BANK OF COMMUNICATIONS (HONG KONG) LIMITED

(Incorporated in Hong Kong with limited liability)

Annual Report 2019

交通銀行
BANK OF COMMUNICATIONS

Bank of Communications (Hong Kong) Limited

Unit B B/F & G/F, Unit C G/F, 1-3/F, 16/F Rm01 & 18/F Wheelock House, 20 Pedder Street, Central, Hong Kong
www.hk.bankcomm.com

Contents

Report of the Directors

The Board of Directors of Bank of Communications (Hong Kong) Limited (the "Company") hereby submit their report with the audited financial statements for the year ended 31 December 2019.

Principal activities

The principle activity of the Company is provision of banking services.

Results and appropriations

The results of the Company for the year are set out in the statement of profit or loss and other comprehensive income on page 7.

The Board of Directors do not recommend the payment of a dividend in respect of the year ended 31 December 2019.

Business Review

No business review was presented for the year ended 31 December 2019 as the Company had been able to claim an exemption under section 388(3)(b) of the Companies Ordinance (Cap. 622) since it is a wholly-owned subsidiary of Bank of Communications Co., Ltd.

Donations

There were no charitable and other donations made by the Company during the years ended 31 December 2019 and 2018.

Share issued in the year

There has been no new issue of share capital for the year ended 31 December 2019. Details of the share capital are set out in Note 29 to the financial statements.

Directors of the Company

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

Chairman:

Wang Feng (appointed on 27 February 2019)
Shou Fugang (resigned on 27 February 2019)

Executive directors:

Chan Ha Fong, Nancy
Meng Yu
Fan Chaorong (appointed on 20 September 2019)
Cheng Man Wang (resigned on 20 September 2019)

Non-executive directors:

Zhang Hui
Zhu Chen

Independent non-executive directors:

Chan Ka Lok
Tang Kwai Chang
Chan Ching Har Eliza (appointed on 3 September 2019)
Lam Yim Nam (appointed on 23 December 2019)

Shou Fugang resigned on 27 February 2019 as Chairman and executive director of the Company and Cheng Man Wang resigned on 20 September 2019 as executive director of the Company. Shou Fugang and Cheng Man Wang had confirmed that they had no disagreement with the Board and nothing relating to the affairs of the Company needed to be brought to the attention of the shareholders of the Company.

Directors of the Company *(continued)*

In accordance with the Company's Articles of Association, the existing directors except Fan Chaorong, Chan Ching Har Eliza and Lam Yim Nam shall remain in the office.

Pursuant to Articles 23.2, 23.5 and 24 of the Company's Articles of Association, Fan Chaorong, Chan Ching Har Eliza and Lam Yim Nam will retire and, being eligible to offer themselves for election as director of the Company at the forthcoming Annual General Meeting.

Directors' material interests in transactions, arrangements and contracts that were significant in relation to the Company's business

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

Directors' interests in the shares and debentures of the Company or any specified undertaking of the Company

At no time during the year was the Company, its fellow subsidiaries or its holding company or its other associated corporations a party to any arrangement to enable the directors of the Company to (including their spouse and children under 18 years of age) hold any interests in the shares or debentures of, the Company or its specified undertakings or other associated corporations.

Events after reporting period

On 6 January 2020, the Company has altered its articles of association and the Company's status has been changed from a private company to a public company with effect from 6 January 2020.

Other non-adjusting events which have occurred after 31 December 2019 are disclosed in note 35 to the notes to financial statements.

Management contracts

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

Permitted indemnity provisions

Pursuant to the Company's Articles of Association, a director or former director of the Company may be indemnified out of the Company's assets against any liability incurred by the director to a person other than the Company or an associated company of the Company in connection with any negligence, default, breach of duty or breach of trust in relation to the Company or associated company. The Company has arranged appropriate directors' and officers' liability insurance for the directors and officers of the Company during the year and up to the date of the Report of the Directors.

Auditor

The financial statements for the year ended 31 December 2019 have been audited by PricewaterhouseCoopers, who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

Wang Feng, *Chairman*

Hong Kong, 8 April 2020

Independent Auditor's Report

TO THE MEMBER OF BANK OF COMMUNICATIONS (HONG KONG) LIMITED
(incorporated in Hong Kong with limited liability)

Opinion

What we have audited

The financial statements of Bank of Communications (Hong Kong) Limited (the "Company") set out on pages 7 to 99, which comprise:

- the statement of financial position as at 31 December 2019;
- the statement of profit or loss and other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2019, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

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

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

Independence

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

Other Information

The directors are responsible for the other information. The other information comprises the information included in the annual report, but does not include the financial statements and our auditor's report thereon.

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

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

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

Responsibilities of Directors and the Audit Committee for the Financial Statements

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

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body, in accordance with Section 405 of the Hong Kong Companies Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

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

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

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

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

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

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

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 8 April 2020

Statement of Profit or Loss and Other Comprehensive Income

(All amounts expressed in thousands of HK$ unless otherwise stated)

		Year ended 31 December	
		2019	2018
	Notes		
Interest income		**6,076,016**	4,814,092
Interest expense		**(3,154,847)**	(2,957,265)
Net interest income	4	**2,921,169**	1,856,827
Fee and commission income	5	**746,623**	777,684
Fee and commission expense	6	**(56,536)**	(45,028)
Net fee and commission income		**690,087**	732,656
Net gains arising from trading activities	8	**76,413**	366,822
Net gains/(losses) arising from financial investments		**425,804**	(9,851)
Dividend income	7	**35**	700
Other operating income	9	**21,541**	20,982
Change in expected credit losses	10	**(159,988)**	(212,589)
Other operating expenses	11	**(1,546,227)**	(1,503,772)
Profit before tax		**2,428,834**	1,251,775
Income tax expenses	14	**(366,160)**	(268,758)
Net profit for the year		**2,062,674**	983,017
Other comprehensive income for the year, net of tax			
Item that will not be reclassified subsequently to profit or loss			
Equity investments at fair value through other comprehensive income – net change in fair value		**(25)**	1,816
Items that may be reclassified to profit or loss:			
Net gain arising from cash flow hedge			
Changes in fair value recorded in equity		**–**	(529)
Debt investments at fair value through other comprehensive income			
Net gains recorded in equity		**890,277**	221,146
Net gains reclassified from equity to profit or loss		**(496,062)**	(19,367)
Other comprehensive income for the year		**394,190**	203,066
Total comprehensive income for the year		**2,456,864**	1,186,083

The accompanying notes form a part of these financial statements.

Statement of Financial Position

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Notes	As at 31 December 2019	2018
ASSETS			
Cash and balances with central bank	15	**1,094,956**	2,353,780
Due from banks and other financial institutions	16	**17,667,908**	25,082,437
Financial assets at fair value through profit or loss	17	**1,064,926**	1,855,354
Financial assets at fair value through other comprehensive income	20	**122,242,273**	109,315,062
Loans and advances to customers	19	**79,201,615**	67,688,719
Property and equipment	21	**53,476**	67,418
Deferred income tax assets	22	**–**	10,978
Right-of-use assets	23	**298,409**	–
Other assets	24	**5,489,437**	1,502,974
Total assets		**227,113,000**	207,876,722
LIABILITIES			
Due to banks and other financial institutions	25	**28,736,570**	21,126,951
Due to customers	26	**170,755,289**	162,074,683
Financial liabilities at fair value through profit or loss	27	**1,168,798**	467,764
Current tax liabilities		**534,932**	151,997
Deferred income tax liabilities	22	**46,906**	–
Lease liabilities		**301,488**	–
Other liabilities	28	**4,483,009**	5,422,094
Total liabilities		**206,026,992**	189,243,489
EQUITY			
Share capital	29	**17,900,000**	17,900,000
Other reserves		**481,164**	86,974
Retained earnings		**2,704,844**	646,259
Total equity		**21,086,008**	18,633,233
Total equity and liabilities		**227,113,000**	207,876,722

The financial statements were approved and authorized for issuance by the Board of Directors on 8 April 2020 and signed on its behalf by:

Wang Feng, Chairman　　　　*Chan Ha Fong, Nancy, Chief Executive*

The accompanying notes form a part of these financial statements.

Statement of Changes in Equity

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Attributable to the shareholder of the Company					
	Head office account	**Share capital**	**Revaluation reserve**	**Cash flow hedge reserve (Note 18)**	**Retained earnings (Note (a))**	**Total**
At 1 January 2019	**–**	**17,900,000**	**86,974**	**–**	**646,259**	**18,633,233**
Change in accounting policy	**–**	**–**	**–**	**–**	**(4,089)**	**(4,089)**
Restated balance at 1 January 2019	**–**	**17,900,000**	**86,974**	**–**	**642,170**	**18,629,144**
Net profit for the year	**–**	**–**	**–**	**–**	**2,062,674**	**2,062,674**
Other comprehensive income	**–**	**–**	**394,190**	**–**	**–**	**394,190**
At 31 December 2019	**–**	**17,900,000**	**481,164**	**–**	**2,704,844**	**21,086,008**
At 1 January 2018	–	300,000	–	–	(7,512)	292,488
Effect of recapitalization of a business	18,380,966	–	940,348	(9,299)	17,539,428	36,851,443
	18,380,966	300,000	940,348	(9,299)	17,531,916	37,143,931
Change in accounting policy	–	–	54,957	–	(101,009)	(46,052)
Restated balance at 1 January 2018	18,380,966	300,000	995,305	(9,299)	17,430,907	37,097,879
Net profit for the year	–	–	–	–	983,017	983,017
Other comprehensive income	–	–	203,595	(529)	–	203,066
Repayment to Head office	(18,380,966)	–	–	–	–	(18,380,966)
Issuance of share capital	–	17,600,000	–	–	–	17,600,000
Transfer of Excluded Business to Bank of Communications Co., Ltd. Hong Kong Branch ("HKBR") (Note 2)	–	–	(1,111,926)	9,828	(17,767,665)	(18,869,763)
At 31 December 2018	–	17,900,000	86,974	–	646,259	18,633,233

Note (a):

In accordance with the requirements of the Hong Kong Monetary Authority (the"HKMA"), the regulatory reserve is set aside for general banking risks, including future losses or other unforeseeable risks. The regulatory reserve is set up in compliance with the HKMA's requirements and is distributable to shareholder of the Company subject to consultation with the HKMA. As at 31 December 2019, HK$891,005,000 (2018: HK$794,919,000) was earmarked as the regulatory reserve from the retained earnings.

The accompanying notes form a part of these financial statements.

Statement of Cash Flows

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Notes	Year ended 31 December 2019	2018
Cash flows from operating activities:			
Profit before tax		**2,428,834**	1,251,775
Adjustments for:			
Change in expected credit losses		**159,988**	212,589
Depreciation and amortization		**30,365**	33,154
Depreciation of right-of-use assets		**166,890**	–
Finance costs – lease interest expense		**4,820**	–
Loss on disposal of property and equipment		**25**	2,183
Interest income from financial investments		**(3,531,136)**	(2,200,059)
Fair value (gains)/losses		**(38,828)**	11,788
Dividend income		**(35)**	(700)
Withholding tax		**–**	59,363
Net (gains)/losses arising from financial investments		**(425,804)**	9,851
Interest expenses on certificates of deposit issued and debt securities issued		**–**	119,347
Operating cash flows before movements in operating assets and liabilities		**(1,204,881)**	(500,709)
Net decrease in due from banks and other financial institutions		**3,000,205**	16,117,318
Net decrease in financial assets at fair value through profit or loss		**829,256**	1,159,657
Net increase in loans and advances to customers		**(11,605,133)**	(13,904,519)
Net increase in other assets		**(3,966,740)**	(8,744,712)
Net increase in due to banks and other financial institutions		**7,609,619**	205,313,139
Net increase in financial liabilities at fair value through profit or loss		**701,034**	2,037,834
Net increase in due to customers		**8,680,606**	22,324,403
Net (decrease)/increase in other liabilities		**(942,931)**	97,482,278
Income tax paid		**–**	(997,878)
Net cash inflows from operating activities		**3,101,035**	320,286,811

Statement of Cash Flows

(All amounts expressed in thousands of HK$ unless otherwise stated)

		Year ended 31 December	
		2019	2018
	Notes		
Cash flows from investing activities:			
Purchase of financial investments		**(155,694,231)**	(211,897,275)
Disposal or redemption of financial investments		**143,601,346**	38,076,566
Dividend received		**35**	700
Interest received from financial investments		**3,520,322**	2,545,279
Purchase of property and equipment		**(15,037)**	(26,135)
Purchase of intangible assets		**(12,114)**	(1,523)
Net cash outflows from investing activities		**(8,599,679)**	(171,302,388)
Cash flows from financing activities:			
Proceeds from debt securities and certificate of deposits issued		**–**	567,236
Repayment of debt securities and certificate of deposits issued		**–**	(6,039,343)
Repayment to Head office		**–**	(18,380,966)
Principal elements of lease payments		**(166,931)**	–
Interest paid for lease		**(4,820)**	–
Interest paid for certificates of deposit issued and debt securities issued		**–**	(305,432)
Proceeds from issuance of share capital		**–**	17,600,000
Net cash outflows from financing activities		**(171,751)**	(6,558,505)
Net (decrease)/increase in cash and cash equivalents		**(5,670,395)**	142,425,918
Transfer of cash and cash equivalents in relation to the Transfer of Excluded Business to HKBR	2	**–**	(171,312,689)
Cash and cash equivalents at the beginning of the year		**11,704,990**	40,591,761
Cash and cash equivalents at the end of the year	31	**6,034,595**	11,704,990
Net cash flows from operating activities include:			
Interest received		**2,471,431**	3,161,720
Interest paid		**(3,267,520)**	(2,945,396)

The accompanying notes form a part of these financial statements.

1 GENERAL

As at 31 December 2019, Bank of Communications (Hong Kong) Limited ("the Company") was a private company incorporated and domiciled in Hong Kong. The address of its registered office is 20 Pedder Street, Central, Hong Kong and principal place of business is Unit B B/F & G/F, Unit C G/F, 1-3/F, 16/F Rm01 & 18/F Wheelock House, 20 Pedder Street, Central, Hong Kong. Its ultimate holding company is Bank of Communications Co., Ltd., which is incorporated in the People's Republic of China.

On 29 September 2015, the Hong Kong Monetary Authority granted the Company a banking licence under the Banking Ordinance.

On 29 January 2018 (the "Appointed Day"), the Bank of Communications (Hong Kong) Limited (Merger) Ordinance (Chapter 1182 of the laws of Hong Kong) (the "Ordinance") has become effective. Pursuant to the Ordinance, certain activities, assets and liabilities which constitute the retail banking business and private banking business ("Transferred Business") of Bank of Communications Co., Ltd. Hong Kong Branch ("HKBR") have been transferred to the Company in accordance with section 4(1) of the Ordinance. Accordingly, the Company commenced its retail banking business and private banking business on the Appointed Day.

On 6 January 2020, the Company has altered its articles of association and the Company's status has been changed from a private company to a public company with effect from 6 January 2020 .

These financial statements are presented in thousands of Hong Kong Dollars (HK$), unless otherwise stated.

