
| Exchange difference | (683,887) | 1,197 | 42,569 |
| At 31 December 2013 | <u>34,717,616</u> | <u>298</u> | <u>1,684,064</u> |

| | The Bank | | |
|-------------------------------------|--|--|--------------------------------------|
| | 2012 | | |
| | Available- for-sale securities HK\$'000 | Held-to- maturity securities HK\$'000 | Loans and receivables 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 | <u>32,155,396</u> | <u>586,825</u> | <u>1,157,262</u> |

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 | |
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Treasury bills | 8,447,909 | 13,385,213 | 585,144 | 884,701 |
| Certificates of deposit | 7,676,885 | 5,569,963 | - | 464,743 |
| Others | 23,877,843 | 19,405,685 | 298 | 122,082 |
| | 40,002,637 | 38,360,861 | 585,442 | 1,471,526 |

| | The Bank | | | |
|-------------------------|-------------------------------|-------------------|-----------------------------|----------------|
| | Available-for-sale securities | | Held-to-maturity Securities | |
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Treasury bills | 4,953,490 | 8,929,657 | - | - |
| Certificates of deposit | 7,676,885 | 5,569,963 | - | 464,743 |
| Others | 22,087,241 | 17,655,776 | 298 | 122,082 |
| | 34,717,616 | 32,155,396 | 298 | 586,825 |

Notes to the Financial Statements (continued)

26. Investment in subsidiaries

| | The Bank | |
|--------------------------|------------------|-----------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Unlisted shares, at cost | 8,171,067 | 8,171,067 |

The particulars of subsidiaries of the Bank as at 31 December 2013 are as follows:

| Name of company | Place and date of incorporation/ operation/ registration | Issued and fully paid up share capital/ registered capital/ units in issue | Interest held | Principal activities |
|--|--|--|------------------|-------------------------|
| Directly held: | | | | |
| Nanyang Commercial Bank (China), Limited | The People's Republic of China 14 December 2007 | Registered capital RMB6,500,000,000 | 100% | Banking business |
| Nanyang Commercial Bank Trustee Limited | Hong Kong 22 October 1976 | 300,000 Ordinary shares of HK\$10 each | 100% | Trustee services |
| Kwong Li Nam Investment Agency Limited | Hong Kong 25 May 1984 | 30,500 Ordinary shares of HK\$100 each | 100% | Investment agency |
| Nanyang Commercial Bank (Nominees) Limited | Hong Kong 22 August 1980 | 500 Ordinary shares of HK\$100 each | 100% | Nominee services |

Notes to the Financial Statements (continued)

27. Investment properties

| | The Group | | The Bank | |
|---|------------------|------------------|------------------|----------------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| At 1 January | 1,027,083 | 847,948 | 979,670 | 802,260 |
| Fair value gains | 169,414 | 178,766 | 167,890 | 177,410 |
| Reclassification to properties, plant and equipment (Note 28) | (22,958) | - | (21,050) | - |
| Exchange difference | 1,399 | 369 | - | - |
| At 31 December | <u>1,174,938</u> | <u>1,027,083</u> | <u>1,126,510</u> | <u>979,670</u> |

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

| | The Group | | The Bank | |
|--------------------------------------|------------------|------------------|------------------|----------------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Held in Hong Kong | | | | |
| On long-term lease (over 50 years) | 1,010,910 | 884,150 | 1,010,910 | 884,150 |
| On medium-term lease (10 – 50 years) | 115,600 | 95,520 | 115,600 | 95,520 |
| Held outside Hong Kong | | | | |
| On medium-term lease (10 – 50 years) | 48,428 | 47,413 | - | - |
| | <u>1,174,938</u> | <u>1,027,083</u> | <u>1,126,510</u> | <u>979,670</u> |

As at 31 December 2013, investment properties are included in the balance sheets at valuation carried out at 31 December 2013 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 price that would be received to sell each investment property in an orderly transaction with market participants at the measurement date.

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 2013 | 5,846,795 | 378,200 | 6,224,995 |
| Additions | 21,258 | 88,697 | 109,955 |
| Disposals | - | (5,329) | (5,329) |
| Revaluation | 802,649 | - | 802,649 |
| Depreciation for the year (Note 12) | (97,703) | (109,253) | (206,956) |
| Reclassification from investment properties (Note 27) | 22,958 | - | 22,958 |
| Exchange difference | 13,421 | 7,544 | 20,965 |
| Net book value at 31 December 2013 | <u>6,609,378</u> | <u>359,859</u> | <u>6,969,237</u> |
| At 31 December 2013 | | | |
| Cost or valuation | 6,609,378 | 835,072 | 7,444,450 |
| Accumulated depreciation | - | (475,213) | (475,213) |
| Net book value at 31 December 2013 | <u>6,609,378</u> | <u>359,859</u> | <u>6,969,237</u> |
| The analysis of cost or valuation of the above assets is as follows: | | | |
| At 31 December 2013 | | | |
| At cost | - | 835,072 | 835,072 |
| At valuation | 6,609,378 | - | 6,609,378 |
| | <u>6,609,378</u> | <u>835,072</u> | <u>7,444,450</u> |

| | 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 12) | (73,522) | (93,417) | (166,939) |
| Exchange difference | 1,486 | 1,350 | 2,836 |
| Net book value at 31 December 2012 | <u>5,846,795</u> | <u>378,200</u> | <u>6,224,995</u> |
| 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 | <u>5,846,795</u> | <u>378,200</u> | <u>6,224,995</u> |
| The analysis of cost or valuation of the above assets is as follows: | | | |
| At 31 December 2012 | | | |
| At cost | - | 764,461 | 764,461 |
| At valuation | 5,846,795 | - | 5,846,795 |
| | <u>5,846,795</u> | <u>764,461</u> | <u>6,611,256</u> |

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 2013 | 5,381,905 | 79,256 | 5,461,161 |
| Additions | 21,019 | 15,824 | 36,843 |
| Disposals | - | (1,296) | (1,296) |
| Revaluation | 775,889 | - | 775,889 |
| Depreciation for the year | (79,082) | (22,601) | (101,683) |
| Reclassification from investment properties (Note 27) | 21,050 | - | 21,050 |
| Exchange difference | - | 3 | 3 |
| Net book value at 31 December 2013 | 6,120,781 | 71,186 | 6,191,967 |
| At 31 December 2013 | | | |
| Cost or valuation | 6,120,781 | 262,876 | 6,383,657 |
| Accumulated depreciation | - | (191,690) | (191,690) |
| Net book value at 31 December 2013 | 6,120,781 | 71,186 | 6,191,967 |
| The analysis of cost or valuation of the above assets is as follows: | | | |
| At 31 December 2013 | | | |
| At cost | - | 262,876 | 262,876 |
| At valuation | 6,120,781 | - | 6,120,781 |
| | 6,120,781 | 262,876 | 6,383,657 |

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

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 | |
|--|------------------|-----------|------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Held in Hong Kong | | | | |
| On long-term lease (over 50 years) | 4,594,346 | 4,009,054 | 4,594,346 | 4,009,054 |
| On medium-term lease (10 – 50 years) | 1,524,730 | 1,371,270 | 1,524,730 | 1,371,270 |
| Held outside Hong Kong | | | | |
| On medium-term lease (10 – 50 years) | 472,697 | 446,070 | 1,705 | 1,581 |
| On short-term lease (less than 10 years) | 17,605 | 20,401 | - | - |
| | 6,609,378 | 5,846,795 | 6,120,781 | 5,381,905 |

As at 31 December 2013, premises are included in the balance sheets at valuation carried out at 31 December 2013 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 price that would be received to sell each premises in an orderly transaction with market participants at the measurement date.

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 | |
|---|----------------|-----------|----------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Increase in valuation credited to premises revaluation reserve | 794,564 | 1,388,296 | 775,889 | 1,379,172 |
| Increase/(decrease) in valuation credited/(charged) to income statement | 8,085 | (1,738) | - | - |
| | 802,649 | 1,386,558 | 775,889 | 1,379,172 |

As at 31 December 2013, the net book value of premises that would have been included in the Group's and the Bank's balance sheets had the premises been carried at cost less accumulated depreciation was HK\$557,532,000 (2012: HK\$528,943,000) and HK\$244,564,000 (2012: HK\$217,003,000) respectively.

Notes to the Financial Statements (continued)

29. Other assets

| | The Group | | The Bank | |
|-------------------------------------|------------------|-----------|------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Reposessed assets | 32,234 | 17,792 | 27,990 | 16,842 |
| Accounts receivable and prepayments | 3,709,361 | 1,424,506 | 3,504,449 | 1,050,826 |
| | 3,741,595 | 1,442,298 | 3,532,439 | 1,067,668 |

30. Financial liabilities at fair value through profit or loss

| | The Group and the Bank | |
|--|------------------------|-----------|
| | 2013 | 2012 |
| | HK\$'000 | HK\$'000 |
| Trading liabilities | | |
| - Short positions in Exchange Fund Bills and Notes | 4,433,736 | 4,975,073 |

At 31 December 2013, there is no financial liabilities designated at fair value through profit or loss (2012: Nil).

Notes to the Financial Statements (continued)

31. Deposits from customers and hedge accounting

(a) Deposits from customers

| | The Group | | The Bank | |
|---|--------------------|------------------|--------------------|------------------|
| | 2013 HK\$'000 | 2012 HK\$'000 | 2013 HK\$'000 | 2012 HK\$'000 |
| Current, savings and other deposit accounts (per balance sheets) | 198,160,417 | 185,533,717 | 131,724,586 | 128,178,500 |
| Analysed by: | | | | |
| Demand deposits and current accounts | | | | |
| - corporate | 15,518,333 | 14,545,822 | 7,474,781 | 7,188,715 |
| - personal | 2,377,882 | 2,433,335 | 1,950,687 | 2,111,554 |
| | 17,896,215 | 16,979,157 | 9,425,468 | 9,300,269 |
| Savings deposits | | | | |
| - corporate | 17,170,844 | 16,078,426 | 15,217,838 | 14,368,581 |
| - personal | 34,145,500 | 33,772,779 | 32,679,064 | 32,504,466 |
| | 51,316,344 | 49,851,205 | 47,896,902 | 46,873,047 |
| Time, call and notice deposits | | | | |
| - corporate | 66,014,321 | 58,500,903 | 33,237,498 | 33,244,808 |
| - personal | 62,933,537 | 60,202,452 | 41,164,718 | 38,760,376 |
| | 128,947,858 | 118,703,355 | 74,402,216 | 72,005,184 |
| | 198,160,417 | 185,533,717 | 131,724,586 | 128,178,500 |

(b) Hedge accounting

Hedges of net investments in foreign operations

As at 31 December 2013, a proportion of the Group's RMB-denominated deposits from customers of HK\$1,431,965,000 (2012: HK\$1,390,910,000) were designated as a hedging instrument to hedge against the net investments in foreign operations.

There were no gains or losses on ineffective portion recognised in the income statement during the year (2012: Nil).