The regulatory disclosure information required under the Banking (Disclosure) Rules is available in the Regulatory Disclosure Section of our website www.hk.bankcomm.com.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ('HKFRSs') and the requirements of the Hong Kong Companies Ordinance (Cap. 622). The financial statements have been prepared on the historical cost basis except for certain financial instruments which are measured at fair value.

The Company adopts the going concern basis in preparing its financial statements.

On 29 January 2018, the transfer of retail bank business and private banking business from HKBR to the Company was a recapitalization of a business and did not result in any changes in business substance, management nor the ultimate controlling shareholder. Accordingly, the assets and liabilities of the Transferred Business have been presented using their carrying value in the records of HKBR.

Certain assets and liabilities of HKBR's corporate banking business have not been transferred to the Company (the "Excluded Business"). Accordingly, the statement of financial position and the statement of profit or loss and other comprehensive income of the Company includes the net assets and results of the Excluded Business up to 28 January 2018 because the results of this business cannot be clearly distinguished from that of the Transferred Business. The Excluded Business have been accounted for as a deduction from equity upon completion of the business transfer at 29 January 2018.

The effects of all transactions for the year ended 31 December 2018 between the Company and the Transferred Business of HKBR before the recapitalization were eliminated in preparing the financial statements.

(All amounts expressed in thousands of HK$ unless otherwise stated)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.1 Basis of preparation *(continued)*

2.1.1 New and revised HKFRSs effective by 1 January 2019 applied by the Company

HKFRIC 23	Uncertainty over income tax
HKFRS 16	Leases
Amendments to HKFRS 9	Prepayment Features with Negative Compensation and Modifications of Financial Liabilities

The Company had to change its accounting policies as a result of adopting HKFRS 16. The Company elected to adopt the new rules retrospectively but recognized the cumulative effect of initially applying the new standard on 1 January 2019. This is disclosed in note 2.2.1 below. The other amendments listed above did not have any impact on the amounts recognized in prior periods and are not expected to significantly affect the current or future periods.

2.1.2 Standards and amendments that are not yet effective and have not been adopted by the Company

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2019 reporting periods and have not been early adopted by the Company. These standards are not expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

2.2 Changes in accounting policies

This note explains the impact of the adoption of HKFRS 16 Leases on the Company's financial statements and discloses the new accounting policies that have been applied from 1 January 2019 in note 2.2.1 below.

The Company has adopted HKFRS 16 retrospectively from 1 January 2019, but has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognized in the opening statement of financial position on 1 January 2019.

2.2.1 HKFRS 16 Leases – Impact of adoption

Adjustments recognized on adoption of HKFRS 16

On adoption of HKFRS 16, the Company recognized lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of HKAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of 1 January 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on 1 January 2019 was 1.3%.

Practical expedients applied
In applying HKFRS 16 for the first time, the Company has used the following practical expedients permitted by the standard:

- applying a single discount rate to a portfolio of leases with reasonably similar characteristics;
- relying on previous assessments on whether leases are onerous as an alternative to performing an impairment review – there were no onerous contracts as at 1 January 2019;
- accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases;
- excluding initial direct costs for the measurement of the right-of-use asset at the date of initial application; and
- using hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The Company has also elected not to reassess whether a contract is, or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date the Company relied on its assessment made applying HKAS 17 and HKFRIC 4 Determining whether an Arrangement contains a Lease.

(All amounts expressed in thousands of HK$ unless otherwise stated)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Changes in accounting policies *(continued)*

2.2.1 HKFRS 16 Leases – Impact of adoption (continued)

Adjustments recognized on adoption of HKFRS 16 (continued)

	2019
Operating lease commitments disclosed as at 31 December 2018 (Note (a))	**–**
Add: New lease liability recognized as at 1 January 2019	**207,291**
Lease liability recognized as at 1 January 2019	**207,291**

Note (a):

As at 31 December 2018, certain lease agreements have been signed by HKBR which the lease are used by the Company. The Company does not have any commitment with respect to these operating lease commitment.

The right-of-use assets were measured on a retrospective basis as if the new rules had always been applied. There were no onerous lease contracts that would have required an adjustment to the right-of-use assets at the date of initial application.

The recognized right-of-use assets relate to the following types of assets:

	31 December 2019	**1 January 2019**
Properties	289,945	188,374
Equipment	8,328	15,198
Others	136	70
Total right-of-use assets	298,409	203,642

The change in accounting policy affected the following items in the statement of financial position on 1 January 2019:

- right-of-use assets – increased by HK$203,642,000;
- prepayments – decreased by HK$440,000; and
- lease liabilities – increased by HK$207,291,000.

The net impact on retained earnings on 1 January 2019 was a decrease of HK$4,089,000.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies

2.3.1 Interest income and expense

Interest income and expense are recognized in profit or loss for interest-bearing financial instruments using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (including a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant periods. 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 Company estimates cash flows considering all contractual terms of the financial instrument (but does not consider future credit losses). The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest income on an impaired financial asset or a group of impaired similar financial assets is recognized using the original interest rate which was used to discount the future cash flows for the purpose of measuring the impairment loss.

2.3.2 Fee and commission income

The Company earns fee and commission income from a diverse range of services it provides to its customers. For those services that are over a period of time, fee and commission income are accrued over that period when the services are rendered. For other services, fee and commission income are recognized when the services are rendered.

2.3.3 Dividend income

Dividends are recognized when the right to receive the dividends is established.

2.3.4 Financial assets and liabilities

Measurement methods

Initial recognition and measurement

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognized on trade-date, the date on which the Company commits to purchase or sell the asset.

At initial recognition, the Company measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Immediately after initial recognition, an expected credit loss allowance (ECL) is recognized for financial assets measured at amortized cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognized in profit or loss when an asset is newly originated.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

Measurement methods (continued)

Initial recognition and measurement (continued)

When the fair value of financial assets and liabilities differs from the transaction price on initial recognition, the Company recognizes the difference as follows:

(a) When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognized as a gain or loss.

(b) In all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortized over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realized through settlement.

Amortized cost and effective interest rate

The amortized cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortized cost before any impairment allowance) or to the amortized cost of a financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired ('POCI') financial assets – assets that are credit-impaired (see definition on note 3.1.2.2) at initial recognition – the Company calculates the credit-adjusted effective interest rate, which is calculated based on the amortized cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

When the Company revises the estimates of future cash flows, the carrying amount of the respective financial assets or financial liability is adjusted to reflect the new estimate discounted cash flows using the original effective interest rate. Any changes are recognized in profit or loss.

Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

(a) POCI financial assets, for which the original credit-adjusted effective interest rate is applied to the amortized cost of the financial asset.

(b) Financial assets that are not 'POCI' but have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortized cost (i.e. net of the expected credit loss provision).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets

(i) Classification and subsequent measurement

From 1 January 2018, the Company has applied HKFRS 9 and classified its financial assets in the following measurement categories:

- Fair value through profit or loss;
- Fair value through other comprehensive income; or
- Amortized cost.

The classification requirements for debt and equity instruments are described below:

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds.

Classification and subsequent measurement of debt instruments depend on:

(i) The Company's business model for managing the asset; and

(ii) The cash flow characteristics of the asset.

Based on these factors, the Company classifies its debt instruments into one of the following three measurement categories:

- Amortized cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at fair value through profit or loss, are measured at amortized cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognized and measured from these financial assets. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

- Fair value through other comprehensive income: Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at fair value through profit or loss, are measured at fair value through other comprehensive income. Movements in the carrying amount are taken through other comprehensive income, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortized cost which are recognized in profit or loss. When the financial asset is derecognized, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss and recognized in 'Net gains/losses arising from financial investment'. Interest income from these financial assets is recognized in profit or loss and included in 'Interest income' using the effective interest rate method.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets (continued)

(i) Classification and subsequent measurement (continued)

Debt instruments *(continued)*

- Fair value through profit or loss: Assets that do not meet the criteria for amortized cost or fair value through other comprehensive income are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognized in profit or loss and recognized in the profit or loss within 'Net gains/losses arising from trading activities' in the period in which it arises.

Business model: the business model reflects how the Company manages the assets in order to generate cash flows. That is, whether the Company's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at fair value through profit or loss. Factors considered by the Company in determining the business model for a Company of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Company assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Company considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets with embedded derivatives are considered in their entirely when determining whether their cash flows are solely payment of principal and interest.

The Company reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets (continued)

(i) Classification and subsequent measurement (continued)

Equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. Examples of equity instruments include basic ordinary shares.

The Company subsequently measures all equity investments at fair value through profit or loss, except where the Company's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Company's policy is to designate equity investments as fair value through other comprehensive income when those investments are held for purposes other than to sell. When this election is used, fair value gains and losses are recognized in other comprehensive income and are not subsequently reclassified to profit or loss, including on disposal. Dividends, when representing a return on such investments, continue to be recognized in profit or loss as 'Dividend income' when the Company's right to receive payments is established.

Gains and losses on equity investments at fair value through profit or loss are recognized in the profit or loss as 'Net gains/losses arising from trading activities'.

(ii) Impairment

The Company assesses on a forward-looking basis the ECL associated with its debt instrument assets carried at amortized cost and fair value through other comprehensive income and with the exposure arising from loan commitments and financial guarantee contracts. The Company recognizes a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Regarding these judgment and estimates, refer to Credit Risk management in Note 3.1. Note 3.1.2 provides details of how the ECL allowance is measured.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets (continued)

(iii) Modification of loans

The Company sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Company assesses whether or not the new terms are substantially different to the original terms. The Company does this by considering, among others, the following factors:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.

- Whether any substantial new terms are introduced, such as a profit share/equity-based return that substantially affects the risk profile of the loan.

- Significant extension of the loan term when the borrower is not in financial difficulty.

- Significant change in the interest rate.

- Change in the currency the loan is denominated in.

- Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Company derecognizes the original financial asset and recognizes a 'new' asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Company also assesses whether the new financial asset recognized is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognized in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Company recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognizes a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

(iv) Derecognition other than on a modification

Financial assets, or a portion thereof, are derecognized when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Company transfers substantially all the risks and rewards of ownership, or (ii) the Company neither transfers nor retains substantially all the risks and rewards of ownership and the Company has not retained control.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets (continued)

(iv) Derecognition other than on a modification (continued)

The Company enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as 'pass through' transfers that result in derecognition if the Company:

(i) Has no obligation to make payments unless it collects equivalent amounts from the assets;

(ii) Is prohibited from selling or pledging the assets; and

(iii) Has an obligation to remit any cash it collects from the assets without material delay.

Collateral (shares and bonds) furnished by the Company under standard repurchase agreements and securities lending and borrowing transactions are not derecognized because the Company retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitization transactions in which the Company retains a subordinated residual interest.

When the contractual rights to receive the cash flows from the assets have been transferred, and the Company neither transfers nor retains substantially all the risks and rewards of ownership, and the Company has retained control of the transferred assets, the Company applies continuing involvement approach. Under this approach, the Company continues to recognize the transferred asset to the extent of its continuing involvement and recognize the associated liability, to reflect the rights and obligations retained by the Company. The net carrying amount of the transferred asset and associated liability is: (a) the amortized cost of the rights and obligations retained by the Company, if the transferred asset is measured at amortized cost; or (b) equal to the fair value of the rights and obligations retained by the Company when measured on a stand-alone basis, if the transferred asset is measured at fair value.

2.3.4.2 Financial liabilities

(i) Classification and subsequent measurement

In both the current and prior period, financial liabilities are classified as liabilities measured at amortized cost, except for:

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;

- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition or when the continuing involvement approach applies. When the transfer of financial asset did not qualify for derecognition, a financial liability is recognized for the consideration received for the transfer. In subsequent periods, the Company recognizes any expense incurred on the financial liability; when continuing involvement approach applies, see note 2.3.4.1(iv); and

- Financial guarantee contracts and loan commitments (see note 2.3.5).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.2 Financial liabilities (continued)

(ii) Derecognition

Financial liabilities are derecognized when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

The exchange between the Company and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is more than 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortized over the remaining term of the modified liability.

2.3.5 Financial guarantee contracts and loan commitments

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

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance; and

- The premium received on initial recognition less income recognized in accordance with the principles of HKFRS 15.

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

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

2.3.6 Derivatives and hedging activities

The Company has elected to apply the hedge accounting requirements of HKFRS 9.

The Company has not provided comparative information for periods before the date of initial application of HKFRS 9 for the new disclosures introduced by HKFRS 9 as a consequential amendment to HKFRS 7, as permitted by HKFRS 7 paragraph 44Z.

Derivatives are initially recognized at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Certain derivatives are embedded in hybrid contracts, such as the conversion option in a convertible bond. If the hybrid contract contains a host that is a financial asset, then the Company assesses the entire contract as described in the financial assets section above for classification and measurement purposes. Otherwise, the embedded derivatives are treated as separate derivatives when:

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.6 Derivatives and hedging activities (continued)

(i) Their economic characteristics and risks are not closely related to those of the host contract;

(ii) A separate instrument with the same terms would meet the definition of a derivative; and

(iii) The hybrid contract is not measured at fair value through profit or loss.

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

The method of recognizing the resulting fair value gain or loss depends on whether the derivative is designated and qualifies as a hedging instrument, and if so, the nature of the item being hedged. The Company designates certain derivatives as either:

(a) Hedges of the fair value of recognized assets or liabilities or a firm commitment (fair value hedges); or

(b) Hedges of highly probable future cash flows attributable to a recognized asset or liability (cash flow hedges).

At the inception of the hedging, the Company documents the economic relationship between hedging instruments and hedged items. The Company documents its risk management objective and strategy for undertaking its hedge transactions. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of derivative financial instruments designated in hedge relationships are disclosed in note 18. Movements in the hedging reserve in shareholder's equity are shown in statement of changes in equity.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statement of profit or loss, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortized to profit or loss over the period to maturity and recorded as net interest income.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the statement of profit or loss.

Amounts accumulated in equity are recycled to the statement of profit or loss in the periods when the hedged item affects profit or loss. They are recorded in the income or expense lines in which the revenue or expense associated with the related hedged item is reported.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.6 Derivatives and hedging activities (continued)

Cash flow hedge (continued)

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognized in the periods when the hedged item affects profit or loss. When a forecast transaction is no longer expected to occur (for example, the recognized hedged asset is disposed of), the cumulative gain or loss previously recognized in other comprehensive income is immediately reclassified to the statement of profit or loss.

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognized immediately in profit or loss and are included in gains/(losses) from trading activities.

2.3.7 Assets transferred under repurchase agreements

Financial assets sold subject to agreements with a commitment to repurchase at a specific future date at a fixed or determinable price are not derecognized in the statement of financial position. The proceeds from selling such assets are presented under "due to banks and other financial institutions" in the statement of financial position. The difference between the selling price and repurchasing price is recognized as interest expense during the term of the agreement using the effective interest method.

2.3.8 Property and equipment

The Company's property and equipment mainly comprise buildings, equipment, transportation equipment and property improvement.

The assets purchased are initially measured at acquisition cost.