32. Other accounts and provisions

| | The Group | | The Bank | |
|------------------------|-------------------|------------------|------------------|------------------|
| | 2013 HK\$'000 | 2012 HK\$'000 | 2013 HK\$'000 | 2012 HK\$'000 |
| Other accounts payable | 15,163,133 | 9,937,324 | 4,173,605 | 2,132,197 |
| Provisions | 66,368 | 61,661 | 48,840 | 52,710 |
| | 15,229,501 | 9,998,985 | 4,222,445 | 2,184,907 |

Notes to the Financial Statements (continued)

33. Assets pledged as security

As at 31 December 2013, liabilities of the Group and the Bank both amounting to HK\$4,148,807,000 (2012: HK\$4,234,713,000) were secured by assets deposited with central depositories to facilitate settlement operations. In addition, the liabilities of the Group amounting to HK\$1,268,641,000 (2012: HK\$348,822,000) were secured by debt securities. The amount of assets pledged by the Group and the Bank to secure these liabilities was HK\$5,454,505,000 (2012: HK\$4,643,771,000) and HK\$4,155,616,000 (2012: HK\$4,239,175,000) mainly included in "Trading securities", "Available-for-sale securities" and "Held-to-maturity 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 sheet, and the movements during the year are as follows:

| | The Group | | | | | |
|---|------------------------------------|-------------------------|----------|--------------------------|-----------------------------------|----------|
| | 2013 | | | | | |
| | 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 2013 | 22,308 | 897,086 | (297) | (165,095) | 24,651 | 778,653 |
| Charged/(credited) to income statement (Note 15) | 4,113 | 2,864 | (115) | (50,716) | (21,687) | (65,541) |
| Charged/(credited) to other comprehensive income | - | 119,553 | - | - | (117,817) | 1,736 |
| Exchange difference | (4) | 1,313 | - | (2,468) | (975) | (2,134) |
| At 31 December 2013 | 26,417 | 1,020,816 | (412) | (218,279) | (115,828) | 712,714 |

| | 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 15) | 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 |

Notes to the Financial Statements (continued)

34. Deferred taxation (continued)

| | The Bank | | | | |
|---|------------------------------------|-------------------------|--------------------------|-----------------------------------|----------------|
| | 2013 | | | | |
| | Accelerated tax depreciation | Property revaluation | Impairment allowances | Other temporary differences | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| At 1 January 2013 | 22,509 | 843,724 | (97,635) | 50,231 | 818,829 |
| Charged/(credited) to income statement | 3,908 | 2,671 | (546) | 191 | 6,224 |
| Charged/(credited) to other comprehensive income | - | 114,777 | - | (83,082) | 31,695 |
| Exchange difference | - | - | (11) | - | (11) |
| At 31 December 2013 | <u>26,417</u> | <u>961,172</u> | <u>(98,192)</u> | <u>(32,660)</u> | <u>856,737</u> |

| | 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 | <u>22,509</u> | <u>843,724</u> | <u>(97,635)</u> | <u>50,231</u> | <u>818,829</u> |

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 sheet:

| | The Group | | The Bank | |
|--------------------------|------------------|----------|-----------------|----------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Deferred tax assets | (152,831) | (49,727) | - | (662) |
| Deferred tax liabilities | 865,545 | 828,380 | 856,737 | 819,491 |
| | 712,714 | 778,653 | 856,737 | 818,829 |

| | The Group | | The Bank | |
|--|------------------|----------|-----------------|----------|
| | 2013 | 2012 | 2013 | 2012 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Deferred tax assets to be recovered after more than twelve months | (75,628) | (73,889) | - | (662) |
| Deferred tax liabilities to be settled after more than twelve months | 898,205 | 778,149 | 889,397 | 769,260 |
| | 822,577 | 704,260 | 889,397 | 768,598 |

As at 31 December 2013, the Group and the Bank has not recognised deferred tax assets in respect of tax losses amounting to HK\$1,260,000 (2012: HK\$4,617,000) and HK\$1,130,000 (2012: HK\$4,483,000) which is considered unlikely to be utilised. Of the amount, HK\$130,000 (2012: HK\$134,000) for the Group and Nil (2012: Nil) for the Bank have no expiry date and HK\$1,130,000 (2012: HK\$4,483,000) for the Group and the Bank is scheduled to expire within five years.

35. Share capital

| | 2013 | 2012 |
|---|-----------------|----------|
| | 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 9 to 10 of the financial statements.

37. Notes to consolidated cash flow statement

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

| | 2013 HK\$'000 | 2012 HK\$'000 |
|---|------------------|--------------------|
| Operating profit | 3,186,320 | 2,587,632 |
| Depreciation | 206,956 | 166,939 |
| Net charge of impairment allowances | 369,967 | 396,948 |
| Unwind of discount on impairment allowances | (2,594) | (8,079) |
| Advances written off net of recoveries | (108,238) | 3,689 |
| Change in balances with banks and other financial institutions with original maturity over three months | (1,863,602) | (482,176) |
| Change in placements with banks and other financial institutions with original maturity over three months | (1,728,068) | 5,102,436 |
| Change in financial assets at fair value through profit or loss | 1,511,233 | (2,410,450) |
| Change in derivative financial instruments | 139,673 | (161,185) |
| Change in advances and other accounts | (17,561,952) | (5,515,755) |
| Change in investment in securities | (1,576,105) | (14,544,859) |
| Change in other assets | (2,299,297) | (622,821) |
| Change in deposits and balances from banks and other financial institutions | 8,583,958 | (7,804,217) |
| Change in financial liabilities at fair value through profit or loss | (541,337) | 3,897,177 |
| Change in deposits from customers | 12,626,700 | 11,064,249 |
| Change in other accounts and provisions | 5,230,516 | 1,602,315 |
| Effect of changes in exchange rates | (247,044) | 18,043 |
| Operating cash inflow/(outflow) before taxation | <u>5,927,086</u> | <u>(6,710,114)</u> |
| Cash flows from operating activities included: | | |
| - Interest received | 8,834,527 | 7,616,520 |
| - Interest paid | (3,811,186) | (3,506,002) |
| - Dividend received | <u>7,975</u> | <u>6,940</u> |

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

| | 2013 HK\$'000 | 2012 HK\$'000 |
|--|-------------------|-------------------|
| Cash and balances with banks and other financial institutions with original maturity within three months | 30,354,603 | 28,267,206 |
| Placements with banks and other financial institutions with original maturity within three months | 4,928,974 | 2,621,986 |
| Treasury bills with original maturity within three months | <u>3,724,988</u> | <u>2,812,021</u> |
| | <u>39,008,565</u> | <u>33,701,213</u> |

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 and is prepared with reference to the Completion Instructions for the HKMA return of capital adequacy ratio.

| | The Group | | The Bank | |
|---|--------------------|-------------------|-------------------|-------------------|
| | 2013 HK\$'000 | 2012 HK\$'000 | 2013 HK\$'000 | 2012 HK\$'000 |
| Direct credit substitutes | 15,907,292 | 12,758,884 | 269,382 | 306,569 |
| Transaction-related contingencies | 5,484,250 | 2,614,550 | 565,013 | 502,009 |
| Trade-related contingencies | 11,870,541 | 8,488,076 | 3,477,038 | 3,408,974 |
| Commitments that are unconditionally cancellable without prior notice | 71,071,494 | 57,032,568 | 20,945,416 | 22,160,355 |
| Other commitments with an original maturity of | | | | |
| - up to one year | 567,314 | 2,212,197 | 567,314 | 1,521,088 |
| - over one year | 5,245,225 | 4,962,820 | 4,825,980 | 3,799,617 |
| | 110,146,116 | 88,069,095 | 30,650,143 | 31,698,612 |
| Credit risk-weighted amount | 14,703,603 | 14,156,562 | 3,207,548 | 3,274,903 |

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 | |
|--|------------------|------------------|------------------|------------------|
| | 2013 HK\$'000 | 2012 HK\$'000 | 2013 HK\$'000 | 2012 HK\$'000 |
| Authorised and contracted for but not provided for | 2,879 | 8,688 | 2,169 | 3,777 |
| Authorised but not contracted for | 725 | 212 | - | - |
| | 3,604 | 8,900 | 2,169 | 3,777 |

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

Notes to the Financial Statements (continued)

40. Operating lease commitments

(a) 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 | |
|---|------------------|------------------|------------------|------------------|
| | 2013 HK\$'000 | 2012 HK\$'000 | 2013 HK\$'000 | 2012 HK\$'000 |
| Land and buildings | | | | |
| - not later than one year | 234,147 | 223,950 | 43,249 | 48,784 |
| - later than one year but not later than five years | 704,338 | 653,918 | 50,272 | 59,874 |
| - later than five years | 322,987 | 420,901 | 9,304 | 9,482 |
| | 1,261,472 | 1,298,769 | 102,825 | 118,140 |
| Other commitments | | | | |
| - not later than one year | 420 | 184 | - | - |
| - later than one year but not later than five years | 323 | 22 | - | - |
| | 1,262,215 | 1,298,975 | 102,825 | 118,140 |

(b) 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 | |
|---|------------------|------------------|------------------|------------------|
| | 2013 HK\$'000 | 2012 HK\$'000 | 2013 HK\$'000 | 2012 HK\$'000 |
| Land and buildings | | | | |
| - not later than one year | 48,571 | 33,100 | 43,904 | 26,488 |
| - later than one year but not later than five years | 53,436 | 25,637 | 52,437 | 20,133 |
| | 102,007 | 58,737 | 96,341 | 46,621 |

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

Notes to the Financial Statements (continued)

41. Litigation

The Group has been 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, NCB (China), 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 | | | | | | | |
|---|---------------------|----------------------|------------------|------------------|-----------------|------------------|-----------------|------------------|
| | 2013 | | | | | | | |
| | 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 | (597,519) | 2,944,696 | 2,343,989 | - | - | 4,691,166 | - | 4,691,166 |
| - inter-segment | 1,435,071 | (374,646) | (1,060,425) | - | - | - | - | - |
| | 837,552 | 2,570,050 | 1,283,564 | - | - | 4,691,166 | - | 4,691,166 |
| Net fee and commission income/(expense) | 418,917 | 565,333 | 25,641 | 173 | (1,439) | 1,008,625 | - | 1,008,625 |
| Net trading gain/(loss) | 37,976 | 116,764 | 94,749 | (152,278) | 10 | 97,221 | - | 97,221 |
| Net loss on financial instruments designated at fair value through profit or loss | - | - | (16,193) | - | - | (16,193) | - | (16,193) |
| Net gain on other financial assets | - | 21,204 | 31,292 | - | - | 52,496 | - | 52,496 |
| Other operating income | 123 | 59 | - | 148,438 | 24,674 | 173,294 | (97,824) | 75,470 |
| Net operating income before impairment allowances | 1,294,568 | 3,273,410 | 1,419,053 | (3,667) | 23,245 | 6,006,609 | (97,824) | 5,908,785 |
| Net charge of impairment allowances | (40,580) | (329,387) | - | - | - | (369,967) | - | (369,967) |
| Net operating income | 1,253,988 | 2,944,023 | 1,419,053 | (3,667) | 23,245 | 5,636,642 | (97,824) | 5,538,818 |
| Operating expenses | (751,369) | (1,144,769) | (387,541) | (97,468) | (69,175) | (2,450,322) | 97,824 | (2,352,498) |
| Operating profit/(loss) | 502,619 | 1,799,254 | 1,031,512 | (101,135) | (45,930) | 3,186,320 | - | 3,186,320 |
| Net gain from fair value adjustments on investment properties | - | - | - | 169,414 | - | 169,414 | - | 169,414 |
| Net gain from disposal/ revaluation of properties, plant and equipment | - | - | - | 3,476 | - | 3,476 | - | 3,476 |
| Profit/(loss) before taxation | 502,619 | 1,799,254 | 1,031,512 | 71,755 | (45,930) | 3,359,210 | - | 3,359,210 |
| Assets | | | | | | | | |
| Segment assets | 28,853,019 | 128,704,708 | 114,367,231 | 8,238,515 | 220,487 | 280,383,960 | - | 280,383,960 |
| Liabilities | | | | | | | | |
| Segment liabilities | 101,329,458 | 108,918,619 | 36,005,845 | 7,225 | 1,822,824 | 248,083,971 | - | 248,083,971 |
| Other information | | | | | | | | |
| Capital expenditure | - | - | - | 109,955 | - | 109,955 | - | 109,955 |
| Depreciation | 26,990 | 56,140 | 23,021 | 97,703 | 3,102 | 206,956 | - | 206,956 |
| Amortisation of securities | - | - | (30,765) | - | - | (30,765) | - | (30,765) |