Subsequent expenditures incurred for the property and equipment are included in the cost of the property and equipment if it is probable that economic benefits associated with the asset will flow to the Company and the subsequent expenditures can be measured reliably. Meanwhile the carrying amount of the replaced part is derecognized. Other subsequent expenditures are recognized in profit or loss in the period in which they are incurred.

Depreciation is calculated on the straight-line method to write down the cost of such assets over their estimated useful lives. The useful lives of assets are reviewed, and adjusted if appropriate, at each financial reporting date.

Buildings comprise primarily branch office premises and office premises. The estimated useful lives and depreciation rate of buildings, equipment, transportation equipment and property improvement are as follows:

Type of assets	Estimated useful lives
Buildings	50 years
Equipment	5 years
Transportation equipment (excluding equipment under operating leases)	3 years
Property improvement	Over the shorter of the economic useful lives and remaining lease terms

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.9 Repossessed assets

Repossessed assets are initially recognized at lower of fair value less cost to sell or amortized cost of the corresponding debt at the date of repossession and included in other assets. At each reporting date, repossessed assets are subsequently measured at lower of fair value less cost to sell and the carrying amount. When the fair value less cost to sell is lower than the carrying amount, an impairment loss is recognized in profit or loss.

When a repossessed asset is disposed, the difference between the disposal proceeds and the carrying amount is recognized in profit or loss.

2.3.10 Investment property

Investment property is a property held to earn rentals or for capital appreciation or both and initially measured at cost.

As there is an active property market in the location in which the Company's investment property is situated, and the Company can obtain the market price and other relevant information regarding the same or similar type of property from the property market so as to reasonably estimate the fair value of the investment property; therefore, the Company uses the fair value model for subsequent measurement of the investment property, with changes in the fair value included in profit or loss for the period in which they arise.

When an investment property is sold, transferred, retired or damaged, the Company recognizes the amount of any proceeds on disposal net of the carrying amount and related taxes in profit or loss for the period.

2.3.11 Intangible assets

An intangible asset is measured initially at cost. When an intangible asset with a finite useful life is available for use, its original cost is amortized over its estimated useful life using the straight-line method. An intangible asset with an indefinite useful life is not amortized.

For an intangible asset with a finite useful life, the Company reviews the useful life and amortization method at the end of each reporting period, and makes adjustments when necessary.

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains and losses arising from de-recognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss when the asset is derecognized.

2.3.12 Impairment of non-financial assets

At the end of the reporting period or whenever there is an indication that the non-financial assets are impaired, the Company reviews the carrying amounts of its tangible and intangible assets with finite useful lives to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized in profit or loss immediately.

Intangible assets with indefinite useful life are tested for impairment annually, irrespective of whether there is any indication that the assets may be impaired.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but the increased carrying amount should not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized in profit or loss immediately.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.13 Leases

2.3.13.1 Accounting policy effective from 1 January 2019

As explained in note 2.2 above, the Company has changed its accounting policy for leases where the Company is the lessee. The new policy is described below and the impact of the change in note 2.2.

For the year ended 31 December 2018, leases in which a significant portion of the risks and rewards of ownership were not transferred to the Company as lessee were classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss on a straight-line basis over the period of the lease.

From 1 January 2019, leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Company.

Contracts may contain both lease and non-lease components. The Company allocates the consideration in the contract to the lease and non-lease components based on their relative stand-alone prices.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable; and

- amounts expected to be payable by the Company under residual value guarantees.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the Company, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

To determine the incremental borrowing rate, the Company:

- where possible, uses recent third-party financing received by the individual lessee as a starting point, adjusted to reflect changes in financing conditions since third party financing was received, and

- makes adjustments specific to the lease, e.g. term, country, currency and security.

Lease payments are allocated between principal and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;

- any lease payments made at or before the commencement date less any lease incentives received;

- any initial direct costs; and

- restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the Company is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.14 Cash and cash equivalents

Cash and cash equivalents are assets with a maturity of less than 3 months from the date of acquisition or highly liquid assets with an original maturity of less than three months, which are readily convertible into known amounts of cash and subject to an insignificant risk of changes in value.

2.3.15 Provisions

Provisions are recognized when the Company has a present obligation related to a contingency, it is probable that an outflow of economic benefits will be required to settle the obligation, and the amount of the obligation can be measured reliably.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account factors pertaining to a contingency such as the risks, uncertainties and time value of money. Where the effect of the time value of money is material, the amount of the provision is determined by discounting the related future cash outflows.

Where all or some of the expenditure required to settle a provision is expected to be reimbursed by a third party, the reimbursement is recognized as a separate asset only when it is virtually certain that reimbursement will be received, and the amount of reimbursement recognized does not exceed the carrying amount of the provision.

2.3.16 Current and deferred income taxes

Income tax expense represents the sum of the tax currently payable and deferred tax.

(a) Current income tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of profit or loss and other comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.16 Current and deferred income taxes (continued)

(b) Deferred income tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax base used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary difference to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realized, based on tax rate (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. Current and deferred tax is recognized in profit or loss, except when it relates to items that are recognized in other comprehensive income, in which case the current and deferred tax are also recognized in other comprehensive income.

For the purposes of measuring deferred tax liabilities or deferred tax assets for investment properties that are measured using the fair value model, the carrying amounts of such properties are presumed to be recovered entirely through sale, unless the presumption is rebutted. The presumption is rebutted when the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.

2.3.17 Contingent liabilities and contingencies

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 Company. It can also be a present obligation arising from past events that is not recognized 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 recognized 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 and the amount can be reliably measured, it will then be recognized as a provision.

2.3.18 Fiduciary activities

In activities where the Company acts in a fiduciary capacity such as trustee, custodian or agent, the assets and income arising from the transaction together with the related undertakings to return the assets to customers are excluded from the Company's financial statements.

2.3.19 Acceptances

Acceptances comprise the Company's commitments on payment for bills that are issued to customers. Acceptances are accounted for as financial guarantees and credit related commitments and are disclosed as contingent liabilities and commitments.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.20 Employee benefits

(i) Employee leave entitlements

Liabilities for wages and salaries, including non-monetary benefits and accumulating sick leave that are expected to be settled wholly within 12 months after the end of the period in which the employees render the related service are recognized in respect of employees' services up to the end of the reporting period and are measured at the amounts expected to be paid when the liabilities are settled.

(ii) Retirement benefit schemes

The Company contributes to defined contribution schemes under either recognized Occupational Retirement Schemes Ordinance (ORSO) Schemes or Mandatory Provident Fund (MPF) Schemes that are available to the Company's employees. Contributions to the schemes by the Company 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. When an employee leaves the Company prior to his/her interest in the Company's employer non-mandatory contributions vesting with the employee, the ongoing contributions payable by the Company may be reduced by the relevant amount of forfeited contributions.

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

2.3.21 Offset financial assets and liabilities

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

2.3.22 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker is the person or Company that allocates resources to and assesses the performance of the operating segments of an entity. The Company has determined the senior management team represented by the governor as its chief operating decision maker.

An operating segment is a component of the Company with all of the following conditions are satisfied: (1) that component can earn revenues and incur expenses from ordinary activities; (2) the component's operating results are regularly reviewed by the chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and (3) discrete financial information for the component is available to the Company. If two or more operating segments have similar economic characteristics, and certain conditions are satisfied, they may be aggregated into a single operating segment.

Intra-segment income and expenses are eliminated. Income and expenses directly associated with each segment are considered in determining segment performance.

2.3.23 Foreign currency translation

HK$ is the currency of the primary economic environment in which the Company operates. Therefore, the Company chooses HK$ as their functional currency and adopts HK$ to prepare its financial statements.

In preparing the financial statements, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions.

At the reporting date, foreign currency monetary items are translated into HK$ using the spot exchange rates at the reporting date. Exchange differences arising from the differences between the spot exchange rates prevailing at the reporting date and those on initial recognition or at the previous reporting date are recognized in profit or loss for the period except that (1) exchange differences related to hedging instruments for the purpose of hedging against foreign exchange risks are accounted for using hedge accounting and (2) exchange differences arising from available-for-sale non-monetary items denominated in foreign currencies and changes in the carrying amounts (other than the amortized cost) of available-for-sale monetary items are recognized as other comprehensive income.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.4 Critical accounting estimates and judgements in applying accounting policies

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense.

In preparing these financial statements, the significant judgements made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were as follow:

(a) Measurement of the expected credit loss ("ECL") allowance

The measurement of the expected credit loss allowance for financial assets measured at amortized cost and fair value through other comprehensive income is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behavior (e.g. the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 3.1.2 and 3.1.3, which also sets out key sensitivities of the ECL to changes in these elements.

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

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

Detailed information about the judgements and estimates made by the Company in the above areas is set out in note 3.1.2.

(b) Fair value of financial instruments

The fair values of financial instruments that are not quoted in active markets are determined by using valuation techniques (e.g. discounted cash flow model). To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty's), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

(c) Determination of lease term

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated).

For leases of retail stores, the following factors are normally the most relevant:

- If any leasehold improvements are expected to have significant remaining value, the Company is typically reasonably certain to extend (or not terminate).
- Otherwise, the Company considers other factors including historical leases durations and the costs and business disruption required to replace the leased asset.

The lease term is reassessed if an option is actually exercised (or not exercised) or the Company becomes obliged to exercise (or not exercise) it. The assessment of reasonable certainty is only revised if a significant event or a significant change in circumstances occurs, which affects this assessment, and that is within the control of the lessee.

3 FINANCIAL RISK MANAGEMENT

The Company's activities expose it to a variety of financial risks and those activities involve analysis, evaluation, acceptance and management of a certain degree of risks or a portfolio of risks. The Company's aim is to achieve an appropriate balance between risk and return and minimize potential adverse effects on the Company's financial performance.

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

The Board of Directors sets out strategies and risk preference for overall risk management strategy and decides the risk tolerance level. The senior management establishes related risk management policies and procedures under the strategy approved by the Board of Directors. Business Units act as the first line of defense in risk management while the Risk Management Department undertakes the main risk management operational functions of the Company. In addition, internal audit department is responsible for the independent review of risk management and the control environment.

The main types of financial risks of the Company are credit risk, liquidity risk, market risk and operational risk, etc. Market risk also includes foreign exchange risk, interest rate risk and other price risk.

3.1 Credit risk

Credit risk, the risk that a borrower or counterparty of the Company will be unable or unwilling to honor a repayment obligation, is one of the key risks encountered by the Company as the Company's main business is still dominated by credit business such as lending, billing and stock financing. If credit deterioration or default occurs, it will cause certain losses and affect the Company's business stability. Therefore, the risks must be strictly monitored. Starting with quality of business, the monitoring approach includes not only rigorous credit review but also ongoing post-lending monitoring. This ensures that the non-performing loan ratio is less than risk tolerance and there is sufficient provision for coverage. The Company manages and controls the overall credit risk in a prudent manner and reports regularly to the senior management and the Board of Directors of the Company.

3.1.1 Credit risk management

The Company's credit risk management is assumed by major functions including Corporate Business Management Department, Retail Business Management Department, Credit Card Centre, Credit Management Department, Risk Management Department, and Finance Department, which are responsible for the standardized management for corporate and retail credit businesses in terms of credit investment, credit investigation and report, credit approval, loan granting, post-loan monitoring and non-performing loan management.

(a) Loans and advances to customers

As for corporate loans, the Company's relationship managers are responsible for receiving application files submitted by the applicants, conducting pre-loan investigation, assessing the credit risk suffered by applicants and relevant businesses, and completing initial internal rating. The Company adopts the hierarchical approval system based on the credit approval authority. Credit line is determined by taking into account the credit record, financial position, collaterals and guarantees of the applicant, overall credit risk of the credit portfolio, macroeconomic regulation and control policies and relevant laws and regulations. The Company keeps a close eye on the economic and financial trend and credit risk profile in the industry and provides more guidance on credit investment by formulating guidance for different industries. It strengthens daily risk pre-warning, monitoring and specific risk investigation to identify customers under major risks and material potential risk points. With improvements in post-loan management, the Company enhanced the refinement of post-loan management in a practical manner. The independent Credit Management Department shall review the compliance, completeness and effectiveness of relevant credit files before loan granting according to the applications for drawdown of credit line. The Company's relationship manger is the person primarily responsible for post-loan management. The Company adopts a series of tools and approaches, such as risk filtering, list management, risk warning and risk investigation, in daily risk monitoring of corporate loans. To minimize the losses arising from credit risks, the Company manages NPLs mainly through (1) collection; (2) restructuring; (3) disposal of collaterals or recourse to the guarantor; (4) litigation or arbitration; and (5) write-off pursuant to regulations and requirements.

For retail credit assets, the Company adopts categorized management for retail credit assets on the basis of overdue ageing and guarantee mode. With regard to retail credit customers with overdue loans, different approaches are adopted to collect such loans based on their overdue days. Retail credit businesses overdue by a certain period shall be managed as impaired assets and relevant impairment allowance shall be provided for such assets.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management (continued)

(a) Loans and advances to customers (continued)

Credit Card Centre accounted for independently by the Company is in charge of the operation and management of credit card business. Credit Card Centre of the Company adopts various supervisory and preventive measures simultaneously. It reinforces data cross-validation to enhance risk prevention in the approval process, tightens credit line on high risk customers through secondary credit investigation to enter into the collection process earlier than scheduled, deploys collection strength in a proper manner to significantly enhance collection efficiency, and optimizes data analytic system to further propel the refined management of credit card business.

(b) Treasury business

For treasury business, the Company chooses banks and other financial institutions prudently and balances the credit risk and return rate of investments. By making reference to internal and external credit rating information, the Company adopts hierarchical credit and uses an appropriate credit limit management system to review and adjust credit lines, aiming to manage the credit risk exposed to the treasury business.

For debt investments, internal and external ratings (such as Standard and Poor's) are used by the Company when available for managing the credit risk exposed to debt investments and bills. The investment in those debts and bills is to have better credit quality assets while maintaining readily available funding sources. The bond issuers involved with the Company are subject to the credit granting review and approval of the Global Market Department, Credit Management Department and credit limits are placed on such issuers.

As for derivative instruments, the Company maintains strict limits on net open derivative investment positions (i.e., the difference between long and short contracts), by both amount and maturity. At any time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Company (i.e., assets where their fair value is positive), which, in relation to derivative instruments, is only a fraction of the contract's notional amount used to express the amount outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market fluctuations. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except when the Company requires margin deposits from counterparties. The management has set limits of these contracts according to counterparty, and regularly monitor and control the actual credit risk when the Company concludes foreign exchange and interest rate contracts with other financial institutions and clients.

The Company manages the credit quality of due from and placements with banks and other financial institutions by considering the size, financial position and the external credit rating of the banks and financial institutions. The Risk Management Department monitors and reviews the credit risk of due from and placements with banks and other financial institutions by counterparties periodically. Limits are placed on different counterparties.