Notes to the Financial Statements (continued)

42. Segmental reporting (continue)

(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 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 (continue)

(a) By operating segment (continued)

| | The Bank | | | | | | | |
|---|------------------|-------------------|----------------|----------------|-----------------|------------------|-----------------|------------------|
| | 2013 | | | | | | | |
| | 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 | (249,151) | 1,696,893 | 1,428,370 | - | - | 2,876,112 | - | 2,876,112 |
| - inter-segment | 813,473 | (80,090) | (733,383) | - | - | - | - | - |
| | 564,322 | 1,616,803 | 694,987 | - | - | 2,876,112 | - | 2,876,112 |
| Net fee and commission income/(expense) | 411,886 | 351,673 | (6,829) | - | (1,439) | 755,291 | - | 755,291 |
| Net trading gain/(loss) | 25,851 | 62,141 | 19,278 | (742) | 10 | 106,538 | - | 106,538 |
| Net loss on financial instruments designated at fair value through profit or loss | - | - | (16,193) | - | - | (16,193) | - | (16,193) |
| Net gain on other financial assets | - | - | 22,303 | - | - | 22,303 | - | 22,303 |
| Other operating income | 121 | 27 | - | 146,700 | 559 | 147,407 | (97,824) | 49,583 |
| Net operating income before impairment allowances | 1,002,180 | 2,030,644 | 713,546 | 145,958 | (870) | 3,891,458 | (97,824) | 3,793,634 |
| Net charge of impairment allowances | (12,151) | (28,577) | - | - | - | (40,728) | - | (40,728) |
| Net operating income | 990,029 | 2,002,067 | 713,546 | 145,958 | (870) | 3,850,730 | (97,824) | 3,752,906 |
| Operating expenses | (510,799) | (391,915) | (54,139) | (79,083) | (69,175) | (1,105,111) | 97,824 | (1,007,287) |
| Operating profit/(loss) | 479,230 | 1,610,152 | 659,407 | 66,875 | (70,045) | 2,745,619 | - | 2,745,619 |
| Net gain from fair value adjustments on investment properties | - | - | - | 167,890 | - | 167,890 | - | 167,890 |
| Net loss from disposal/ revaluation of properties, plant and equipment | - | - | - | (1,265) | - | (1,265) | - | (1,265) |
| Profit/(loss) before taxation | 479,230 | 1,610,152 | 659,407 | 233,500 | (70,045) | 2,912,244 | - | 2,912,244 |
| Assets | | | | | | | | |
| Segment assets | 18,393,275 | 81,867,045 | 63,240,738 | 15,553,575 | 16,668 | 179,071,301 | - | 179,071,301 |
| Liabilities | | | | | | | | |
| Segment liabilities | 77,300,761 | 56,094,120 | 14,488,430 | 6,726 | 1,247,059 | 149,137,096 | - | 149,137,096 |
| Other information | | | | | | | | |
| Capital expenditure | - | - | - | 36,843 | - | 36,843 | - | 36,843 |
| Depreciation | 11,598 | 6,976 | 924 | 79,083 | 3,102 | 101,683 | - | 101,683 |
| Amortisation of securities | - | - | 3,702 | - | - | 3,702 | - | 3,702 |

Notes to the Financial Statements (continued)

42. Segmental reporting (continue)

(a) By operating segment (continued)

| | The Bank | | | | | | | |
|---|---------------------|----------------------|------------|------------|-----------|-------------|--------------|--------------|
| | 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 | (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 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)

(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 | | | |
|-------------------|---|--|---|--|
| | 2013 | | 2012 | |
| | Net operating income before impairment allowance HK\$'000 | Profit before taxation HK\$'000 | Net operating income before impairment allowance HK\$'000 | Profit before taxation HK\$'000 |
| Hong Kong | 3,754,292 | 2,899,990 | 3,367,514 | 2,445,061 |
| Mainland of China | 2,111,161 | 443,766 | 1,525,417 | 300,124 |
| Others | 43,332 | 15,454 | 37,946 | 14,586 |
| Total | 5,908,785 | 3,359,210 | 4,930,877 | 2,759,771 |

| | The Group | | | |
|-------------------|-----------------------------|----------------------------------|-----------------------------------|---|
| | 2013 | | | |
| | Total assets HK\$'000 | Total liabilities HK\$'000 | Non-current assets HK\$'000 | Contingent liabilities and commitments HK\$'000 |
| Hong Kong | 164,667,896 | 146,467,458 | 7,343,360 | 30,381,110 |
| Mainland of China | 112,857,400 | 99,487,847 | 830,096 | 79,638,140 |
| Others | 2,858,664 | 2,128,666 | 3,467 | 126,866 |
| Total | 280,383,960 | 248,083,971 | 8,176,923 | 110,146,116 |

| | The Group | | | |
|-------------------|-----------------------------|----------------------------------|-----------------------------------|---|
| | 2012 | | | |
| | Total assets HK\$'000 | Total liabilities HK\$'000 | Non-current assets HK\$'000 | Contingent liabilities and commitments HK\$'000 |
| Hong Kong | 156,910,130 | 139,227,486 | 6,436,888 | 31,329,350 |
| Mainland of 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 |

Notes to the Financial Statements (continued)

42. Segmental reporting (continued)

(b) By geographical area (continued)

| | The Bank | | | |
|-------------------|---|--|---|--|
| | 2013 | | 2012 | |
| | Net operating income before impairment allowance HK\$'000 | Profit before taxation HK\$'000 | Net operating income before impairment allowance HK\$'000 | Profit before taxation HK\$'000 |
| Hong Kong | 3,747,959 | 2,893,422 | 3,367,411 | 2,446,562 |
| Mainland of China | 2,343 | 3,368 | 637 | 428 |
| Others | 43,332 | 15,454 | 37,946 | 14,585 |
| Total | <u>3,793,634</u> | <u>2,912,244</u> | <u>3,405,994</u> | <u>2,461,575</u> |

| | The Bank | | | |
|-------------------|-----------------------------|----------------------------------|-----------------------------------|---|
| | 2013 | | | |
| | Total assets HK\$'000 | Total liabilities HK\$'000 | Non-current assets HK\$'000 | Contingent liabilities and commitments HK\$'000 |
| Hong Kong | 175,682,048 | 146,647,568 | 7,343,360 | 30,448,151 |
| Mainland of China | 530,589 | 360,862 | - | 75,126 |
| Others | 2,858,664 | 2,128,666 | 3,467 | 126,866 |
| Total | <u>179,071,301</u> | <u>149,137,096</u> | <u>7,346,827</u> | <u>30,650,143</u> |

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

Notes to the Financial Statements (continued)

43. Offsetting financial instruments

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

| The Group | | | | | |
|----------------------------------|---|---|--|--|--------------------------|
| 2013 | | | | | |
| | Gross amounts recognised financial assets | Gross amounts recognised financial liabilities set off in the balance sheet | Net amounts of financial assets presented in the balance sheet | Related amounts not set off in the balance sheet | |
| | | | | Financial instruments | Cash collateral received |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Assets | | | | | |
| Derivative financial instruments | 82,212 | - | 82,212 | (27,605) | - |
| Other assets | 1,193,321 | (883,177) | 310,144 | - | - |
| Total | 1,275,533 | (883,177) | 392,356 | (27,605) | - |

| The Group | | | | | |
|----------------------------------|--|--|---|--|-------------------------|
| 2013 | | | | | |
| | Gross amounts recognised financial liabilities | Gross amounts recognised financial assets set off in the balance sheet | Net amounts of financial liabilities presented in the balance sheet | Related amounts not set off in the balance sheet | |
| | | | | Financial instruments | Cash collateral pledged |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Liabilities | | | | | |
| Derivative financial instruments | 239,495 | - | 239,495 | (27,605) | - |
| Other liabilities | 946,711 | (883,177) | 63,534 | - | - |
| Total | 1,186,206 | (883,177) | 303,029 | (27,605) | - |

Notes to the Financial Statements (continued)

43. Offsetting financial instruments (continued)

| The Group | | | | | | |
|----------------------------------|---|---|--|--|--------------------------|----------------|
| 2012 | | | | | | |
| | Gross amounts recognised financial assets | Gross amounts recognised financial liabilities set off in the balance sheet | Net amounts of financial assets presented in the balance sheet | Related amounts not set off in the balance sheet | | |
| | HK\$'000 | HK\$'000 | HK\$'000 | Financial instruments | Cash collateral received | Net amount |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Assets | | | | | | |
| Derivative financial instruments | 173,442 | - | 173,442 | (60,919) | - | 112,523 |
| Other assets | 1,382,570 | (1,166,909) | 215,661 | - | - | 215,661 |
| Total | 1,556,012 | (1,166,909) | 389,103 | (60,919) | - | 328,184 |

| The Group | | | | | | |
|----------------------------------|--|--|---|--|-------------------------|----------------|
| 2012 | | | | | | |
| | Gross amounts recognised financial liabilities | Gross amounts recognised financial assets set off in the balance sheet | Net amounts of financial liabilities presented in the balance sheet | Related amounts not set off in the balance sheet | | |
| | HK\$'000 | HK\$'000 | HK\$'000 | Financial instruments | Cash collateral pledged | Net amount |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Liabilities | | | | | | |
| Derivative financial instruments | 248,893 | - | 248,893 | (60,919) | - | 187,974 |
| Other liabilities | 1,200,803 | (1,166,909) | 33,894 | - | - | 33,894 |
| Total | 1,449,696 | (1,166,909) | 282,787 | (60,919) | - | 221,868 |

Notes to the Financial Statements (continued)

43. Offsetting financial instruments (continued)

| The Bank | | | | | |
|----------------------------------|---|---|--|--|--------------------------|
| 2013 | | | | | |
| | Gross amounts recognised financial assets | Gross amounts recognised financial liabilities set off in the balance sheet | Net amounts of financial assets presented in the balance sheet | Related amounts not set off in the balance sheet | |
| | HK\$'000 | HK\$'000 | HK\$'000 | Financial instruments | Cash collateral received |
| | | | | HK\$'000 | HK\$'000 |
| | | | | | Net amount |
| | | | | | HK\$'000 |
| Assets | | | | | |
| Derivative financial instruments | 65,336 | - | 65,336 | (13,306) | - |
| Other assets | 1,193,321 | (883,177) | 310,144 | - | - |
| Total | 1,258,657 | (883,177) | 375,480 | (13,306) | - |

| The Bank | | | | | |
|----------------------------------|--|--|---|--|-------------------------|
| 2013 | | | | | |
| | Gross amounts recognised financial liabilities | Gross amounts recognised financial assets set off in the balance sheet | Net amounts of financial liabilities presented in the balance sheet | Related amounts not set off in the balance sheet | |
| | HK\$'000 | HK\$'000 | HK\$'000 | Financial instruments | Cash collateral pledged |
| | | | | HK\$'000 | HK\$'000 |
| | | | | | Net amount |
| | | | | | HK\$'000 |
| Liabilities | | | | | |
| Derivative financial instruments | 150,999 | - | 150,999 | (13,306) | - |
| Other liabilities | 946,711 | (883,177) | 63,534 | - | - |
| Total | 1,097,710 | (883,177) | 214,533 | (13,306) | - |

Notes to the Financial Information (continued)

43. Offsetting financial instruments (continued)

| The Bank | | | | | | |
|----------------------------------|---|---|--|--|--------------------------|----------------|
| 2012 | | | | | | |
| | Gross amounts recognised financial assets | Gross amounts recognised financial liabilities set off in the balance sheet | Net amounts of financial assets presented in the balance sheet | Related amounts not set off in the balance sheet | | |
| | HK\$'000 | HK\$'000 | HK\$'000 | Financial instruments | Cash collateral received | Net amount |
| | | | | HK\$'000 | HK\$'000 | HK\$'000 |
| Assets | | | | | | |
| Derivative financial instruments | 147,617 | - | 147,617 | (36,346) | - | 111,271 |
| Other assets | 1,382,570 | (1,166,909) | 215,661 | - | - | 215,661 |
| Total | 1,530,187 | (1,166,909) | 363,278 | (36,346) | - | 326,932 |

| The Bank | | | | | | |
|----------------------------------|--|--|---|--|-------------------------|----------------|
| 2012 | | | | | | |
| | Gross amounts recognised financial liabilities | Gross amounts recognised financial assets set off in the balance sheet | Net amounts of financial liabilities presented in the balance sheet | Related amounts not set off in the balance sheet | | |
| | HK\$'000 | HK\$'000 | HK\$'000 | Financial instruments | Cash collateral pledged | Net amount |
| | | | | HK\$'000 | HK\$'000 | HK\$'000 |
| Liabilities | | | | | | |
| Derivative financial instruments | 166,685 | - | 166,685 | (36,346) | - | 130,339 |
| Other liabilities | 1,200,803 | (1,166,909) | 33,894 | - | - | 33,894 |
| Total | 1,367,488 | (1,166,909) | 200,579 | (36,346) | - | 164,233 |

For master netting agreements of OTC derivative transactions entered into by the Group, related amounts with the same counterparty can be offset if an event of default or other predetermined events occur.

Notes to the Financial Statements (continued)

44. Transfers of financial assets

As at 31 December 2013 and 2012, there were no transfers of financial assets.

45. 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:

| | 2013 HK\$'000 | 2012 HK\$'000 |
|---|------------------|------------------|
| Aggregate amount of relevant transactions outstanding at year end | - | - |
| Maximum aggregate amount of relevant transactions outstanding during the year | - | 30 |

46. 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.

The significant related party transactions are defined according to HKAS 24.

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

General information of the parent companies:

The Group's immediate holding company is BOCHK, which is in turn controlled by BOC. Central Huijin is the controlling entity of BOC, 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)

46. Significant related party transactions (continued)

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

The majority of transactions with BOC arise from money market activities. As at 31 December 2013, the related aggregate amounts due from and to BOC of the Group were HK\$6,796,023,000 (2012: HK\$5,503,655,000) and HK\$2,702,999,000 (2012: HK\$2,396,034,000) respectively. The aggregate amounts of income and expenses of the Group arising from these transactions with BOC for the year ended 31 December 2013 were HK\$240,822,000 (2012: HK\$252,609,000) and HK\$39,549,000 (2012: HK\$28,013,000) respectively.

The majority of transactions with BOCHK arise from money market activities. As at 31 December 2013, the related aggregate amounts due from and to BOCHK of the Group were HK\$2,139,709,000 (2012: HK\$4,594,543,000) and HK\$21,270,585,000 (2012: HK\$16,336,165,000) respectively. The aggregate amounts of income and expenses of the Group arising from these transactions with BOCHK for the year ended 31 December 2013 were HK\$10,252,000 (2012: HK\$17,298,000) and HK\$708,001,000 (2012: HK\$613,384,000) respectively. Transactions with other companies controlled by BOCHK are not considered material.

(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)

46. Significant related party transactions (continue)

(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:

| | 2013 | 2012 |
|---|-----------------------|-----------------------|
| | Other related parties | Other related parties |
| | HK\$'000 | HK\$'000 |
| Income statement items: | | |
| Interest income | 10,829 | 9,672 |
| Interest expense | (97,774) | (85,450) |
| Insurance premium paid/insurance commission received (net) | 2,980 | 6,083 |
| Administrative services fees paid/payable | (17,068) | (16,641) |
| Rental fees received/receivable | 21,999 | 19,842 |
| Securities brokerage commission paid/payable (net) | (16,615) | (14,321) |
| Rental paid/payable | (295) | (295) |
| Funds selling commission received | 12,828 | 7,215 |
| Other expense | (6,140) | (11,747) |
| Other commission income | 11,571 | 3,782 |
| Other fees and commission expense | (5,529) | (4,628) |
| Dividend income | 6,113 | 5,215 |
| Net trading gains | (227) | (171) |
| Balance sheet items: | | |
| Cash and balances with banks and other financial institutions | 202,412 | 1,717 |
| Derivative financial instruments assets | 84 | - |
| Advances and other accounts | 1,347,157 | - |
| Investment in securities | 60,530 | 53,472 |
| Other assets | 17,258 | 112,349 |
| Deposits and balances of banks and other financial institutions | (202,468) | (10,715) |
| Deposits from customers | (7,121,533) | (8,218,014) |
| Other accounts and provisions | (16,509) | (800) |
| Derivative financial instruments liabilities | - | (53) |

(d) Key management personnel

Key management personnel 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 and its holding companies, as well as parties related to them.

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

| | 2013 | 2012 |
|---|----------|----------|
| | HK\$'000 | HK\$'000 |
| Salaries and other short-term employee benefits | 28,882 | 31,079 |
| Post-employment benefits | 1,635 | 1,597 |
| | 30,517 | 32,676 |

Notes to the Financial Statements (continued)

47. 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 Authorised Institution" issued by the HKMA.

| | 2013 | | | |
|---------------------------|--------------------------------|---------------|--------------------------------|--------------------------------|
| | Equivalent in thousand of HK\$ | | | |
| | US Dollars | Renminbi | Other foreign currencies | Total foreign currencies |
| Spot assets | 51,589,784 | 121,853,558 | 9,384,830 | 182,828,172 |
| Spot liabilities | (44,518,523) | (111,464,523) | (9,925,494) | (165,908,540) |
| Forward purchases | 24,399,649 | 10,648,881 | 4,468,976 | 39,517,506 |
| Forward sales | (29,771,697) | (21,621,410) | (3,875,909) | (55,269,016) |
| Net long/(short) position | 1,699,213 | (583,494) | 52,403 | 1,168,122 |
| Net structural position | 333,141 | 8,263,668 | - | 8,596,809 |

| | 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 |

Notes to the Financial Statements (continued)

48. Cross-border claims

The below analysis is prepared with reference to the Completion Instructions for the HKMA return of cross-border claims. Cross-border claims are exposures to foreign counterparties on which the ultimate risk lies, and are derived according to the location of the counterparties after taking into account the transfer of risk. For a claim guaranteed by a party situated in a country different from the counterparty, the risk will be transferred to the country of the guarantor. For a claim on an overseas branch of a bank whose head office is located in another country, the risk will be transferred to the country where its head office is located. Claims on individual countries or areas, after risk transfer, amounting to 10% or more of the aggregate cross-border claims are shown as follows:

| 2013 | | | |
|----------------------------|-------------------|--------------------------------|-------------------|
| | Banks | Public sector entities* | Others |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| | | | Total |
| | | | HK\$'000 |
| Asia, other than Hong Kong | | | |
| - Mainland of China | 35,085,897 | 647,145 | 34,557,836 |
| - Others | 6,522,598 | 851 | 1,259,319 |
| | 41,608,495 | 647,996 | 35,817,155 |
| | | | 78,073,646 |
| 2012 | | | |
| | Banks | Public sector entities* | Others |
| | HK\$'000 | HK\$'000 | HK\$'000 |
| | | | Total |
| | | | HK\$'000 |
| Asia, other than Hong Kong | | | |
| - Mainland of China | 26,367,246 | 559,646 | 29,262,032 |
| - Others | 11,466,066 | 1,468,168 | 1,307,642 |
| | 37,833,312 | 2,027,814 | 30,569,674 |
| | | | 70,430,800 |

* None of cross-border claims on Asia, other than Hong Kong is eligible to be classified as public sector entities under the Banking (Capital) Rules (2012: Nil).

Notes to the Financial Statements (continued)

49. Non-bank Mainland exposures

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

| | 2013 | | | |
|--|-------------------------------------|--------------------------------------|-------------------|--|
| | On- balance sheet exposure | Off- balance sheet exposure | Total exposure | Individually assessed impairment allowances |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Mainland entities | 33,157,420 | 2,321,948 | 35,479,368 | - |
| Companies and individuals outside Mainland where the credit is granted for use in Mainland | 4,967,844 | 1,553,941 | 6,521,785 | - |
| Other non-bank Mainland exposures | 5,655,388 | 439,024 | 6,094,412 | 9,277 |
| | <u>43,780,652</u> | <u>4,314,913</u> | <u>48,095,565</u> | <u>9,277</u> |
| Exposures incurred by the Bank's Mainland subsidiary | <u>59,757,870</u> | <u>29,690,114</u> | <u>89,447,984</u> | <u>201,357</u> |

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

50. 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.

51. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 20 March 2014.

Unaudited Supplementary Financial Information

1. Regulatory 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 adoption of Banking (Capital) (Amendment) Rules 2012 and Banking (Capital) (Amendment) Rules 2013 since 1 January 2013 and 30 June 2013 respectively, the capital disclosure for 2013 are not directly comparable to those 2012.