(c) Credit-related commitments

Credit risk exposures to financial guarantees are the same as that of loans. However, commercial letters of credit are usually pledged by the relevant shipped goods, and therefore is subject to lower risk compared with direct loans. Credit related commitments are included in the management of overall credit line granted to the applicant. For customers with transactions beyond the credit limit or infrequent transactions, the applicant shall be requested to provide relevant guarantee in order to reduce credit risk exposures.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management (continued)

(d) Credit risk quality

In accordance with the Guideline on Loan Classification System issued by the HKMA, the Company has established a loan credit risk classification system and performs credit risk management based on loan classification in one of five categories. The Company classifies loans into the following five categories: normal, special-mention, substandard, doubtful and loss, of which substandard, doubtful and loss loans are regarded as non-performing loans.

The five categories of loan classification into which the Company classifies its loans and advances to customers are set out below:

Pass:	Loans for which borrowers are current in meeting commitments and for which the full repayment of interest and principal is not in doubt.
Special-mention:	Loans with which borrowers are experiencing difficulties and which may threaten the authorized institution's position.
Substandard:	Loans in which borrowers are displaying a definable weakness that is likely to jeopardise repayment.
Doubtful:	Loans for which collection in full is improbable and the authorized institution expects to sustain a loss of principal and/or interest, taking into account the net realizable value of collateral.
Loss:	Loans that are considered uncollectable after all collection options (such as the realization of collateral or the institution of legal proceedings) have been exhausted.

Regarding risk, the treasury business is classified into five categories based on five categories of loan classification.

(e) Credit risk measurement

The Company has established an internal rating system to measure credit risk arising from default events.

The credit risk internal rating system considers the "probability of default" by debtors (or debts). This is similar to the approach used for the purposes of measuring Expected Credit Loss ("ECL") under HKFRS 9. Please refer to note 3.1.2 for more details.

Probability of default is the probability of occurrence of default event in a given period of time in future.

Exposure at default represents the total amount of on-balance sheet and off-balance sheet exposure at the time of default by debtor, reflecting the total amount of possible losses to be incurred. In general, this includes the utilized credit limit, interest receivable, the anticipated usage of unused credit facilities as well as the related expenses to be incurred.

Loss given default represents the percentage of amount of loss to be occurred in the event of default to the total risk exposure. It is expressed as the loss percentage per unit of exposure which typically varies by nature of debtor, type and seniority of claim and the availability of collaterals or other credit enhancements.

The Company summarized a series of financial and other related factors to build the internal credit rating model to measure the probability of default, which is based on historical data collection, data statistics and data analysis on the characteristics of risks of the clients/debts before the default occurs. Internal rating model applies the principle of regression to forecast the probability of default and then matches the probability of default with relevant rank of default risk which is used for determination of the borrower's credit ranking within the internal rating system. In order to improve the model's accuracy and stability, the Company performs evaluation of the model every three months and monitors the results by performing back testing and comparing the results from model using the default from customers.

The above credit risk factors are considered for the measurement of possible credit losses to be incurred, and applied in the daily operations of the Company.

For retail business, the assets are categorized and credit risk is measured by aging analysis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management (continued)

(e) Credit risk measurement (continued)

For corporate business, the rating is determined at the borrower level. A relationship manager will incorporate any updated or new information/credit assessments into the credit system on an ongoing basis. In addition, the relationship manager will also update information about the creditworthiness of the borrower every year from sources such as public financial statements. This will determine the updated internal credit rating and the probability of default.

For debt securities in the Treasury portfolio, external rating agency credit grades are mapped onto the master scale. These published grades are continuously monitored and updated. The mapping to the master scale will determine the updated internal credit rating and the probability of default.

The Company's rating method comprises 18 rating levels for instruments not in default (1.1 to 1.4, 2 to 15) and one default class. The master scale assigns each rating category a specific range of probabilities of default, which is stable over time. The rating methods are subject to annual validation and recalibration so that they reflect the latest projections in light of all actual observed defaults.

The Company's internal rating scale and mapping of external ratings are set out below:

Internal Rating	PD Range	Corresponding Rating (S&P)	Description of Grade
1.1 – 4	0.03% – 0.53%	AAA to BBB–	Investment Grade
5 – 11	0.53% – 14.07%	BB+ to B–	Standard Monitoring
12 – 15	14.07% – 99.99%	CCC+ to C	Special Monitoring
Default	100.00%	D	Default

3.1.2 Expected credit loss measurement

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

If the credit risk on a financial instrument has not increased significantly since initial recognition, the financial instrument is classified in 'Stage 1' and has its credit risk continuously monitored by the Company.

If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 3.1.2.1 for a description of how the Company determines when a significant increase in credit risk has occurred.

If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 3.1.2.2 for a description of how the Company defined credit-impaired and default.

Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 3.1.2.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.

A pervasive concept in measuring ECL in accordance with HKFRS 9 is that it should consider forward-looking information. Note 3.1.2.4 includes an explanation of how the Company has incorporated this in its ECL models.

Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

The following diagram summaries the impairment requirements under HKFRS 9 (other than purchased or originated credit-impaired financial assets):

Stage 1	Stage 2	Stage 3
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired assets)
12- month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

The key judgements and assumptions adopted at the Company in addressing the requirements of the standards are addressed below.

3.1.2.1 Significant increase in credit risk (SICR)

The criteria for the determination of "a significant increase in credit risk" includes but is not limited to the following factors:

(a) Notch difference

For investment securities, significant increase in credit risk is assessed based on the notch difference threshold by comparing ratings at measurement date and initial recognition date.

Internal Rating	Notch Difference
1.1 – 1.3	4
1.4 – 4	3
5 – 8	2
9 – 15	1

(b) Day past due

Different levels of day past due are considered as significant credit deterioration criteria for different portfolios.

(c) Watch list

Qualitative and forward-looking information, e.g. industry outlook of obligor, future organization, restructure plan of obligor, are considered as criteria of adding to the watch list, which is considered as significant increase in credit risk. For investment securities, significant decrease in market price and external rating are considered as significant increase in credit risk.

(d) HKMA ratings

Under HKMA's Guideline on Loan Classification System, the Special Mention grade is considered as threshold for retail loan, corporate loan and credit card portfolio.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

(e) Other risk alarm indicators imply growing potential risk, and could cause losses of financial assets to the Company.

The financial assets are moveable between stages. For instance, financial instruments originally classified at stage 1 should be downgraded to stage 2 if events occur such as a significant increase in credit risk. Financial instruments at stage 2 could be upgraded to stage 1 if credit risk decreases and the criteria for the determination of "a significant increase in credit risk" are no longer met.

The assessment of significant increase in credit risk incorporates forward-looking information (refer to note 3.1.2.4 for further information) and is performed on a periodic basis at a counterparty level for all financial instruments held by the Company.

3.1.2.2 Definition of default and credit-impaired assets

The Company defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

- The borrower is more than 90 days past due on its contractual payments (with the sole exception of credit card where a borrower only needs to be 60 days past due to be considered in default).

- The borrower has been classified as Substandard, Doubtful or Loss under the HKMA classification system.

- The loan has been placed on individual assessment list (applicable only to loans).

The credit impairment definition has been applied consistently to model the probability of default, exposure at default and loss given default throughout the Company's expected loss calculations.

3.1.2.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The ECL is measured on either a 12-month or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of credit-impaired" above), either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.

- EAD is based on the amounts the Company expects to be owed at the time of default. For example, for a revolving commitment, the Company includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.

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

The ECL is determined by projecting the PD, LGD and EAD for each future year and for each individual exposure. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier year). This effectively calculates an ECL for each future year, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The Lifetime PD is developed by using forecasted macroeconomic factor to calculate a forecasted 12M PD for the 2nd to 5th year. For the years after the fifth year, it is assumed that the PD will remain the same.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement *(continued)*

3.1.2.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques (continued)

EAD represents the total amount of on-balance sheet and off-balance sheet exposure at the time of default by debtor, reflecting the total amount of possible losses to be incurred. In general, this includes the utilized credit limit, interest receivable, the anticipated usage of unused credit facilities as well as the related expenses to be incurred.

LGDs are determined based on the factors which impact the recoveries made post default. These vary by product type.

- For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/ book values due to forced sales, time to repossession and recovery costs observed.

- For unsecured products, LGD's are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGD's are influenced by collection strategies, including contracted debt sales and price.

3.1.2.4 Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Company has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio.

These economic variables and their associated impact on the PD, EAD and LGD vary by financial instrument. Expert judgment has also been applied in this process. Forecasts of these economic variables (the "base economic scenario") over the next five years are gathered from economics team of the Bank of Communications Co. Ltd., HKBR's Development Strategy Team and the International Monetary Fund (IMF). After five years, economic variables are assumed to remain stable and the last available forecast is used. The impact of these economic variables on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

In addition to the base economic scenario, the Company's Risk Management Department and Development Strategy Team have also considered other economic scenarios which are calculated using historical data, along with weightings for each of the scenarios. The number of other scenarios used is set based on the analysis of each major product type to ensure non-linearities are captured. The number of scenarios and their attributes are reassessed at each reporting date. At 31 December 2018 and 31 December 2019, the Company concluded that three scenarios appropriately captured non-linearities. The scenario weightings are determined by a combination of statistical analysis and expert credit judgement, taking account of the range of possible outcomes each chosen scenario is representative of.

Following this assessment, The Company then measures ECL as either a probability weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Company considers these forecasts to represent its best estimate of the possible outcomes and has analyzed the non-linearities and asymmetries within the Company's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios. The proposed macroeconomic forecasts and probability weightings are subject to management review.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

Economic variable assumptions

The scenarios "base", "upside" and "downside" were used for all portfolios. The most significant period-end assumptions used for the ECL estimate as at 31 December 2019 are set out below.

		2020	2021	2022	2023	2024
Hong Kong CPI	Base	**2.50%**	**2.50%**	**2.50%**	**2.50%**	**2.50%**
	Upside	**6.32%**	**5.84%**	**2.86%**	**-4.02%**	**-3.69%**
	Downside	**-1.66%**	**-3.06%**	**-2.50%**	**-0.45%**	**0.90%**
Hong Kong Unemployment rate	Base	**3.70%**	**4.00%**	**4.30%**	**4.50%**	**4.50%**
	Upside	**2.77%**	**2.20%**	**4.70%**	**6.25%**	**4.95%**
	Downside	**5.09%**	**7.32%**	**7.94%**	**6.81%**	**5.59%**
China Real GDP (first difference)	Base	**-0.10%**	**0.00%**	**-0.20%**	**-0.10%**	**-0.10%**
	Upside	**-1.08%**	**-0.65%**	**-1.58%**	**-0.03%**	**0.75%**
	Downside	**-0.10%**	**0.67%**	**0.98%**	**0.13%**	**1.15%**
US Real GDP (first difference)	Base	**-0.26%**	**-0.34%**	**-0.19%**	**0.02%**	**0.04%**
	Upside	**1.08%**	**0.69%**	**-0.04%**	**0.24%**	**-0.59%**
	Downside	**-3.12%**	**0.81%**	**1.02%**	**0.98%**	**-0.44%**

The weightings assigned to each economic scenario as at 31 December 2019 were as follows:

Upside	Base	Downside
20%	65%	15%

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

Economic variable assumptions (continued)

The most significant period-end assumptions used for the ECL estimate as at 31 December 2018 are set out below.

		2019	**2020**	**2021**	**2022**	**2023**
Hong Kong CPI	Base	1.50%	1.50%	1.50%	1.50%	1.50%
	Upside	6.32%	5.84%	2.86%	-4.02%	–3.69%
	Downside	-1.66%	–3.06%	–2.50%	–0.45%	0.90%
Hong Kong Unemployment rate	Base	3.20%	3.30%	3.40%	3.50%	3.50%
	Upside	2.77%	2.20%	4.70%	6.25%	4.95%
	Downside	5.09%	7.32%	7.94%	6.81%	5.59%
China Real GDP (first difference)	Base	-0.20%	0.00%	–0.10%	–0.10%	–0.10%
	Upside	-1.08%	–0.65%	–1.58%	–0.03%	0.75%
	Downside	-0.10%	0.67%	0.98%	0.13%	1.15%
US Real GDP (first difference)	Base	-0.34%	–0.73%	–0.09%	–0.24%	–0.11%
	Upside	1.08%	0.69%	-0.04%	0.24%	–0.59%
	Downside	-3.12%	0.81%	1.02%	0.98%	–0.44%

The weightings assigned to each economic scenario as at 31 December 2018 were as follows:

Upside	**Base**	**Downside**
25%	60%	15%

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

Sensitivity analysis

The following table presents the base ECL scenario compared to the probability-weighted ECL derived from using three ECL scenarios. The difference reflects the impact of deriving multiple scenarios around the base ECL and resultant change in ECL due to non-linearity and sensitivity to using macroeconomic forecasts.

Change from Base to Probability-weighted ECL	**As at 31 December 2019**	As at 31 December 2018
Probability-weighted ECL	**477,417**	324,147
Base ECL	**480,756**	291,262
Difference in amount	**(3,339)**	32,885
Difference in percentage	**(0.7%)**	10.1%

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment

The following tables contain an analysis of the credit risk exposure of financial instruments for when an ECL allowance is recognized.

The gross carrying amount of financial assets below also represents the company's maximum exposure of credit risk on these assets.

	2019			
	Stage 1	**Stage 2**	**Stage 3**	
Corporate Loan	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**10,474,278**	**–**	**–**	**10,474,278**
Standard Monitoring	**15,201,423**	**108,155**	**–**	**15,309,578**
Special Monitoring	**13,529**	**181,967**	**–**	**195,496**
Defaults	**–**	**–**	**32,605**	**32,605**
Unrated	**18,333,628**	**34,338**	**–**	**18,367,966**
Gross carrying amount	**44,022,858**	**324,460**	**32,605**	**44,379,923**
Loss allowance	**(138,330)**	**(16,797)**	**(14,316)**	**(169,443)**
Carrying amount	**43,884,528**	**307,663**	**18,289**	**44,210,480**

	2018			
	Stage 1	Stage 2	Stage 3	
Corporate Loan	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	12,460,563	–	–	12,460,563
Standard Monitoring	9,131,492	10,358	–	9,141,850
Special Monitoring	–	50,606	–	50,606
Defaults	–	–	17,900	17,900
Unrated	17,943,052	18,597	–	17,961,649
Gross carrying amount	39,535,107	79,561	17,900	39,632,568
Loss allowance	(141,821)	(8,578)	(8,236)	(158,635)
Carrying amount	39,393,286	70,983	9,664	39,473,933

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment (continued)

	2019			
Retail loan	**Stage 1 12 month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Investment Grade	**34,672,630**	**22,340**	**–**	**34,694,970**
Standard Monitoring	**158,575**	**204,003**	**–**	**362,578**
Special Monitoring	**–**	**20,337**	**–**	**20,337**
Defaults	**–**	**–**	**29,783**	**29,783**
Gross carrying amount	**34,831,205**	**246,680**	**29,783**	**35,107,668**
Loss allowance	**(90,033)**	**(43,605)**	**(14,329)**	**(147,967)**
Carrying amount	**34,741,172**	**203,075**	**15,454**	**34,959,701**

	2018			
Retail loan	Stage 1 12 month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Investment Grade	27,871,785	6,467	–	27,878,252
Standard Monitoring	168,877	165,443	182	334,502
Special Monitoring	–	29,377	208	29,585
Defaults	–	–	46,026	46,026
Gross carrying amount	28,040,662	201,287	46,416	28,288,365
Loss allowance	(34,877)	(23,384)	(15,318)	(73,579)
Carrying amount	28,005,785	177,903	31,098	28,214,786

	2019			
Due from banks and other financial institutions	**Stage 1 12 month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Investment Grade	**17,676,217**	**–**	**–**	**17,676,217**
Gross carrying amount	**17,676,217**	**–**	**–**	**17,676,217**
Loss allowance	**(8,309)**	**–**	**–**	**(8,309)**
Carrying amount	**17,667,908**	**–**	**–**	**17,667,908**

	2018			
Due from banks and other financial institutions	Stage 1 12 month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Investment Grade	25,088,522	–	–	25,088,522
Gross carrying amount	25,088,522	–	–	25,088,522
Loss allowance	(6,085)	–	–	(6,085)
Carrying amount	25,082,437	–	–	25,082,437

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment (continued)

	2019			
	Stage 1	**Stage 2**	**Stage 3**	
Debt securities at fair value through other comprehensive income	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**83,818,392**	**–**	**–**	**83,818,392**
Unrated	**38,413,916**	**–**	**–**	**38,413,916**
Gross carrying amount	**122,232,308**	**–**	**–**	**122,232,308**
Loss allowance	**(121,331)**	**–**	**–**	**(121,331)**
Carrying amount	**122,110,977**	**–**	**–**	**122,110,977**

	2018			
	Stage 1	Stage 2	Stage 3	
Debt securities at fair value through other comprehensive income (restated)	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	103,793,107	–	–	103,793,107
Unrated	5,511,965	–	–	5,511,965
Gross carrying amount	109,305,072	–	–	109,305,072
Loss allowance	(61,089)	–	–	(61,089)
Carrying amount	109,243,983	–	–	109,243,983

Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in notes 3.1.2.

3.1.3.2 Maximum exposure to credit risk – Financial instruments

The following table contains an analysis of the maximum credit risk exposure from financial assets not subject to impairment:

	Maximum exposure to credit risk	
	2019	2018
Financial assets at fair value through profit or loss		
Derivative financial instruments	**874,964**	1,290,050
Government bonds	**189,962**	544,483
Other debt securities	**–**	20,821
Total	**1,064,926**	1,855,354

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.3 Collateral and other credit enhancements

The Company manages limits and controls concentrations of credit risk wherever they are identified, in particular, to individual counterparties, company and groups and geographical regions.

The Company structures the levels of credit risk it undertakes by placing limits in relation to one borrower, or group of borrowers. Such risks are monitored on a regular basis and subject to annual or more frequent review, whenever necessary.

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

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing their lending limits where appropriate.

Some other specific control and risk mitigation measures are outlined below:

(a) Collaterals

The Company employs a range of policies and practices to mitigate credit risk. The most useful practice is to accept collaterals. The Company implements guidelines on the acceptability of specific classes of collaterals. The principal types of collaterals for loans and advances to customers are:

- Residential properties;
- Business assets such as premises, inventory and accounts receivable; and
- Financial instruments such as debt securities and stocks.

Long-term loans and advances to corporate and individual customers are generally secured; while revolving individual credit facilities are generally unsecured. In addition, in order to minimize the credit loss the Company will seek additional collaterals from the counterparties as soon as impairment indicators are noted for the relevant individual loans and advances.

For loans guaranteed by a third-party guarantor, the Company will assess the financial condition, credit history and ability to meet obligations of the guarantor.

Collaterals held as security for financial assets other than loans and advances to customers are determined by the nature of the instrument. Debt securities and treasury bonds are generally unsecured, with the exception of asset backed securities, which are secured by portfolios of financial instruments.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.3 Collateral and other credit enhancements (continued)

(a) Collaterals (continued)

The Company closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Company will take possession of collateral to mitigate potential credit losses. The fair value is capped at lower of carrying amount and fair value. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

As at 31 December 2019:

	Gross exposure	**ECL allowance**	**Carrying amount**	**Fair value of collateral held**
Loans to individuals	**29,783**	**(14,329)**	**15,454**	**13,687**
Loans to corporate entities	**32,605**	**(14,316)**	**18,289**	**10,560**
	62,388	**(28,645)**	**33,743**	**24,247**

As at 31 December 2018:

	Gross exposure	ECL allowance	Carrying amount	Fair value of collateral held
Loans to individuals	46,416	(15,318)	31,098	29,241
Loans to corporate entities	17,900	(8,236)	9,664	9,664
	64,316	(23,554)	40,762	38,905

(b) Master netting arrangements

The Company further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of assets and liabilities in the statement of financial position, as transactions are usually settled on a gross basis. However, the credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if a default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Company's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period, as each transaction subject to the arrangement affects credit risk.

3.1.4 Movements of gross carrying amount and ECL allowance

The loss allowance recognized in the period is impacted by a variety of factors, such as:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent step up (or step down) between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognized during the period, as well as releases for financial instruments derecognized in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis; and
- Financial assets derecognized during the period and write-offs of allowances related to assets that were written off during the period (see note 3.1.5).

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

The following tables explain the changes in the loss allowance between the beginning and the end of the annual period due to these factors:

Movement of gross amount – Corporate Loan

Corporate loan	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Gross carrying amount as at 1 January 2019	**39,535,107**	**79,561**	**17,900**	**39,632,568**
Transfers:				
Transfer from Stage 1 to Stage 2	**(124,257)**	**124,257**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(12,789)**	**–**	**12,789**	**–**
Transfer from Stage 2 to Stage 1	**21,431**	**(21,431)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(2,390)**	**2,390**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**4,648,945**	**144,463**	**(452)**	**4,792,956**
Foreign Exchange and other movements	**(45,579)**	**–**	**(22)**	**(45,601)**
Gross carrying amount as at 31 December 2019	**44,022,858**	**324,460**	**32,605**	**44,379,923**

Corporate Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Gross carrying amount as at 1 January 2018	225,391,235	3,074,621	534,753	229,000,609
Transfer of Excluded Business to HKBR (Note 2)	(200,702,708)	(2,566,843)	(448,179)	(203,717,730)
Transfers:				
Transfer from Stage 1 to Stage 2	(83,975)	83,975	–	–
Transfer from Stage 1 to Stage 3	(5,683)	–	5,683	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	14,936,160	(512,190)	(74,357)	14,349,613
Foreign exchange and other movements	78	(2)	–	76
Gross carrying amount as at 31 December 2018	39,535,107	79,561	17,900	39,632,568

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Corporate Loan

Corporate Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance as at 1 January 2019	**141,821**	**8,578**	**8,236**	**158,635**
Transfers:				
Transfer from Stage 1 to Stage 2	**(941)**	**941**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(107)**	**–**	**107**	**–**
Transfer from Stage 2 to Stage 1	**2,317**	**(2,317)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(374)**	**374**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**17,600**	**3,534**	**1,705**	**22,839**
Changes in PDs/LGDs/EADs	**(22,040)**	**6,274**	**3,799**	**(11,967)**
Unwind of discount (Note a)	**–**	**203**	**–**	**203**
Foreign Exchange and other movements	**(320)**	**(42)**	**95**	**(267)**
Loss allowance amount as at 31 December 2019	**138,330**	**16,797**	**14,316**	**169,443**

Corporate Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance as at 1 January 2018	875,665	34,744	264,855	1,175,264
Transfer of Excluded Business to HKBR (Note 2)	(856,478)	(34,654)	(242,222)	(1,133,354)
Transfers:				
Transfer from Stage 1 to Stage 2	(738)	738	–	–
Transfer from Stage 1 to Stage 3	(10)	–	10	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	173,404	(12)	(17,896)	155,496
Changes in PDs/LGDs/EADs	(26,084)	7,735	272	(18,077)
Foreign Exchange and other movements	(23,938)	27	3,217	(20,694)
Loss allowance amount as at 31 December 2018	141,821	8,578	8,236	158,635

Note a: The unwind of discount on Stage 3 financial assets is reported within 'interest income' so that interest income is recognized on the amortized cost (after deducting the ECL allowance).

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of gross amount – Retail Loan

Retail Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Gross carrying amount as at 1 January 2019	**28,040,662**	**201,287**	**46,416**	**28,288,365**
Transfers:				
Transfer from Stage 1 to Stage 2	**(185,428)**	**185,428**	–	**–**
Transfer from Stage 1 to Stage 3	**(18,522)**	–	**18,522**	**–**
Transfer from Stage 2 to Stage 1	**89,474**	**(89,474)**	–	**–**
Transfer from Stage 2 to Stage 3	–	**(1,357)**	**1,357**	**–**
Transfer from Stage 3 to Stage 1	**74**	–	**(74)**	**–**
Transfer from Stage 3 to Stage 2	–	**495**	**(495)**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**6,910,503**	**(49,586)**	**(29,148)**	**6,831,769**
Write-offs	**–**	**–**	**(6,794)**	**(6,794)**
Foreign exchange and other movements	**(5,558)**	**(113)**	**(1)**	**(5,672)**
Gross carrying amount as at 31 December 2019	**34,831,205**	**246,680**	**29,783**	**35,107,668**

Retail Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Gross carrying amount as at 1 January 2018	28,553,939	188,847	22,149	28,764,935
Transfers:				
Transfer from Stage 1 to Stage 2	(171,510)	171,510	–	–
Transfer from Stage 1 to Stage 3	(28,322)	–	28,322	–
Transfer from Stage 2 to Stage 1	117,476	(117,476)	–	–
Transfer from Stage 2 to Stage 3	–	(263)	263	–
Transfer from Stage 3 to Stage 1	2	–	(2)	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	(432,580)	(41,337)	2,090	(471,827)
Write-offs	–	–	(6,405)	(6,405)
Foreign exchange and other movements	1,657	6	(1)	1,662
Gross carrying amount as at 31 December 2018	28,040,662	201,287	46,416	28,288,365

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Retail Loan

Retail Loan	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Loss allowance amount as at 1 January 2019	**34,877**	**23,384**	**15,318**	**73,579**
Transfers:				
Transfer from Stage 1 to Stage 2	**(409)**	**409**	–	**–**
Transfer from Stage 1 to Stage 3	**(44)**	–	**44**	**–**
Transfer from Stage 2 to Stage 1	**15,529**	**(15,529)**	–	**–**
Transfer from Stage 2 to Stage 3	–	**(266)**	**266**	**–**
Transfer from Stage 3 to Stage 1	**13**	–	**(13)**	**–**
Transfer from Stage 3 to Stage 2	**–**	**506**	**(506)**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**22,116**	**1,482**	**(845)**	**22,753**
Unwind of discount (Note a)	**–**	**558**	**–**	**558**
Changes in PDs/LGDs/EADs	**18,127**	**33,178**	**6,546**	**57,851**
Write-offs	**–**	**–**	**(6,794)**	**(6,794)**
Foreign Exchange and other movements	**(176)**	**(117)**	**313**	**20**
Loss allowance amount as at 31 December 2019	**90,033**	**43,605**	**14,329**	**147,967**

Retail Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance amount as at 1 January 2018	45,526	28,937	22,332	96,795
Transfers:				
Transfer from Stage 1 to Stage 2	(347)	347	–	–
Transfer from Stage 1 to Stage 3	(47)	–	47	–
Transfer from Stage 2 to Stage 1	23,292	(23,292)	–	–
Transfer from Stage 2 to Stage 3	–	(84)	84	–
Transfer from Stage 3 to Stage 1	6	–	(6)	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	(2,239)	(375)	57	(2,557)
Unwind of discount (Note a)	–	454	–	454
Changes in PDs/LGDs/EADs	(33,865)	17,395	6,064	(10,406)
Write-offs	–	–	(6,405)	(6,405)
Foreign Exchange and other movements	2,551	2	(6,855)	(4,302)
Loss allowance amount as at 31 December 2018	34,877	23,384	15,318	73,579

Note a: The unwind of discount on Stage 3 financial assets is reported within 'interest income' so that interest income is recognized on the amortized cost (after deducting the ECL allowance).

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – loans and advances to customers

Loans and advances to customers	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Loss allowance amount as at 1 January 2019	**176,698**	**31,962**	**23,554**	**232,214**
Transfers:				
Transfer from Stage 1 to Stage 2	**(1,350)**	**1,350**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(151)**	**–**	**151**	**–**
Transfer from Stage 2 to Stage 1	**17,846**	**(17,846)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(640)**	**640**	**–**
Transfer from Stage 3 to Stage 1	**13**	**–**	**(13)**	**–**
Transfer from Stage 3 to Stage 2	**–**	**506**	**(506)**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**39,716**	**5,016**	**860**	**45,592**
Changes in PDs/LGDs/EADs	**(3,913)**	**39,452**	**10,345**	**45,884**
Unwind of discount (Note a)	**–**	**761**	**–**	**761**
Write-offs	**–**	**–**	**(6,794)**	**(6,794)**
Foreign Exchange and other movements	**(496)**	**(159)**	**408**	**(247)**
Loss allowance amount as at 31 December 2019	**228,363**	**60,402**	**28,645**	**317,410**

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance amount as at 1 January 2018	921,191	63,681	287,187	1,272,059
Transfer of Excluded Business to HKBR (Note 2)	(856,478)	(34,654)	(242,222)	(1,133,354)
Transfers:				
Transfer from Stage 1 to Stage 2	(1,085)	1,085	–	–
Transfer from Stage 1 to Stage 3	(57)	–	57	–
Transfer from Stage 2 to Stage 1	23,292	(23,292)	–	–
Transfer from Stage 2 to Stage 3	–	(84)	84	–
Transfer from Stage 3 to Stage 1	6	–	(6)	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	171,165	(387)	(17,839)	152,939
Changes in PDs/LGDs/EADs	(59,949)	25,130	6,336	(28,483)
Unwind of discount (Note a)	–	454	–	454
Write-offs	–	–	(6,405)	(6,405)
Foreign Exchange and other movements	(21,387)	29	(3,638)	(24,996)
Loss allowance amount as at 31 December 2018	176,698	31,962	23,554	232,214

Note a: The unwind of discount on Stage 3 financial assets is reported within 'interest income' so that interest income is recognized on the amortized cost (after deducting the ECL allowance).