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 ratios are set out in Note 4.4(A) to the Financial Statements.

The table below summarises the regulatory capital computed on the same consolidation basis for credit, market, and operational risks.

| | 2013 | 2012 |
|------------------|-------------------|------------|
| | HK\$'000 | HK\$'000 |
| Credit risk | 13,485,328 | 11,494,335 |
| Market risk | 77,209 | 53,509 |
| Operational risk | 775,167 | 658,454 |
| | 14,337,704 | 12,206,298 |

For details of capital management and capital ratios 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 tables below show the capital requirements for each class and subclass of credit risk exposures as specified in the Banking (Capital) Rules.

| | 2013 |
|---|-------------------|
| | HK\$'000 |
| Capital required for exposures under the IRB approach | |
| Corporate | |
| Specialised lending under supervisory slotting criteria approach | |
| - Project finance | 76,474 |
| Small-and-medium sized corporate | 1,201,437 |
| Other corporates | 6,853,958 |
| Bank | |
| Banks | 3,294,819 |
| Securities firms | 674 |
| Retail | |
| Residential mortgages | |
| - Individuals | 56,135 |
| - Property-holding shell companies | 5,347 |
| Qualifying revolving retail | - |
| Small business retail | 22,470 |
| Other retail to individuals | 166,376 |
| Others | |
| Cash items | - |
| Other items | 706,400 |
| Credit valuation adjustment | 8,245 |
| Total capital requirements for exposures under the IRB approach | 12,392,335 |
| Capital required for exposures under the standardised (credit risk) approach | |
| On-balance sheet exposures | |
| Sovereigns | 8,208 |
| Public sector entities | 4,500 |
| Multilateral development banks | - |
| Banks | 2,398 |
| Securities firms | - |
| Corporate | 539,825 |
| Regulatory retail | 105,337 |
| Residential mortgage loans | 341,461 |
| Other exposures which are not past due | 55,176 |
| Past due exposures | 2,816 |
| Off-balance sheet exposures | |
| Off-balance sheet exposures other than securities financing transactions and derivative contracts | 31,404 |
| Securities financing transactions and derivative contracts | 1,868 |
| Total capital requirements for exposures under the standardised (credit risk) approach | 1,092,993 |
| Total capital requirements for credit risk exposures | 13,485,328 |

Unaudited Supplementary Financial Information (continued)

2. Capital requirements for credit risk (continued)

| | 2012 |
|--|-------------------|
| | HK\$'000 |
| Capital required for exposures under the IRB approach | |
| Corporate | |
| Specialised lending under supervisory slotting criteria approach | |
| - Project finance | 114,846 |
| Small-and-medium sized corporate | 997,910 |
| Other corporates | 6,849,776 |
| Bank | |
| Banks | 1,867,574 |
| Securities firms | - |
| Retail | |
| Residential mortgages | |
| - Individuals | 42,467 |
| - Property-holding shell companies | 5,190 |
| Qualifying revolving retail | - |
| Small business retail | 29,100 |
| Other retail to individuals | 84,296 |
| Others | |
| Cash items | - |
| Other items | 628,756 |
| Total capital requirements for exposures under the IRB approach | 10,619,915 |
| Capital required for exposures under the standardised (credit risk) approach | |
| On-balance sheet exposures | |
| Sovereigns | 30,366 |
| Public sector entities | 4,958 |
| Multilateral development banks | - |
| Banks | 1,762 |
| Securities firms | - |
| Corporate | 536,152 |
| Regulatory retail | 27,531 |
| Residential mortgage loans | 230,177 |
| Other exposures which are not past due | 17,759 |
| Past due exposures | 1,611 |
| Off-balance sheet exposures | |
| Off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts | 23,478 |
| OTC derivative transactions | 626 |
| Total capital requirements for exposures under the standardised (credit risk) approach | 874,420 |
| Total capital requirements for credit risk exposures | 11,494,335 |

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 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-classes of exposures (other than securitisation exposures).

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

(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 retail borrowers, and loss given default ("LGD") and exposure at default ("EAD") for retail exposures under retail IRB approach.

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 the average PD are derived for RWA calculation.

In the process of obligor rating assignment, variables of latest financial performance, management quality, industry risks, group connection and negative warning signals 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 obligors 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 into 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 defaulted 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 into different 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 significant to very high default risk and are vulnerable to nonpayment. The obligors currently and in the near term 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 regulatory capital calculation in corporate and bank exposures, the Group uses the PD together with the LGD and EAD estimates in the credit approval, credit monitoring, reporting and analysis of credit risk information, etc., for the purpose of strengthening the daily management on all credit related matters.

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 of credit risk mitigation as stated in the Banking (Capital) Rules.

For the credit exposures adopting FIRB approach for capital calculation purpose, the recognised eligible guarantees include the guarantees provided by banks, corporates and securities firms with a lower risk weights than the counterparty. 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 and Risk Management Committee 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 internal 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 put in place to ensure the integrity, accuracy and consistency of the rating assignment. For the wholesale (corporate and bank) credit 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 periodic post-approval review of ratings by 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 data input for automatic rating assignment are verified by units independent from business development function.

The obligor rating 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 models. For reasons of conservatism and prudential considerations, overrides are unlimited in terms of downgrades but more restricted for 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 performance review on IRB rating models.

The performance of internal rating system is put under ongoing periodic monitoring. The 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 systems 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 the 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 regulatory and management requirements. Review of a rating model will be triggered if the performance of the model deteriorates materially against pre-determined tolerance 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.

| | 2013 | | | | |
|--|-----------------------------|--|-----------------------------|-------------------------------------|-----------------------|
| | Foundation | Supervisory | Retail | Specific | Total |
| | IRB Approach HK\$'000 | Slotting Criteria Approach HK\$'000 | IRB Approach HK\$'000 | Risk-weight Approach HK\$'000 | exposures HK\$'000 |
| Corporate | 137,287,288 | 851,200 | - | - | 138,138,488 |
| Bank | 86,657,273 | - | - | - | 86,657,273 |
| Retail | | | | | |
| Residential mortgages to individuals and property- holding shell companies | - | - | 11,570,062 | - | 11,570,062 |
| Qualifying revolving retail | - | - | - | - | - |
| Other retail to individuals and small business retail | - | - | 8,782,927 | - | 8,782,927 |
| Others | - | - | - | 12,746,845 | 12,746,845 |
| Total | 223,944,561 | 851,200 | 20,352,989 | 12,746,845 | 257,895,595 |

| | 2012 | | | | |
|--|-----------------------------|--|-----------------------------|-------------------------------------|-----------------------|
| | Foundation | Supervisory | Retail | Specific | Total |
| | IRB Approach HK\$'000 | Slotting Criteria Approach HK\$'000 | IRB Approach HK\$'000 | Risk-weight Approach HK\$'000 | exposures 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 |

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

The table below shows the total EAD of the Group's exposures subject to supervisory estimates under the use of IRB approach (including the specialised lending subject to the supervisory slotting criteria approach).

| | <u>2013</u> <u>HK\$'000</u> | <u>2012</u> <u>HK\$'000</u> |
|-----------|--------------------------------|--------------------------------|
| Corporate | 138,138,488 | 124,339,594 |
| Bank | 86,657,273 | 72,331,164 |
| Others | 12,746,845 | 8,065,560 |
| | <u>237,542,606</u> | <u>204,736,318</u> |

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. The exposures as at 31 December 2013 exclude securities financing transactions and derivative contracts while those as at 31 December 2012 exclude OTC derivative transactions and repo-style transactions.

| | <u>2013</u> <u>HK\$'000</u> | <u>2012</u> <u>HK\$'000</u> |
|-----------|--------------------------------|--------------------------------|
| Corporate | 28,007,658 | 25,658,272 |
| Bank | 452 | 10,290 |
| Others | - | - |
| | <u>28,008,110</u> | <u>25,668,562</u> |

(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. The exposures as at 31 December 2013 exclude securities financing transactions and derivative contracts while those as at 31 December 2012 exclude OTC derivative transactions and repo-style transactions.

| | <u>2013</u> <u>HK\$'000</u> | <u>2012</u> <u>HK\$'000</u> |
|-----------|--------------------------------|--------------------------------|
| Corporate | 27,280,949 | 3,264,083 |
| Bank | 5,173,810 | 4,685,877 |
| Retail | - | - |
| Others | - | - |
| | <u>32,454,759</u> | <u>7,949,960</u> |

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.

The EAD and PD disclosed below in respect of corporate and bank exposures have taken into account the effect of recognised collateral, recognised netting and recognised guarantees. The Group did not have recognised credit derivative contracts.

For definition of each obligor grade, please refer to page 186.

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

| Internal Credit Grades | 2013 | | |
|------------------------|------------------------|---|-------------------------------------|
| | Exposure at default | Exposure- weighted average risk-weight | Exposure- weighted average PD |
| | HK\$'000 | % | % |
| Grade 1 | - | 0.00% | 0.00% |
| Grade 2 | 1,069,155 | 18.47% | 0.03% |
| Grade 3 | 18,189,567 | 24.17% | 0.07% |
| Grade 4 | 27,793,369 | 44.33% | 0.24% |
| Grade 5 | 61,570,944 | 72.90% | 1.09% |
| Grade 6 | 28,140,949 | 115.44% | 4.50% |
| Grade 7 | 108,677 | 215.78% | 31.20% |
| Grade 8 / Default | 414,627 | 113.42% | 100.00% |
| | 137,287,288 | | |

| 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 | 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 | | |

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 | 2013 | | 2012 | |
|---------------------------|------------------------------------|--|------------------------------------|---|
| | Exposure at default HK\$'000 | Exposure- weighted average risk-weight % | Exposure at default HK\$'000 | Exposure- weighted average risk- weight % |
| Strong | 171,262 | 70.00% | 15,791 | 70.00% |
| Good | - | 0.00% | 952,775 | 90.00% |
| Satisfactory | 679,938 | 115.00% | 422,406 | 115.00% |
| Weak | - | 0.00% | - | 0.00% |
| Default | - | 0.00% | - | 0.00% |
| | 851,200 | | 1,390,972 | |

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 | 2013 | | |
|------------------------|------------------------------------|--|--|
| | Exposure at default HK\$'000 | Exposure- weighted average risk-weight % | Exposure- weighted average PD % |
| Grade 1 | - | 0.00% | 0.00% |
| Grade 2 | 6,419,624 | 23.37% | 0.04% |
| Grade 3 | 39,500,694 | 31.72% | 0.07% |
| Grade 4 | 36,515,469 | 58.83% | 0.24% |
| Grade 5 | 4,221,486 | 79.36% | 0.68% |
| Grade 6 | - | 0.00% | 0.00% |
| Grade 7 | - | 0.00% | 0.00% |
| Grade 8 / Default | - | 0.00% | 0.00% |
| | 86,657,273 | | |

| Internal Credit Grades | 2012 | | |
|------------------------|------------------------------------|---|--|
| | Exposure at default HK\$'000 | Exposure- weighted average risk- weight % | Exposure- weighted average PD % |
| 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 | | |