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of gross carrying amount – Due from banks and other financial institutions

Due from banks and other financial institutions	**Stage 1 12-month ECL allowance**	**Stage 2 Lifetime ECL allowance**	**Stage 3 Lifetime ECL allowance**	**Total**
Gross carrying amount as at 1 January 2019	**25,088,522**	**–**	**–**	**25,088,522**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**(7,412,305)**	**–**	**–**	**(7,412,305)**
Gross carrying amount as at 31 December 2019	**17,676,217**	**–**	**–**	**17,676,217**

Due from banks and other financial institutions	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
Gross carrying amount as at 1 January 2018	105,855,209	–	–	105,855,209
Transfer of Excluded Business to HKBR (Note 2)	(164,809,851)	–	–	(164,809,851)
New financial assets originated or purchased, assets derecognized, repayments and further lending	84,043,164	–	–	84,043,164
Gross carrying amount as at 31 December 2018	25,088,522	–	–	25,088,522

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Due from banks and other financial institutions

Due from banks and other financial institutions	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance amount as at 1 January 2019	**6,085**	**–**	**–**	**6,085**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**1,868**	**–**	**–**	**1,868**
Change in PDs/LGDs/EADs	**356**	**–**	**–**	**356**
Foreign exchange and other movements	**–**	**–**	**–**	**–**
Loss allowance amount as at 31 December 2019	**8,309**	**–**	**–**	**8,309**

Due from banks and other financial institutions	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance amount as at 1 January 2018	28,284	–	–	28,284
Transfer of Excluded Business to HKBR (Note 2)	(33,777)	–	–	(33,777)
New financial assets originated or purchased, assets derecognized, repayments and further lending	11,586	–	–	11,586
Foreign exchange and other movements	(8)	–	–	(8)
Loss allowance amount as at 31 December 2018	6,085	–	–	6,085

Movement of gross amount – Debt securities at fair value through other comprehensive income

Debt securities at fair value through other comprehensive income	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2019	**109,305,072**	**–**	**–**	**109,305,072**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**13,396,487**	**–**	**–**	**13,396,487**
Foreign exchange and other movements	**(469,251)**	**–**	**–**	**(469,251)**
Gross carrying amount as at 31 December 2019	**122,232,308**	**–**	**–**	**122,232,308**

Debt securities at fair value through other comprehensive income	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2018	185,586,498	727,049	–	186,313,547
Transfer of Excluded Business to HKBR (Note 2)	(245,146,574)	(727,049)	–	(245,873,623)
New financial assets originated or purchased, assets derecognized, repayments and further lending	168,865,148	–	–	168,865,148
Gross carrying amount as at 31 December 2018	109,305,072	–	–	109,305,072

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Debt securities at fair value through other comprehensive income

Debt securities at fair value through other comprehensive income	**Stage 1** **12-month ECL allowance**	**Stage 2** **Lifetime ECL allowance**	**Stage 3** **Lifetime ECL allowance**	**Total**
Loss allowance amount as at 1 January 2019	**61,089**	**–**	**–**	**61,089**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**52,428**	**–**	**–**	**52,428**
Changes in PDs/LGDs/EADs	**7,814**	**–**	**–**	**7,814**
Loss allowance amount as at 31 December 2019	**121,331**	**–**	**–**	**121,331**

Debt securities at fair value through other comprehensive income	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
Loss allowance amount as at 1 January 2018	91,858	414	–	92,272
Transfer of Excluded Business to HKBR (Note 2)	(98,668)	(414)	–	(99,082)
New financial assets originated or purchased, assets derecognized, repayments and further lending	67,899	–	–	67,899
Loss allowance amount as at 31 December 2018	61,089	–	–	61,089

Financial guarantee and credit related commitment	**Stage 1** **12-month ECL**	**Stage 2** **Lifetime ECL**	**Stage 3** **Lifetime ECL**	**Total**
Gross carrying amount as at 31 December 2019	**11,780,758**	**9,303**	**–**	**11,790,061**
Gross carrying amount as at 31 December 2018	**12,082,761**	**38,937**	**–**	**12,121,698**

Financial guarantees and credit related commitment	**Stage 1** **12-month ECL**	**Stage 2** **Lifetime ECL**	**Stage 3** **Lifetime ECL**	**Total**
Loss allowance amount as at 31 December 2019	**12,780**	**2,092**	**–**	**14,872**
Loss allowance amount as at 31 December 2018	**9,588**	**1,353**	**–**	**10,941**

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.5 Write-off policy

The Company writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include but is not limited to (i) ceasing enforcement activity and (ii) where the Company's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovering in full.

The Company may write-off financial assets that are still subject to enforcement activity. The Company still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

3.1.6 Modification of Financial Assets

The amortized cost of financial assets that were modified during the year ended 31 December 2019 was HK$5.1 million (31 December 2018: HK$2.6 million) before modification, with insignificant modification gain or loss. As of 31 December, 2019, there have been no significant modified assets for which the loss allowance has changed from lifetime to twelve month expected credit loss.

3.1.7 Derivative instruments

The Company undertakes its transactions in foreign exchange, interest rate derivative contracts and others with other financial institutions and customers. The management has established limits for these contracts based on counterparties, industry sectors and countries. Actual credit exposures and limits are regularly monitored and controlled by management.

Settlement risk arises mainly from foreign exchange transactions with counterparties and also from derivatives transactions 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 risk arising from the Company's market transactions on any single day.

3.1.8 Repossessed assets

Repossessed assets are collateral of the outstanding indebtedness that the Company takes possession of the collateral assets thorough court proceedings or voluntary delivery actions by the borrower. It will be sold as soon as practicable with the proceeds used to repay the outstanding indebtedness.

As at 31 December 2019 and 2018 , there was no repossessed asset that being held by the Company.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.9 Concentration risk analysis for loans and advances to customers with credit risk exposure

The Company mainly manages concentration risk for loans and advances to customers by geographical sectors. The following tables are the geographical analysis of gross loans and advances to customers:

Geographical sectors

	2019	2018
Mainland China	**10,630,761**	12,793,225
Hong Kong	**68,517,199**	54,913,438
Others	**371,065**	214,270
	79,519,025	67,920,933

3.2 Market risk

3.2.1 Overview

The Company takes on exposure to market risks, which is initiated by the fluctuation of the fair value of or future cash flow of financial instruments as a result of the changes of the market prices. Market risks arise from open positions in interest rates, exchange rates and equity products, all of which are exposed to market fluctuations and changes in interest rates, foreign exchange rates and equity products.

The Company established a management model of "large and small middle offices" for its market risk management, which is a centralized control framework led by Board of Directors and senior management. With the establishment of segregation of different duties, the Risk Management Department formulates market risk policies and ensures the Company's exposure are within risk appetite of the Board of Directors, while Global Markets Department is the execution unit of market risk management. The Internal Audit Department is responsible for independent verification of the market risk management system policies and processes.

The Company monitors market risk separately in respect of trading portfolios and non-trading portfolios. The trading account consists of financial instruments held either for trading intent or economic hedging for other elements of the account. The non-trading account consists of the investments purchased by the Company with excess funds and other financial instruments that are not captured in the trading account.

With regard to the exchange rate risks and the interest rate risks of trading book, the Company established an effective limit management system by implementing Net Position, Risk Sensitivity, Value at Risk ("VaR") and other indicators. Net interest income sensitivity analysis, interest rate repricing gap analysis and foreign exchange risk concentration analysis are the major tools used by the Company to monitor the market risk of its overall businesses. In addition, through adequate pricing management and asset allocation, the Company strived to maximize its rate of return while keeping its risks under control.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.1 Overview (continued)

The Company has continuously improved the management system of market risk. The Company conducted stress tests on historical scenarios and hypothetical scenarios in the consideration of the Company's major market risk factors. The Company has implemented daily automatic collection of trading data and market data in the system. The Company conducted the management of risk capital and VaR quota, and formulated the quota allocation plans.

As part of market risk management, the Company enters into interest rate swaps to match the interest rate risk associated with the structured deposits and fix-rate long-term debt securities.

The major measurement techniques used to measure and control market risk are outlined below:

3.2.2 VaR

VaR refers to the maximum loss that an investment portfolio may incur at a given confidence level and holding period caused by the changes in market price factors such as interest rates and exchange rates etc. The Company adopted the historical simulation method to calculate daily VaR (99% confidence interval, the holding period of one day).

A summary of VaR by risk type of the Company's portfolios is as follows:

	For the year ended 31 December 2019			
Items	**31 December 2019**	**Average**	**Maximum**	**Minimum**
VaR	**1,422**	**1,071**	**3,324**	**182**
– Interest rate risk	**1,519**	**1,465**	**2,360**	**4**
– Foreign exchange risk	**2,111**	**1,797**	**4,182**	**732**

	For the year ended 31 December 2018			
Items	31 December 2018	Average	Maximum	Minimum
VaR	1,188	2,438	24,085	387
– Interest rate risk	369	1,615	21,444	–
– Foreign exchange risk	1,312	3,327	35,902	387

3.2.3 Sensitivity tests

Interest rate sensitivity test

The Company performs interest rate sensitivity analysis on net interest income for the Company by measuring the impact of a change in net interest income of financial assets and liabilities, not taking customer behaviour and repayment option into consideration.

On an assumption of a parallel shift of 100 basis points in RMB, USD and HKD interest rates, the Company calculates the changes in net interest income for the year on a monthly basis.

The table below illustrates the impact to net interest income of the coming year of the Company based on the structure of interest bearing assets and liabilities as at 31 December 2019 and 31 December 2018, caused by a parallel shift of 100 basis points of RMB, USD and HKD interest rates.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.3 Sensitivity tests (continued)

Interest rate sensitivity test (continued)

	Expected changes in net interest income	
	As at 31 December 2019	As at 31 December 2018
+100 basis points parallel shift in yield curves	**(174,814)**	71,935
-100 basis points parallel shift in yield curves	**174,814**	(71,935)

The results of the interest rate sensitivity tests set out in the table above are illustrative only and are based on simplified scenarios. The figures represent the projected impact to the net interest income caused by the projected movement of current interest risk structure yield curves. This effect, however, does not take into account actions that would be taken by the Company to mitigate the impact of interest rate changes. The projections above also assume that interest rates of all maturities excluding demand deposits move by the same amount and, therefore, do not reflect the potential impact on net interest income due to changes in certain rates while others remain unchanged. The projections make other simplifying assumptions as well, including that all positions are to be held to maturity. There will be changes to the projection if positions are not held to maturity but it is not expected that the changes would be material.

Foreign exchange sensitivity test

The Company performs exchange rate sensitivity analysis on net profit and equity for the Company by measuring the impact of a change in exchange rate on financial assets and liabilities denominated in different currencies. Since HK$ is pegged to USD under linked exchange rate system, no sensitivity analysis against USD is presented. On an assumption of an appreciation or depreciation of RMB spot and forward rates against HK$ by 5%, the Company calculates the changes in net profit and other comprehensive income for the year on a monthly basis.

The table below illustrates the impact of an appreciation or depreciation of RMB spot and forward rates against HK$ by 5% on the Company's net profit and equity:

	Expected changes in net profit and equity	
	As at 31 December 2019	As at 31 December 2018
5% appreciation of RMB	**(796,224)**	1,098,095
5% depreciation of RMB	**796,224**	(1,098,095)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.4 Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the market value of a financial instrument will fluctuate because of changes in market interest rates.

The Company takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows.

The interest rate repricing risk for foreign currency denominated debt securities and the remaining part of the financial guarantees and credit commitments businesses which are not based upon these basic interest rates is not expected to be significant.

The tables below summarize the Company's exposures to interest rate risks. The tables show the Company's assets and liabilities at carrying amounts, categorized by the earlier of contractual repricing or maturity dates.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.4 Interest rate risk (continued)

	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non-interest bearing	Total
As at 31 December 2019							
Assets							
Cash and balances with central bank	–	–	–	–	–	1,094,956	1,094,956
Due from banks and other financial institutions	6,675,582	10,992,326	–	–	–	–	17,667,908
Financial assets at fair value through profit or loss	–	155,478	34,484	–	–	874,964	1,064,926
Financial assets at fair value through other comprehensive income	21,797,930	51,856,957	11,323,189	24,118,908	13,135,324	9,965	122,242,273
Loans and advances to customers	71,775,867	4,803,560	384,790	337,202	1,900,196	–	79,201,615
Other financial assets	–	–	–	–	–	5,418,372	5,418,372
Total financial assets	100,249,379	67,808,321	11,742,463	24,456,110	15,035,520	7,398,257	226,690,050
Liabilities							
Due to banks and other financial institutions	7,102,118	20,060,545	1,556,264	–	–	17,643	28,736,570
Due to customers	104,042,804	48,076,879	16,294,765	1,819	–	2,339,022	170,755,289
Financial liabilities at fair value through profit or loss	–	–	–	–	–	1,168,798	1,168,798
Lease liabilities	15,241	29,375	103,545	152,287	1,040	–	301,488
Other financial liabilities	–	–	–	–	–	4,378,083	4,378,083
Total financial liabilities	111,160,163	68,166,799	17,954,574	154,106	1,040	7,903,546	205,340,228
Total interest sensitivity gap	(10,910,784)	(358,478)	(6,212,111)	24,302,004	15,034,480	(505,289)	21,349,822

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.4 Interest rate risk (continued)

	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non-interest bearing	Total
As at 31 December 2018							
Assets							
Cash and balances with central bank	–	–	–	–	–	2,353,780	2,353,780
Due from banks and other financial institutions	14,626,550	10,075,887	380,000	–	–	–	25,082,437
Financial assets at fair value through profit or loss	–	20,821	544,483	–	–	1,290,050	1,855,354
Financial assets at fair value through other comprehensive income	20,030,202	31,765,511	42,112,452	13,165,599	2,231,308	9,990	109,315,062
Loans and advances to customers	56,489,616	7,140,491	1,117,481	1,147,727	1,793,404	–	67,688,719
Other financial assets	–	–	–	–	–	1,429,059	1,429,059
Total financial assets	91,146,368	49,002,710	44,154,416	14,313,326	4,024,712	5,082,879	207,724,411
Liabilities							
Due to banks and other financial institutions	13,035,005	8,077,074	–	–	–	14,872	21,126,951
Due to customers	78,186,275	28,167,636	53,131,413	2,645	–	2,586,714	162,074,683
Financial liabilities at fair value through profit or loss	–	–	–	–	–	467,764	467,764
Other financial liabilities	–	–	–	–	–	5,280,872	5,280,872
Total financial liabilities	91,221,280	36,244,710	53,131,413	2,645	–	8,350,222	188,950,270
Total interest sensitivity gap	(74,912)	12,758,000	(8,976,997)	14,310,681	4,024,712	(3,267,343)	18,774,141

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.5 Foreign exchange risk

The Company conducts the majority of its businesses in HK$, with certain foreign transactions in USD, RMB and other currencies. The Company takes on exposure to the effects of fluctuations in the prevailing foreign exchange rates and changes on its financial position and cash flows. The senior management sets limits on the level of exposure in exchange rate risk and monitors the exposure regularly. The tables below summarize the Company's exposure to foreign exchange risk at the end of the year. The tables show the Company's total assets and liabilities in carrying amounts in HK$, are categorized by the original currency.

	HK$	RMB (HK$ Equivalent)	USD (HK$ Equivalent)	Others (HK$ Equivalent)	Total
As at 31 December 2019					
Assets					
Cash and balances with central bank	1,053,928	24,047	9,960	7,021	1,094,956
Due from banks and other financial institutions	14,400,318	231,532	694,820	2,341,238	17,667,908
Financial assets at fair value through profit or loss	771,072	189,970	103,826	58	1,064,926
Financial assets at fair value through other comprehensive income	9,868,713	11,696,443	73,939,649	26,737,468	122,242,273
Loans and advances to customers	68,270,613	276,087	10,637,366	17,549	79,201,615
Other financial assets	4,424,277	133,769	789,592	70,734	5,418,372
Total financial assets	98,788,921	12,551,848	86,175,213	29,174,068	226,690,050
Liabilities					
Due to banks and other financial institutions	6,246,364	24,006	22,336,912	129,288	28,736,570
Due to customers	101,926,676	26,899,726	34,250,657	7,678,230	170,755,289
Financial liabilities at fair value through profit or loss	973,920	–	194,862	16	1,168,798
Lease liabilities	301,488	–	–	–	301,488
Other financial liabilities	1,983,634	1,552,595	756,883	84,971	4,378,083
Total financial liabilities	111,432,082	28,476,327	57,539,314	7,892,505	205,340,228
Net position	(12,643,161)	(15,924,479)	28,635,899	21,281,563	21,349,822

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.5 Foreign exchange risk (continued)

	HK$	RMB (HK$ Equivalent)	USD (HK$ Equivalent)	Others (HK$ Equivalent)	Total
As at 31 December 2018					
Assets					
Cash and balances with central bank	2,298,318	37,534	12,390	5,538	2,353,780
Due from banks and other financial institutions	11,956,572	2,771,471	8,095,903	2,258,491	25,082,437
Financial assets at fair value through profit or loss	1,291,511	559,903	3,940	–	1,855,354
Financial assets at fair value through other comprehensive income	10,358,704	51,101,942	32,422,542	15,431,874	109,315,062
Loans and advances to customers	56,280,306	952,986	10,448,190	7,237	67,688,719
Other financial assets	801,818	318,023	223,887	85,331	1,429,059
Total financial assets	82,987,229	55,741,859	51,206,852	17,788,471	207,724,411
Liabilities					
Due to banks and other financial institutions	3,643,886	11,793,287	5,650,743	39,035	21,126,951
Due to customers	96,528,813	21,630,426	35,937,504	7,977,940	162,074,683
Financial liabilities at fair value through profit or loss	438,633	12	29,119	–	467,764
Other financial liabilities	2,143,432	356,231	2,684,968	96,241	5,280,872
Total financial liabilities	102,754,764	33,779,956	44,302,334	8,113,216	188,950,270
Net position	(19,767,535)	21,961,903	6,904,518	9,675,255	18,774,141

3.2.6 Other price risk

The Company is exposed to other price risk arising from financial assets such as equity investments and derivatives linked to commodity price. The Company considers the exposure to the other price risk to be insignificant.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk

3.3.1 Overview

Liquidity risk is the risk that the Company will be unable to meet its payment obligations associated with its financial liabilities when they fall due and other current liquidity needs. The consequence may be the failure to meet obligations to repay depositors and fulfill loan commitments for lending. The Company's objective in liquidity management is to ensure the availability of adequate funding to meet the demands of fund deposit withdrawals and other liabilities as they fall due and to ensure that it is able to meet its obligations to fund loan originations and commitments and to take advantage of new investment opportunities.

The Company is exposed to daily calls on its available cash resources from overnight deposits, current accounts, matured deposits, loan drawdowns, guarantees and from margin and other calls on cash settled derivatives. The Company set limits on the minimum proportion of funds to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover different levels of unexpected withdrawals.

3.3.2 Liquidity risk management process

Funding liquidity risk relates to the Company's ability to fulfill its obligations arising from financial liabilities as they fall due, or its ability to fulfill maturing funding needs, which subsequently affects the Company's capacity to support deposit withdrawal or drawdown on loan commitments. Effective liquidity risk management helps to sustain the expansion of the Company's business with liquidity cost and risk under control. The Company has established and implemented its own liquidity risk management policy per local regulatory requirements in order to fulfill its liquidity risk management. The Asset and Liability Management Committee (ALCO) of the Company is the decision-making body in balance sheet management and is responsible for coordinating and overseeing all related strategies, including risk management framework and risk appetite. Asset and Liability Management Department is responsible for analyzing and monitoring activities related to liquidity risk. Global Markets Department is responsible for managing daily liquidity position and related executions. Internal Audit Department is responsible for conducting periodic review to ensure liquidity risk management framework is effectively implemented.

The cornerstone of the Company's funding sources is customer deposit. The Company strives to build up core deposits while diversifying funding sources via various funding channels to enhance financing capacity. Regarding liquidity arrangement with parent bank, the Company performs regular funding transfer with parent bank to preserve prompt intragroup backup funding supply if necessary. Monitoring and control on intragroup funding transactions are in line with those of third parties. Moreover, parent bank has set up groupwide internal limits to control the Company's reliance on parent bank's funding.

The majority of the liquidity risk of the Company arises from maturity mismatch of assets and liabilities. Therefore, regular cash flow analysis and projections on both on- and off-balance sheet items falling within different maturity buckets is performed to ensure funding need. Moreover, the Company closely monitors off-balance sheet funding obligations (such as commitments or letters of guarantee) and assesses their impact to our liquidity capacity. Furthermore, the Company strives to maintain high marketability of the asset portfolio to allow prompt monetization in case of unforeseeable liquidity crunch in the market.

The Company has in place various limits and indicators for liquidity risk, including liquidity coverage ratio, loan-to-deposit ratio, concentration limits on customer deposits, interbank borrowing utilization ratio, etc. for effective identification and control of liquidity risk. The Company utilizes relevant management information systems to perform daily liquidity risk management functions. Moreover, the Company performs daily cash flow analysis to assess liquidity in normal circumstances, and performs regular stress test (at least monthly) to evaluate the Company's resilience under significant stress conditions. The stress test scenarios are designed with reference to the HKMA's Supervisory Policy Manuals, and also historical liquidity stress scenarios. The Company's stress test takes into account the impact of all assets, liabilities and off-balance sheet positions and estimates possible funding short-fall with historical data and plausible stress conditions. The results will be scrutinized and appropriate measures will be taken if necessary.

The Company has set up early warning indicator system, and movement of relevant indicators are closely monitored on a regular basis. In case of liquidity crisis emerges, the Company's Crisis Management Committee will be formed to formulate appropriate contingency funding plan to resolve the crisis. The Company also performs regular drill in order to ensure prompt actions and feasibility of contingency funding plan under crisis.

To cope with unpredictable liquidity needs, the Company has set up liquidity buffer to maintain sufficient highly liquid assets. The buffer portfolio contains cash, Exchange Fund Bills/Notes¸ unencumbered sovereign bonds and other high quality bonds, which is managed by Asset and Liability Management Department and operated by Global Markets Department on a daily basis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.3 Non-derivative financial instruments cash flows

The table below presents the cash flows of the Company related to non-derivative financial liabilities (including accrued interest) by remaining contractual maturities at the end of the reporting date. The amounts disclosed in the tables are undiscounted contractual cash flows. The Company's expected cash flows on these financial instruments may vary significantly from the following analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance although they have been classified as repayable on demand in the following tables.

	On Demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2019									
Financial liabilities									
Due to banks and other financial institutions	893,526	4,257,386	20,159,183	1,577,260	–	2,018,313	–	–	28,905,668
Due to customers	56,976,420	49,419,265	48,129,887	16,358,893	1,838	–	–	–	170,886,303
Lease liabilities	–	15,636	30,107	106,029	155,011	1,049	–	–	307,832
Other financial liabilities	8,442	3,915,441	323,103	101,489	7	14,730	–	–	4,363,212
Total financial liabilities	57,878,388	57,607,728	68,642,280	18,143,671	156,856	2,034,092	–	–	204,463,015

	On Demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2018									
Financial liabilities									
Due to banks and other financial institutions	1,151,931	9,927,788	8,118,841	–	–	2,003,944	–	–	21,202,504
Due to customers	58,493,481	22,289,469	28,217,512	53,373,532	2,676	–	–	–	162,376,670
Other financial liabilities	279,842	4,399,196	235,300	340,990	12	14,591	–	–	5,269,931
Total financial liabilities	59,925,254	36,616,453	36,571,653	53,714,522	2,688	2,018,535	–	–	188,849,105

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.4 Derivative financial instruments cash flows

The Company's derivative financial instruments are either settled on a net basis or a gross basis.

The Company's derivative financial instruments that will be settled on a net basis mainly include interest rate swaps, forward rate agreements and others, whereas derivative financial instruments that will be settled on a gross basis mainly include currency forward and currency swaps.

The table below analyses the cash flows of the Company by remaining contractual period as at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
As at 31 December 2019						
Derivative financial instruments settled on net basis	**7,410**	**40,421**	**27,381**	**(203,949)**	**(3,403)**	**(132,140)**
Derivative financial instruments settled on a gross basis						
– Outflow	**(126,233,759)**	**(33,134,641)**	**(36,720,407)**	**(1,556,264)**	**–**	**(197,645,071)**
– Inflow	**126,244,425**	**32,992,658**	**36,771,837**	**1,560,239**	**–**	**197,569,159**
Total	**10,666**	**(141,983)**	**51,430**	**3,975**	**–**	**(75,912)**

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2018						
Derivative financial instruments settled on net basis	1,285	597	18,534	(43,780)	(5,491)	(28,855)
Derivative financial instruments settled on a gross basis						
– Outflow	(72,948,707)	(29,354,422)	(82,027,870)	(4,032,556)	–	(188,363,555)
– Inflow	73,077,909	29,305,793	82,758,922	4,029,869	–	189,172,493
Total	129,202	(48,629)	731,052	(2,687)	–	808,938

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.5 Maturity analysis

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

	On demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2019									
Assets									
Cash and balances with central banks	1,094,956	–	–	–	–	–	–	–	1,094,956
Due from banks and other financial institutions	2,600,646	2,338,993	–	–	12,728,269	–	–	–	17,667,908
Financial assets at fair value through profit or loss	–	484,743	217,857	260,203	24,778	77,345	–	–	1,064,926
Financial assets at fair value through other comprehensive income	–	2,877,750	8,531,613	18,113,310	79,026,583	13,683,052	–	9,965	122,242,273
Loans and advances to customers	2,408,975	452,250	2,440,628	6,375,084	28,787,124	38,507,967	229,587	–	79,201,615
Other financial assets	2,902	4,724,076	22,694	39,626	449,284	170,039	9,751	–	5,418,372
Total financial assets	6,107,479	10,877,812	11,212,792	24,788,223	121,016,038	52,438,403	239,338	9,965	226,690,050
Liabilities									
Due to banks and other financial institutions	893,526	4,226,235	20,060,545	1,556,264	–	2,000,000	–	–	28,736,570
Due to customers	56,976,420	49,405,406	48,076,879	16,294,765	1,819	–	–	–	170,755,289
Financial liabilities at fair value through profit or loss	–	525,672	215,192	211,890	121,987	94,057	–	–	1,168,798
Lease liabilities	–	15,241	29,375	103,545	152,287	1,040	–	–	301,488
Other financial liabilities	11,917	3,915,441	323,103	112,885	7	14,730	–	–	4,378,083
Total financial liabilities	57,881,863	58,087,995	68,705,094	18,279,349	276,100	2,109,827	–	–	205,340,228
Net amount on liquidity gap	(51,774,384)	(47,210,183)	(57,492,302)	6,508,874	120,739,938	50,328,576	239,338	9,965	21,349,822

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.5 Maturity analysis (continued)

	On demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2018									
Assets									
Cash and balances with central banks	2,353,780	–	–	–	–	–	–	–	2,353,780
Due from banks and other financial institutions	8,669,337	4,263,724	1,081,473	380,000	10,687,903	–	–	–	25,082,437
Financial assets at fair value through profit or loss	–	296,837	57,126	1,495,340	6,051	–	–	–	1,855,354
Financial assets at fair value through other comprehensive income	–	4,368,036	6,512,334	48,934,349	46,776,451	2,713,902	–	9,990	109,315,062
Loans and advances to customers	1,464,922	1,064,537	208,405	6,727,289	25,424,400	32,527,079	272,087	–	67,688,719
Other financial assets	28,594	11,391	16,946	927,387	347,503	87,434	9,804	–	1,429,059
Total financial assets	12,516,633	10,004,525	7,876,284	58,464,365	83,242,308	35,328,415	281,891	9,990	207,724,411
Liabilities									
Due to banks and other financial institutions	1,151,931	9,897,946	8,077,074	–	–	2,000,000	–	–	21,126,951
Due to customers	58,493,481	22,279,509	28,167,636	53,131,413	2,644	–	–	–	162,074,683
Financial liabilities at fair value through profit or loss	–	163,216	69,998	202,735	19,746	12,069	–	–	467,764
Other financial liabilities	282,768	4,402,217	235,486	342,233	614	17,554	–	–	5,280,872
Total financial liabilities	59,928,180	36,742,888	36,550,194	53,676,381	23,004	2,029,623	–	–	188,950,270
Net amount on liquidity gap	(47,411,547)	(26,738,363)	(28,673,910)	4,787,984	83,219,304	33,298,792	281,891	9,990	18,774,141

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.6 Off-balance sheet items

The table below lists the off-balance sheet items of the Company according to their remaining period to the contractual maturity date. Financial guarantees are included at notional amounts and based on the earliest contractual maturity date.

	Up to 3 months	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
As at 31 December 2019					
Loan commitments and credit related commitments	**7,103,107**	**1,980,552**	**155,847**	**2,356,918**	**11,596,424**
Guarantees, acceptances and letters of credit	**126,844**	**61,973**	**1,914**	**2,906**	**193,637**
Total	**7,229,951**	**2,042,525**	**157,761**	**2,359,824**	**11,790,061**

	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2018					
Loan commitments and credit related commitments	7,872,156	1,344,434	125,905	2,597,322	11,939,817
Guarantees, acceptances and letters of credit	158,236	22,778	200	667	181,881
Total	8,030,392	1,367,212	126,105	2,597,989	12,121,698

3.4 Fair value of financial assets and liabilities

(a) Determination of fair value and valuation techniques

Certain financial assets and liabilities of the Company are measured at fair value or with fair value disclosed for financial reporting purposes. The fair value has been determined using appropriate valuation techniques and inputs for fair value measurements. The appropriateness of the valuation techniques and the inputs to the fair value measurements are reviewed periodically.

Fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

Level 1: The fair value of financial instruments traded in active markets is based on quoted (unadjusted) market prices at the end of the reporting period. The quoted market price used for financial assets held by the Company is the current bid price. These instruments are included in level 1.

Level 2: The fair value of financial instruments that are not traded in an active market is determined using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Level 3: If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.4 Fair value of financial assets and liabilities *(continued)*

(a) Determination of fair value and valuation techniques (continued)

Specific valuation techniques used to value for Level 2 financial instruments include:

- The use of quoted market prices or dealer quotes for similar instruments.
- Calculation of the present value of the estimated future cash flows based on observable yield curves for interest rate swaps.
- The fair value of foreign currency forwards is determined using forward exchange rates at the balance sheet date.
- The fair value of the remaining financial instruments is determined using discounted cash flow analysis.

(b) Financial assets and financial liabilities measured at fair value on a recurring basis

The table below summarizes the information relating to the fair value hierarchy of the financial assets and financial liabilities measured at fair value on a recurring basis.