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

| | 2013 HK\$'000 | 2012 HK\$'000 |
|----------|-------------------|-------------------|
| Up to 1% | 11,506,539 | 12,620,692 |
| >1% | 59,100 | 32,586 |
| Default | 4,423 | 9,223 |
| | 11,570,062 | 12,662,501 |

Qualifying revolving retail

| | 2013 HK\$'000 | 2012 HK\$'000 |
|-----------|------------------|------------------|
| Up to 10% | - | - |
| >10% | - | - |
| Default | - | - |
| | - | - |

Other retail

| | 2013 HK\$'000 | 2012 HK\$'000 |
|----------|------------------|------------------|
| Up to 2% | 6,038,363 | 4,750,375 |
| >2% | 111,983 | 10,370 |
| Default | 2,274 | 2,662 |
| | 6,152,620 | 4,763,407 |

Small business retail

| | 2013 HK\$'000 | 2012 HK\$'000 |
|----------|------------------|------------------|
| Up to 1% | 2,547,797 | 2,888,452 |
| >1% | 52,392 | 89,464 |
| Default | 30,118 | 16,289 |
| | 2,630,307 | 2,994,205 |

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 broken down by class of risk exposure, 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.

| | 2013 | 2012 |
|---|-----------------|-----------------|
| | HK\$'000 | HK\$'000 |
| Corporate | 195,492 | 138,901 |
| Bank | - | - |
| Residential mortgages to individuals and property-holding shell companies | 1,166 | 4,865 |
| Other retail to individuals | 698 | 1,053 |
| Small business retail | 13,260 | 7,125 |
| | 210,616 | 151,944 |

Increase in the loan impairment charge of corporate exposures was mainly caused by loan overdue of a few corporate customers leading to loans downgraded.

The table below shows the expected loss broken down by class of risk exposure, 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 2012 | Expected loss at 31 December 2011 |
|---|--|--|
| | HK\$'000 | HK\$'000 |
| Corporate | 1,046,174 | 910,265 |
| Bank | 64,038 | 40,003 |
| Residential mortgages to individuals and property-holding shell companies | 6,249 | 5,162 |
| Other retail to individuals | 25,832 | 10,987 |
| Small business retail | 19,598 | 5,604 |
| | 1,161,891 | 972,021 |

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

| | Actual default rate during 2013 | Estimated PD at 31 December 2012 |
|---|--|---|
| | % | % |
| Corporate | 0.62% | 2.03% |
| Bank | 0.00% | 0.19% |
| Residential mortgages to individuals and property-holding shell companies | 0.02% | 0.53% |
| Other retail to individuals | 0.07% | 0.73% |
| Small business retail | 1.44% | 1.51% |

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 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% |

It should be noted that expected loss and actual loss are measured and calculated using different methodologies compliant with relevant regulatory and accounting standards, which therefore may not be directly comparable. The limitation arises mainly from the fundamental differences in the definition of “loss”. The expected loss under Basel Accord 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 during the workout process, while actual loss is the net charge of individually assessed impairment allowances and write-offs made during the year in accordance with the accounting standards.

The actual default rate 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 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 default rate in a particular year (“point-in-time”) will typically differ from the estimated probability of default which is the “through-the-cycle” estimates as economies move above or below the cyclical norms.

The estimated probability of default is more conservative than the actual default rate for all asset classes.

Unaudited Supplementary Financial Information (continued)

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

4.1 Use of ratings from External Credit Assessment Institutions (“ECAI”)

The Group continues to adopt STC approach based on external credit rating to determine the risk weight of the small residual credit exposures that were approved by HKMA to be exempted from FIRB approach and 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 equities 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 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, or banks and those corporates with ECAI issuer ratings both exempted from FIRB approach for credit exposures, that have lower risk weights than the counterparty.

Unaudited Supplementary Financial Information (continued)

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

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

| | 2013 | | | | | | Total exposures covered by recognised guarantees or recognised credit derivative contracts |
|---|-----------------|----------------------|------------|----------------------|------------|--|--|
| | Total Exposures | Exposures after CRM* | | Risk-weighted amount | | Total exposures covered by recognised collateral | |
| | HK\$'000 | Rated | Unrated | Rated | Unrated | HK\$'000 | HK\$'000 |
| On-balance sheet exposures | | | | | | | |
| Sovereign | 27,595,960 | 27,622,626 | - | 102,605 | - | - | - |
| Public sector entity | 664,230 | 638,986 | - | 56,253 | - | - | 26,667 |
| Multilateral development bank | 324,836 | 324,836 | - | - | - | - | - |
| Bank | 143,969 | 143,969 | - | 29,976 | - | - | - |
| Securities firm | - | - | - | - | - | - | - |
| Corporate | 6,757,537 | 116,331 | 6,631,485 | 116,331 | 6,631,485 | 9,721 | - |
| Cash item | 599 | - | 599 | - | - | - | - |
| Regulatory retail | 1,819,295 | - | 1,755,612 | - | 1,316,709 | 63,683 | - |
| Residential mortgage loans | 8,537,942 | - | 8,536,519 | - | 4,268,259 | - | 1,423 |
| Other exposures which are not past due | 695,770 | - | 589,761 | - | 689,706 | 106,010 | - |
| Past due exposures | 33,467 | - | 33,467 | - | 35,200 | 30,000 | - |
| Total for on-balance sheet exposures | 46,573,605 | 28,846,748 | 17,547,443 | 305,165 | 12,941,359 | 209,414 | 28,090 |
| Off-balance sheet exposures | | | | | | | |
| Off-balance sheet exposures other than securities financing transactions and derivative contracts | 625,438 | 429,175 | 196,264 | 224,736 | 167,817 | - | 5,171 |
| Securities financing transactions and derivative contracts | 29,638 | - | 29,639 | - | 23,350 | - | - |
| Total for off-balance sheet exposures | 655,076 | 429,175 | 225,903 | 224,736 | 191,167 | - | 5,171 |
| Total for non-securitisation exposures | 47,228,681 | 29,275,923 | 17,773,346 | 529,901 | 13,132,526 | 209,414 | 33,261 |
| Exposures that are risk-weighted at 1,250% | - | | | | | | |

Unaudited Supplementary Financial Information (continued)

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

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

| 2012 | | | | | | |
|--|-----------------|----------------------|------------|----------------------|-----------|--|
| | Total Exposures | Exposures after CRM* | | Risk-weighted amount | | Total exposures covered by recognised guarantees or recognised credit derivative contracts |
| | HK\$'000 | Rated | Unrated | Rated | Unrated | 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 | - |
| 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 |
| 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 |
| 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 |
| Total for non-securitisation exposures | 43,448,577 | 30,245,585 | 12,977,289 | 979,352 | 9,950,900 | 729,043 |
| Exposures deducted from Core Capital or Supplementary Capital | 53,473 | | | | | |

* 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 derivative contracts and securities financing 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 derivative transactions and settlement limit to control the settlement risk arising from foreign exchange-related transactions for counterparties 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 unit.

Credit equivalent amount and capital charge for the relevant counterparty credit exposures are determined following the regulatory capital requirements. Currently, the Group has adopted the Current Exposure Method to measure the relevant credit equivalent amount, which comprises current exposures and potential future exposures. The relevant counterparty default risk capital charge is calculated under the FIRB / STC approach. In addition, the Group has adopted standardised credit valuation adjustment ("CVA") method to calculate the relevant counterparty CVA capital charge.

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

The Group formulates policy for classification of credit assets according to the PD of counterparties 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.

In controlling and monitoring of wrong-way risk (risk of existence of positive correlation between the PD of a counterparty and credit exposures driven by mark-to-market value of the underlying transactions), specific wrong-way risk transactions are generally not allowed and monitoring measures have been formulated for those counterparties identified by stress testing that would be exposed to potential general wrong-way risk.

Unaudited Supplementary Financial Information (continued)

5. Counterparty credit risk-related exposures (continued)

5.1 Counterparty credit risk exposures under the internal ratings-based approach

The following table summarises the Group's exposures to counterparty credit risk arising from securities financing transactions and derivative contracts calculated using the Current Exposure Method. There is no effect of valid bilateral and cross-product netting agreements on these exposures.

| | 2013 | |
|---|---|-------------------------|
| | Securities financing transactions | Derivative contracts |
| | HK\$'000 | HK\$'000 |
| Gross total positive fair value | | 107,654 |
| Default risk exposures | 1,282,671 | 476,445 |
| Less: Value of recognised collateral | | |
| - debt securities | - | - |
| - others | (1,262,875) | - |
| Default risk exposures net of recognised collateral | 19,796 | 476,445 |
| Default risk exposures by counterparty type | | |
| Corporate | - | 138,480 |
| Banks | 1,282,671 | 337,965 |
| Retail | - | - |
| Others | - | - |
| | 1,282,671 | 476,445 |
| Risk-weighted amounts by counterparty type | | |
| Corporate | - | 184,443 |
| Banks | 5,304 | 113,139 |
| Retail | - | - |
| Others | - | - |
| | 5,304 | 297,582 |

Unaudited Supplementary Financial Information (continued)

5. Counterparty credit risk-related exposures (continued)

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

The following table summarises the Group's exposures to counterparty credit risk arising from OTC derivative. There is no effect of valid bilateral netting agreements on the credit equivalent amounts.

| | 2012 |
|--|----------------|
| | OTC derivative |
| | HK\$'000 |
| Gross total positive fair value | 223,464 |
| Credit equivalent amounts | 592,012 |
| Less: Value of recognised collateral | |
| - debt securities | - |
| - others | - |
| Net credit equivalent amounts | 592,012 |
| Exposure at default by counterparty type | |
| Corporate | 155,844 |
| Banks | 436,168 |
| Retail | - |
| Others | - |
| | 592,012 |
| Risk weighted amounts by counterparty type | |
| Corporate | 177,909 |
| Banks | 101,054 |
| Retail | - |
| Others | - |
| | 278,963 |

There were no outstanding repo-style transactions under the internal ratings-based approach as at 31 December 2012.

Unaudited Supplementary Financial Information (continued)

5. Counterparty credit risk-related exposures (continued)

5.2 Counterparty credit risk exposure under the standardised (credit risk) approach

The following table summarises the Group's exposures to counterparty credit risk arising from derivative contracts calculated using the Current Exposure Method. There is no effect of valid cross-product netting agreements on these exposures.

| | 2013 |
|---|-------------------------|
| | Derivative contracts |
| | HK\$'000 |
| Gross total positive fair value | 25,593 |
| Default risk exposures | 29,639 |
| Less: Value of recognised collateral | |
| - debt securities | - |
| - others | - |
| Default risk exposures net of recognised collateral | 29,639 |
| Default risk exposures by counterparty type | |
| Sovereign | - |
| Public sector entity | - |
| Bank | - |
| Corporate | 4,484 |
| Regulatory retail | 25,155 |
| Other exposures which are not past due exposures | - |
| Past due exposures | - |
| | 29,639 |
| Risk-weighted amounts by counterparty type | |
| Sovereign | - |
| Public sector entity | - |
| Bank | - |
| Corporate | 4,484 |
| Regulatory retail | 18,866 |
| Other exposures which are not past due exposures | - |
| Past due exposures | - |
| | 23,350 |

There were no outstanding securities financing transactions under the standardised (credit risk) approach as at 31 December 2013.

Unaudited Supplementary Financial Information (continued)

5. Counterparty credit risk-related exposures (continued)

5.2 Counterparty credit risk exposure under the standardised (credit risk) approach (continued)

The following table summarises the Group's exposures to counterparty credit risk arising from OTC derivative. There is no effect of valid bilateral netting agreements on the credit equivalent amounts.

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

There were no outstanding repo-style transactions under the standardised (credit risk) approach as at 31 December 2012.

There were no outstanding credit derivative contracts as at 31 December 2013 (2012: Nil).

6. Assets securitisation

There was no asset securitisation for which the Group is an investing institution at 31 December 2013 (2012: Nil)

Unaudited Supplementary Financial Information (continued)

7. Capital charge for market risk

| | 2013 HK\$'000 | 2012 HK\$'000 |
|--|------------------|------------------|
| Under the standardised (market risk) approach | | |
| Foreign exchange exposures (net) | - | - |
| Interest rate exposures | | |
| - non-securitisation exposure | 10 | 10 |
| Commodity exposures | - | - |
| Equity exposures | - | - |
| Under the internal models approach | | |
| General foreign exchange and interest rate exposures | 77,199 | 53,499 |
| Capital charge for market risk | 77,209 | 53,509 |

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 VAR¹ 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 | 2013 | 3,479 | 3,479 | 7,502 | 5,730 |
| | 2012 | 5,324 | 2,752 | 6,742 | 5,618 |
| IMM VAR for foreign exchange risk | 2013 | 3,634 | 3,634 | 7,552 | 5,641 |
| | 2012 | 5,122 | 2,807 | 6,207 | 5,432 |
| IMM VAR for interest rate risk | 2013 | 1,658 | 274 | 1,688 | 739 |
| | 2012 | 678 | 260 | 1,579 | 559 |
| Stressed VAR for foreign exchange and interest rate risk | 2013 | 14,085 | 7,651 | 31,968 | 14,556 |
| | 2012 | 14,231 | 6,075 | 28,399 | 12,967 |
| Stressed VAR for foreign exchange risk | 2013 | 8,216 | 5,708 | 9,207 | 7,716 |
| | 2012 | 6,979 | 3,860 | 8,218 | 7,444 |
| Stressed VAR for interest rate risk | 2013 | 10,102 | 2,170 | 25,053 | 8,719 |
| | 2012 | 13,653 | 2,189 | 22,555 | 7,474 |

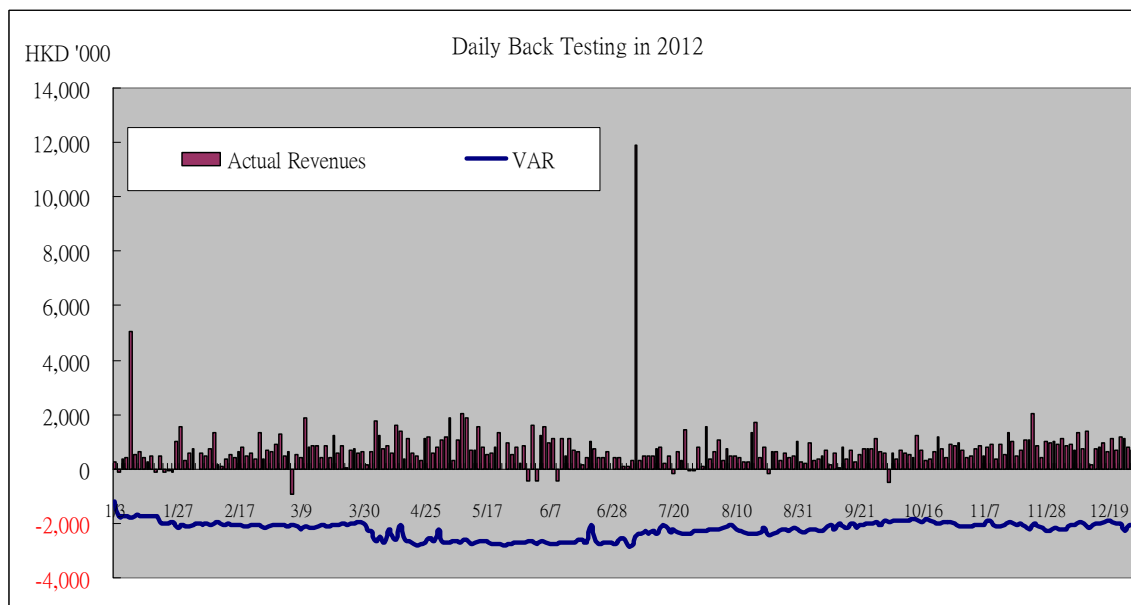
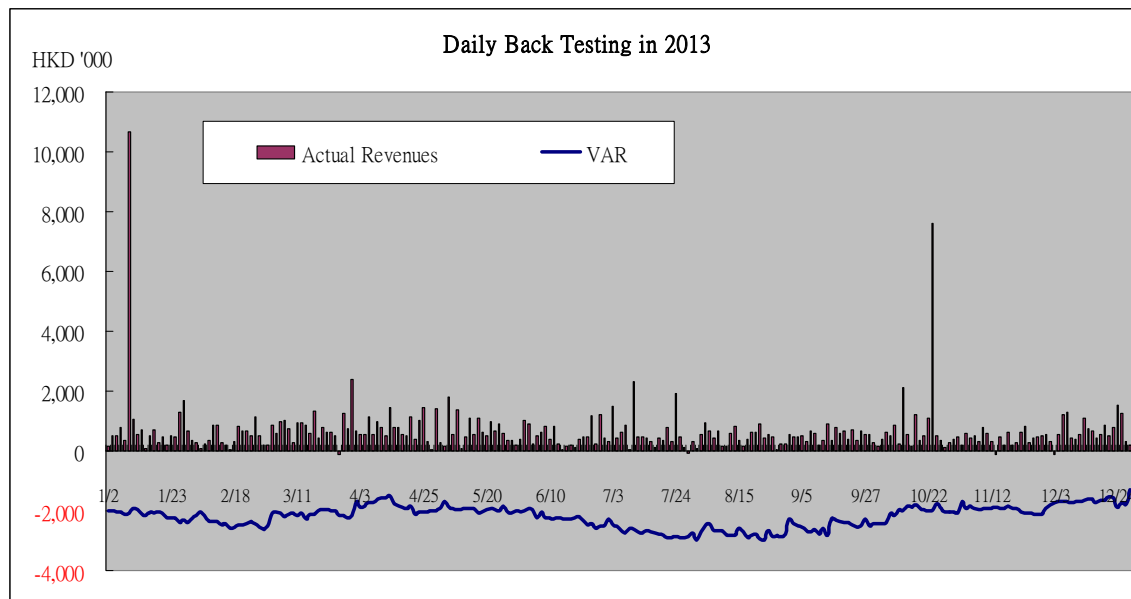
Note:

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 market data from a continuous 12-month period of significant financial stress relevant to the Group's portfolio.

Unaudited Supplementary Financial Information (continued)

7. Capital charge for market risk (continued)

The graph below shows the regulatory back-testing result of the Group's market risk under IMM approach.



There was no actual loss exceeding the VAR for the Group as shown in the back-testing results.

Unaudited Supplementary Financial Information (continued)

8. Capital charge for operational risk

| | 2013 HK\$'000 | 2012 HK\$'000 |
|-------------------------------------|------------------|------------------|
| Capital charge for operational risk | 775,167 | 658,454 |

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 "Investment 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), 2.12, 2.13 and 2.14 to the Financial Statements, further details on their valuation are outlined in Note 5.1 "Financial instruments measured at fair value". 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:

| | 2013 HK\$'000 | 2012 HK\$'000 |
|--|------------------|------------------|
| Realised gains from sales | - | 463 |
| Unrealised gains on revaluation recognised in reserves but not through income statement | 52,775 | 44,956 |

The unrealised gains included in supplementary capital for the year ended 31 December 2012 were HK\$20,230,000.

Management of Risks

The Overview

The principal types of risk inherent in the Group's businesses 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 set up by the Chief Executive.

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 Audit 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 Audit 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.

(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.

Management of Risks (continued)

Risk Management Structure (continued)

(iv) Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and 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 and self enhancement. The Operational Risk, Legal and Compliance Division together with certain specialist functional units in relation to operational risk management within the Group, including the Human Resources Division, Business Planning & Optimization Division, Administration 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 Operational Risk, Legal and Compliance Division, 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 Risk Management Committee. 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. Audit Department is the third line of defence which provides independent assessment to the effectiveness 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

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.

Management of Risks (continued)

Risk Management Structure (continued)

(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 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 Group, 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 helps build confidence in the 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 the Group may suffer as a result of its failure to comply with all applicable laws and regulations. Legal and compliance risks are managed by the Operational Risk, Legal and Compliance Division. All legal matters are handled by the Operational Risk, Legal and Compliance Division. The Operational Risk, Legal and Compliance Division 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 Risk Management Committee as delegated by the Board.

(vii) Strategic risk management

Strategic risk generally refers to the risks that may cause current or future negative impacts on the earnings, or capital or reputation or market position of the Group because of poor business decisions, improper implementation of strategies and inadequacies in the response to the changing market condition. The Board reviews and approves the strategic risk management policy. Key strategic issues have to be fully evaluated and properly endorsed by the Management and the Board.

The Group regularly reviews its business strategies to cope with the latest market situation and developments.

Corporate Governance

The Group strives to achieve high standards of corporate governance and has followed CG-1 “Corporate Governance of Locally Incorporated Authorised Institutions” of the Supervisory Policy Manual 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 nine Directors with a variety of different experience and professionalism. Among them, two are Executive Directors, while the remaining seven are Non-executive Directors. Of the seven 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 89.5%. 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) and Mr. Chan Sai Ming. Both of them were Executive Directors of the Bank.

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, Ms. Zhu Yanlai¹ and Mr. Zhuo Chengwen². 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.

Notes:

1. Appointed as member of the Audit Committee with effect from 12 August 2013.
2. Resigned as Non-executive Director and ceased to be member of the Audit Committee with effect from 12 August 2013.

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;
- the review and assessment of the adequacy and effectiveness of the Bank's risk management policies, system and internal control, including the Bank's compliance with prudential, legal and regulatory requirements governing the businesses of the Bank;
- review and approval of high-level risk-related policies of the Bank; and
- review and approval of significant or high risk exposures or transactions.

The members of the Risk Management Committee during the year were Mr. Li Jiuzhong (Chairman), Mr. Fang Hongguang, Mr. Chang Hsin Kang, Mr. Lau Hon Chuen, Mr. Chan Sai Ming and Mr. Zhuo Chengwen¹. All were Directors of the Bank. Among them, Mr. Chang Hsin Kang and Mr. Lau Hon Chuen were Independent Non-executive Directors.

Notes:

1. Resigned as Non-executive Director and ceased to be member of the Risk Management Committee with effect from 12 August 2013.

Corporate Governance (continued)

Nomination and Remuneration Committee

The Nomination and Remuneration Committee comprises three members, including one Non-executive Director, Ms. Zhu Yanlai, and two Independent Non-executive Directors, namely Mr. Lau Hon Chuen and Mr. Lan Hong Tsung David. It was chaired by Mr. Lan Hong Tsung David, an Independent Non-executive Director of the Board. With effect from 12 August 2013, Mr. Zhuo Chengwen, a Non-executive Director of the Board, resigned as the Chairman of Nomination and Remuneration Committee. Mr Lan Hong Tsung David was appointed as the Chairman and Ms. Zhu Yanlai was appointed as a member. Prior and subsequent to such changes, 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, among others, the following areas:

- human resources, 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 (defined as “Senior Management”);
- structure, size and composition (including but not limited to gender, age, cultural and educational background, ethnicity, geographical location, professional experience, skills and knowledge etc.) of the Board and Board Committees;
- remuneration of Directors, Board Committee members, Senior Management and Key Personnel;
- effectiveness of the Board and Board Committees; and
- training and continuous professional development of directors and Senior Management.

Key tasks performed by the Nomination and Remuneration Committee during 2013 included the approval, review and proposal 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 of the “Remuneration and Incentive 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 result of the Senior Management and Key Personnel for year 2012;
- proposal on staff bonus for year 2012 and salary adjustment for year 2013 of the Senior Management and Key Personnel;
- key performance indicators of the Senior Management and Key Personnel for year 2013;
- review of the Mandate, Working Rules and Standing Agenda of the Nomination and Remuneration Committee;
- review of the Directors’ Independency Policy;
- review of the Guidelines for the Annual Self Evaluation Report of the Board and Board Committees and the questionnaires for the Annual Self Evaluation of the Board and Board Committees for year 2013;
- election of directors for 2013;
- Directors’ independency report for 2012;
- self-evaluation report of the Nomination and Remuneration Committee for 2012;
- consideration of the matters relating to the adjustment and appointment of the directors of the Group;

There were two Nomination and Remuneration Committee meetings held during 2013. The attendance rate of the three directors was 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 generally in line with the broad principles set out in the HKMA’s “Guideline on a Sound Remuneration System” and applicable to Nanyang Commercial Bank Limited and all of its subsidiaries (including the branches and subsidiaries within and outside 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 group-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 Treasury, as well as Head of Risk Management Department.

● 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.

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. Credit risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk, compliance risk and reputation risk form the framework of “The Risk Adjustment Method for Group Bonus Funding Mechanics”. 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.

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 (“the Pool”) 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.

- **Disclosure on remuneration**

The Group has fully complied with the guideline in Part 3 of the "Guideline on a Sound Remuneration System" issued by the HKMA to disclosure information in relation to our remuneration and incentive mechanism.

Business Review

During 2013, amidst such a complex and rigorous operating environment, the Group continued its strategy of solid progress and sustainable growth by integrating distinct features in “NCB Wealth Management”, personal loans, SME business, and cross-border business, and constantly seizing more opportunities for profiting constantly. All our core businesses underwent sound growth with improved operating results in 2013.

Financial Highlights

As at the end of December 2013, the Group's net operating income before impairment allowances was HKD5,909 million, representing a growth of 19.83% compared with the previous year. Net interest income increased by 19.28% to HKD4,691 million, while our non-interest income increased by 22.00% to HKD1,218 million, of which net fee and commission income was up by 33.56%. The Group's profit after tax was HKD2,829 million, representing a growth of 20.88% compared with the previous year. Net interest margin was 1.83%, an increase of 0.2 percentage point compared with the previous year, primarily due to our effective structural adjustment.

As at the end of December 2013, deposits and loans increased by 6.81% and 9.45% from the previous year respectively, primarily due to continuous expansion in customer base. The Group continued to exercise stringent risk management while growing our business, resulted in sound loan quality, with classified or impaired loan ratio of 0.34%.

Review on Core Business

During 2013, on the basis of consolidating and expanding our customer base, the Group centered on structural adjustment, captured opportunities in developing new business, and strengthened risk management, which resulted in sound business growth. The Group also placed emphasis on services and products in core areas like personal loans, cross-border business, “NCB Wealth Management”, and SME business to enhance customer loyalty.

Personal Banking As at the end of December 2013, net operating income before impairment allowances of personal banking amounted to HKD1,295 million. Deposits and loans both demonstrated a steady growth from the end of the previous year. During the year, the Group launched products of different currencies, interest rates and deposit terms. With our diversified marketing and promotion incentives, the products were well received by the market, which ensured the Group a steady and growing source of income.

The marketing of “NCB Wealth Management” also comprised of diversified activities. During the year, the activities included new account rewards, incentive plans, and customer referrals, further broadened customer base of wealth management.

Business Review (continued)

To confront the decline in demand for property loans, we emphasised on developing a diversified personal loans and advances business and further optimised the personal loan structure by offering a wide range of asset financing schemes. As at the end of December 2013, the balance of personal loans and advances increased by 21.48%.

By entering into a nation-wide memorandum of cooperation framework, the Group established all-round cooperation with Bank of China, and particularly strengthened the partnership in customer services through the implementation of a new cooperation mechanism. Our customers in the Mainland enjoy timely and convenient services of acquiring our information and supports through local branches of Bank of China. Our wealth management officers and customer service officers in Hong Kong could provide tailor-made solutions, based on information and requirements of the customers collected by customer managers in the Mainland. The Group endeavoured to offer its customers with outstanding cross-border financial services.

With the rising popularity of smartphones, the Group strengthened the development and application of mobile banking platform. Our latest promotions and information about securities, deposits and wealth management will be timely updated in our mobile platform, enabling our customers to have our latest information at their fingertips.

Corporate Banking Corporate banking continued its growth momentum with improved loan structure. As at the end of December 2013, corporate loans and advances recorded an increase of 7.02%. Net interest income of corporate banking amounted to HKD2,570 million which drove a growth of 28.75% to HKD3,273 million in net operating income before impairment allowances.

In order to increase our total income amid prolonged low interest rate and weak environment, the Group, on one hand, adjusted its business structure by shifting its focus to SME to gradually increase the weight of income from SME business. On the other hand, the Group improved its ability to balance pricing and risk by adopting flexible bargaining mechanism to maximise income with reasonable interest spreads. In the meantime, we also strengthened cross-selling to drive up income from other businesses like wealth management.

Treasury As at the end of December 2013 net operating income before impairment allowances of our treasury activities amounted to HKD1,419 million, which perfectly met performance target. Net interest income rose by 15.58% as compared with the previous year.

During the period, in view of the complex market circumstances, the Group adopted a series of measures to optimise our investment portfolio, primarily by enlarging our bonds investment. In order to improve exchange gain which was part of net income from trading and securities investment, the Group strived to engage in direct foreign exchange transactions and promoted foreign currencies deposits by privilege exchange rates, which led to an upturn in total exchange gain.

Business Review (continued)

Risk Management During 2013, the unstable operating environment and more stringent regulatory requirement in the banking sector made our risk management more difficult than ever before. The Group strictly complied with all risk management requirements set by regulatory authorities, and closely monitored changes in economic conditions. We also oversaw operations of our major businesses in a more prospective way, and carried out comprehensive assessment on key exposures of the Bank, so as to ensure that all our daily procedures are in line with regulatory requirements and implemented completely.

Mainland Business By adhering to its development strategy featured with profession, differentiation, diversification, and intelligence, NCB (China) endeavoured to improve its service and employed an active risk management and operating condition. Its personal banking centred on personal finance, consumer finance, cross-border finance, and international travel financial services to promote its special brand for mid- to high-end individual services. Its corporate banking mainly focused on trade finance, offshore finance, financial institution, and treasury businesses by proactively innovating product mix and business model, which resulted in great efficacy.

Prospects and Outlook Looking forward, in 2014, the revitalisation of global economy is obscured by a number of uncertainties. The environment we are facing is still rather challenging. Traditional business model of the banking sector will not witness much growth potential, coming along with greater pressure for business transformation and innovation. However, with the rapid growth of internet, we see favourable opportunities for developing on-line financial innovation and combination. In this regard, on the basis of consolidating our key businesses, we will devote more efforts in rolling out capital-lite businesses with high return and low capital charge, so as to achieve a rapid and sound growth.

Definitions

In this Financial Statements, unless the context otherwise requires, the following terms shall have the meanings set out below:

| Terms | Meanings |
|---------------------------------|--|
| "AT1" | Additional Tier 1 |
| "Board" or "Board of Directors" | the Board of Directors of the Bank |
| "Board of BOCHK" | the Board of Directors of the BOCHK |
| "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 |
| "BOCHK" | Bank of China (Hong Kong) Limited, a company incorporated under the laws of Hong Kong |
| "BOCI-Prudential Manager" | BOCI-Prudential Asset Management Limited, a company incorporated under the laws of Hong Kong, in which BOCI Asset Management Limited, a wholly-owned subsidiary of BOC International Holdings Limited, and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively |
| "BOCI-Prudential Trustee" | BOCI-Prudential Trustee Limited, a company incorporated under the laws of Hong Kong, in which BOC Group Trustee Company Limited and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively |

Definitions (continued)

| Terms | Meanings |
|------------------|--|
| "CET1" | Common Equity Tier 1 |
| "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) |
| "EL" | Expected Loss |
| "EV" | Economic Value Sensitivity Ratio |
| "FIRB" | Foundation Internal Ratings-based |
| "Fitch" | Fitch Ratings |
| "HKAS(s)" | Hong Kong Accounting Standard(s) |
| "HKD" | Hong Kong Special Administrative Region Dollar, the lawful currency of the Hong Kong |
| "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 |
| "IMM" | Internal Models |
| "IRB" | Internal Ratings-based |
| "LGD" | Loss Given Default |
| "MPF" | Mandatory Provident Fund |
| "MPF Schemes Ordinance" | the Mandatory Provident Fund Schemes Ordinance, Chapter 485 of the Laws of Hong Kong, as amended |
| "Mainland" or "Mainland of China" | the mainland of the PRC |
| "Moody's" | Moody's Investors Service |
| "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 |
| "PVBP" | Price Value of a Basis Point |
| "RMB" or "Renminbi" | Renminbi, the lawful currency of the PRC |
| "RWA" | Risk-weighted Assets |
| "SME(s)" | Small and Medium-sized Enterprise(s) |
| "STC" | Standardised (Credit Risk) |
| "STM" | Standardised (Market Risk) |
| "STO" | Standardised (Operational Risk) |
| "Standard & Poor's" | Standard & Poor's Ratings Services |
| "Hong Kong Stock Exchange" | The Stock Exchange of Hong Kong Limited |
| "US" | the United States of America |
| "USD" | United States of America Dollar, the lawful currency of the US |
| "VAR" | Value at Risk |