	Level 1	Level 2	Level 3	Total
As at 31 December 2019				
Financial assets at fair value through profit or loss				
Debt securities				
– Governments and central banks	189,962	–	–	189,962
Derivative financial instruments				
– Foreign exchange contracts	–	773,118	–	773,118
– Interest rate contracts and others	–	101,846	–	101,846
	189,962	874,964	–	1,064,926
Financial assets at fair value through other comprehensive income				
Debt securities				
– Governments and central banks	22,084,902	–	–	22,084,902
– Banks and other financial institutions	65,751,353	16,149,042	–	81,900,395
– Corporate entities	18,247,011	–	–	18,247,011
Equity securities				
– Banks and other financial institutions	–	–	9,965	9,965
	106,083,266	16,149,042	9,965	122,242,273
Total financial assets measured at fair value	106,273,228	17,024,006	9,965	123,307,199
Financial liabilities at fair value through profit or loss				
Derivative financial instruments				
– Foreign exchange contracts	–	951,285	–	951,285
– Interest rate contracts and others	–	217,513	–	217,513
Total financial liabilities measured at fair value	–	1,168,798	–	1,168,798

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.4 Fair value of financial assets and liabilities *(continued)*

(b) Financial assets and financial liabilities measured at fair value on a recurring basis (continued)

	Level 1	Level 2	Level 3	Total
As at 31 December 2018				
Financial assets at fair value through profit or loss				
Debt securities				
– Governments and central banks	544,483	–	–	544,483
– Banks and other financial institutions	20,821	–	–	20,821
Derivative financial instruments				
– Foreign exchange contracts	–	1,284,902	–	1,284,902
– Interest rate contracts and others	–	5,148	–	5,148
	565,304	1,290,050	–	1,855,354
Financial assets at fair value through other comprehensive income				
Debt securities				
– Governments and central banks	14,914,288	–	–	14,914,288
– Banks and other financial institutions	67,974,051	25,945,556	–	93,919,607
– Corporate entities	471,177	–	–	471,177
Equity securities				
– Banks and other financial institutions	–	–	9,990	9,990
	83,359,516	25,945,556	9,990	109,315,062
Total financial assets measured at fair value	83,924,820	27,235,606	9,990	111,170,416
Financial liabilities at fair value through profit or loss				
Derivative financial instruments				
– Foreign exchange contracts	–	438,645	–	438,645
– Interest rate contracts and others	–	29,119	–	29,119
Total financial liabilities measured at fair value	–	467,764	–	467,764

There was no transfer between level 1 and 2 during the years.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.5 Offsetting financial assets and financial liabilities

Certain financial assets and financial liabilities of the Company are subject to enforceable master netting arrangements or similar agreements. The agreement between the Company and the counterparty generally allows for net settlement of the relevant financial assets and financial liabilities when both elect to settle on a net basis. In the absence of such a mutual consent, financial assets and financial liabilities will be settled on a gross basis. However, each party to the master netting arrangements or similar agreements will have the option to settle all such amounts on a net basis in the event of default of the other party. These financial assets and financial liabilities of the Company are not offset in accordance with HKFRS.

The following table presents the recognized financial instruments that are offset, or subject to enforceable master netting arrangements and other similar agreements but not offset, as at 31 December 2019 and 31 December 2018. The column 'net amount' shows the impact on the Company's statement of financial position if all set-off rights were exercised.

	Gross amounts of recognized financial assets	Gross amounts of recognized financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	Related amounts not offset		Net amount
				Financial instruments (including non-cash collateral)	Cash collateral received	
2019						
Financial assets						
Derivative financial instruments	874,964	–	874,964	(696,273)	(2,093)	176,598
Financial assets at fair value through other comprehensive income	11,067,402	–	11,067,402	(10,459,812)	–	607,590
Total	11,942,366	–	11,942,366	(11,156,085)	(2,093)	784,188

	Gross amounts of recognized financial liabilities	Gross amounts of recognized financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	Related amounts not offset		Net amount
				Financial instruments (including non-cash collateral)	Cash collateral advanced	
2019						
Financial liabilities						
Derivative financial instruments	1,168,798	–	1,168,798	(696,273)	(217,465)	255,060
Due to banks and other financial institutions	10,459,812	–	10,459,812	(10,459,812)	–	–
Total	11,628,610	–	11,628,610	(11,156,085)	(217,465)	255,060

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.5 Offsetting financial assets and financial liabilities *(continued)*

(restated)	Gross amounts of recognized financial assets	Gross amounts of recognized financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	Related amounts not offset: Financial instruments (including non-cash collateral)	Related amounts not offset: Cash collateral received	Net amount
2018						
Financial assets						
Derivative financial instruments	1,290,050	–	1,290,050	(448,378)	(219,325)	622,347
Financial assets at fair value through other comprehensive income	250,842	–	250,842	(250,000)	–	842
Total	1,540,892	–	1,540,892	(698,378)	(219,325)	623,189

	Gross amounts of recognized financial liabilities	Gross amounts of recognized financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	Related amounts not offset: Financial instruments (including non-cash collateral)	Related amounts not offset: Cash collateral advanced	Net amount
2018						
Financial liabilities						
Derivative financial instruments	467,764	–	467,764	(448,378)	(930)	18,456
Due to banks and other financial institutions	250,000	–	250,000	(250,000)	–	–
Total	717,764	–	717,764	(698,378)	(930)	18,456

3.6 Capital management

The Company's objectives in managing "capital", which is a broader concept than the "shareholder equity" on the statement of financial position, are:

- To comply with the capital requirements set by the regulators of the markets where the Company operates;
- To ensure the Company's ability to maintain a stable operation so as to continue provide returns for shareholders and benefits for other stakeholders; and
- To maintain a strong capital base to support the development of its business.

Consistent with industry practice, the Company monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Company's policy on the management of capital during the year.

The Company has complied with all externally imposed capital requirements during 2019.

(All amounts expressed in thousands of HK$ unless otherwise stated)

4 NET INTEREST INCOME

	2019	2018
Interest income		
Due from banks and other financial institutions	**408,951**	933,600
Loans and advances to customers	**2,135,929**	1,679,549
Financial assets at fair value through other comprehensive income	**3,531,136**	2,200,059
Others	**–**	884
	6,076,016	4,814,092
Interest expense		
Due to banks and other financial institutions	**(560,225)**	(360,719)
Due to customers	**(2,594,622)**	(2,476,770)
Debt securities and certificates of deposit issued	**–**	(119,347)
Others	**–**	(429)
	(3,154,847)	(2,957,265)
Net interest income	**2,921,169**	1,856,827

5 FEE AND COMMISSION INCOME

	2019	2018 (restated)
Settlement service	**46,684**	45,137
Interchange service	**38,575**	34,929
Credit facilities, guarantee and commitment	**2,589**	85,777
Agency service	**592,260**	542,169
Depositary service	**61,752**	59,095
Others	**4,763**	10,577
	746,623	777,684
Of which arise from:		
Financial assets/liabilities not at fair value through profit or loss	**2,589**	85,777
Trust and other fiduciary activities	**83,402**	87,420

6 FEE AND COMMISSION EXPENSE

	2019	2018
Settlement and brokerage service	**38,503**	28,826
Interchange service	**9,870**	9,748
Others	**8,163**	6,454
	56,536	45,028
Of which arise from:		
Financial assets/liabilities not at fair value through profit or loss	**9,870**	9,748

(All amounts expressed in thousands of HK$ unless otherwise stated)

7 DIVIDEND INCOME

	2019	2018
Financial assets at fair value through other comprehensive income – unlisted investments	**35**	700

8 NET GAINS ARISING FROM TRADING ACTIVITIES

	2019	2018
Foreign exchange	**37,585**	175,895
Interest rate instruments and others	**(163)**	318,456
Debt securities at fair value through profit or loss	**44,278**	(127,405)
Net losses of interest rate instruments and items under fair value hedge	**(5,287)**	(124)
	76,413	366,822

Net gains on foreign exchange include gains or losses from the trading of spot and forward contracts, currency swaps, cross currency interest rate swaps, currency options and the translation of foreign currency monetary assets and liabilities into HK$.

Net gains on interest rate instruments and others include trading gains and losses and fair value changes of interest rate swaps, interest rate options and other derivatives.

9 OTHER OPERATING INCOME

	2019	2018
Rental income	**–**	1,258
Management fee from a branch of the ultimate holding company (Note 33g)	**6,565**	6,684
Others	**14,976**	13,040
	21,541	20,982

Others mainly include income arising from miscellaneous banking services provided to the Company's customers.

(All amounts expressed in thousands of HK$ unless otherwise stated)

10 CHANGE IN EXPECTED CREDIT LOSSES ("ECL")

	2019	2018
Changes in ECL allowance		
Loans and advances to customers		
– new charges	**126,463**	204,710
– recoveries	**(34,226)**	(79,800)
	92,237	124,910
Financial investments	**60,242**	67,899
Other receivables	**1,354**	21,563
Due from banks and other financial institutions	**2,224**	11,586
Financial guarantees and credit related commitments	**3,931**	(13,369)
	67,751	87,679
	159,988	212,589

11 OTHER OPERATING EXPENSES

	2019	2018
Staff costs		
– salaries and other allowances	**512,954**	529,014
– retirement benefit costs (Note 12)	**34,261**	35,294
Loss on disposal of property and equipment	**25**	2,183
General operational and administrative expenses	**260,597**	215,094
Depreciation and amortization	**30,365**	33,154
Depreciation of right-of-use assets	**166,890**	–
Auditor's remuneration	**4,200**	4,200
Buildings administration fee	**10,113**	11,973
Rental expenses	**45,645**	209,870
Repairs and maintenance	**44,162**	46,657
Printing, postage and telegram	**51,133**	62,711
Withholding tax	**–**	59,363
Directors', senior management's and key personnel's emoluments (Note 13)	**18,715**	18,881
Management fee to a branch of the ultimate holding company	**344,728**	259,738
Finance costs – lease interest expense	**4,820**	–
Others	**17,619**	15,640
	1,546,227	1,503,772

12 RETIREMENT BENEFIT COSTS

	2019	2018
Pension costs – defined contribution plans	**34,261**	35,294

(All amounts expressed in thousands of HK$ unless otherwise stated)

13 BENEFITS AND INTEREST OF DIRECTORS (DISCLOSURES REQUIRED BY SECTION 383 OF THE COMPANIES ORDINANCE (CAP. 622) AND COMPANIES (DISCLOSURE OF INFORMATION ABOUT BENEFITS OF DIRECTORS) REGULATION (CAP. 622G)

(a) Directors' emoluments

Details of the emoluments paid to or receivable by the directors of the Company in respect of their services rendered for the Company are as follows:

	2019	2018
Directors' fees	**1,397**	1,513
Salaries, allowances and benefits in kind	**180**	817
Bonuses	**1,176**	852
Retirement benefit costs	**3**	17
	2,756	3,199

For the year ended 31 December 2019 and 2018, some of the executive directors received emoluments and emoluments receivable from HKBR, amounting to HK$13,834,000 (2018: HK$12,514,000), in respect of their service to the Company and HKBR. The portion of the directors' emoluments in relation to the services to the Company of HK$8,980,000 (2018: HK$8,346,000) has been borne by HKBR and included in management fee to a branch of the ultimate holding company (Note 11).

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

No significant transactions, arrangements and contracts in relation to the Company's business to which the Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

(All amounts expressed in thousands of HK$ unless otherwise stated)

14 INCOME TAX EXPENSES

	2019	2018
Current tax		
– Hong Kong profits tax	**390,780**	284,049
– (Over)/under provision in prior years	**(7,930)**	23,980
	382,850	308,029
Deferred income tax	**(16,690)**	(39,271)
Income tax expense	**366,160**	268,758

The current tax provision for the year ended 31 December 2019 and 2018 is based on the estimated assessable profit by using the Hong Kong profits tax rate of 16.5 per cent. The major reconciliation items are as follows:

	2019	2018
Profit before tax	**2,428,834**	1,251,775
Tax calculated at a tax rate of 16.5%	**400,758**	206,543
Tax effect of expense not deductible for tax purpose	**–**	32,699
Tax effect arising from income not subject to tax	**(35,332)**	(4,366)
(Over)/under provision in prior years	**(7,930)**	23,980
Utilization of tax loss previously not recognized	**–**	(1,246)
Others	**8,664**	11,148
	366,160	268,758

15 CASH AND BALANCES WITH CENTRAL BANK

	2019	2018
Cash	**440,753**	411,344
Balances with central bank	**654,203**	1,942,436
	1,094,956	2,353,780

(All amounts expressed in thousands of HK$ unless otherwise stated)

16 DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	2019	2018
Due from banks and other financial institutions	**2,600,649**	8,669,382
Placements with and loans to banks	**15,075,568**	16,419,140
Less: ECL allowances	**(8,309)**	(6,085)
	17,667,908	25,082,437

17 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2019	2018
Derivative financial instruments (Note 18)	**874,964**	1,290,050
Debt securities at fair value through profit or loss		
Government bonds		
– Listed outside Hong Kong	**34,484**	–
– Unlisted	**155,478**	544,483
Other debt securities		
– Unlisted – banking sector	**–**	20,821
	1,064,926	1,855,354

Debt securities at fair value through profit or loss are analyzed by issuer as follows:

	2019	2018
Debt securities at fair value through profit or loss		
– Governments and central banks	**189,962**	544,483
– Banks and other financial institutions	**–**	20,821
	189,962	565,304

18 DERIVATIVE FINANCIAL INSTRUMENTS

The following derivative instruments are utilized by the Company for trading or hedging purposes:

Currency forwards are contracts between two parties to buy or sell certain currencies at a specified future date at a predetermined price. The party agreeing to buy the underlying currency in the future assumes a long position, and the party agreeing to sell the currency in the future assumes a short position. The price agreed upon is called the delivery price, which is equal to the forward price at the time the contract is entered into.

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates (for example, fixed rate for floating rate) or a combination of all these (i.e. cross-currency interest rate swaps). The Company's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligation. This risk is monitored on an ongoing basis with reference to the current fair value, the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Company assesses counterparties using the same techniques as for its lending activities.

Currency and interest rate 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), on or before a set date or during a set period, a specific amount of a foreign currency at a predetermined price or to receive an interest payment based on a variable interest rate and pay a fixed interest rate or vice versa. The seller receives a premium from the purchaser in consideration for assuming foreign exchange or interest rate risk. Options may be either exchange-traded or negotiated between the Company and a customer (over the-counter market).

The notional amounts of certain types of financial instruments provide a reference of the amounts recognized in the statement of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Company's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time. The fair values of derivative instruments held are set out in the following tables.

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

	For hedging			For trading			Total		
	Contractual/ notional amount	Fair values		Contractual/ Notional amount	Fair values		Contractual/ Notional amount	Fair values	
		Assets	Liabilities		Assets	Liabilities		Assets	Liabilities
As at 31 December 2019									
Foreign exchange contracts	**–**	**–**	**–**	**197,148,441**	**773,118**	**(951,285)**	**197,148,441**	**773,118**	**(951,285)**
Interest rate contracts and others	**25,129,426**	**96,572**	**(211,910)**	**749,341**	**5,274**	**(5,603)**	**25,878,767**	**101,846**	**(217,513)**
Total amount of derivative instruments recognized	**25,129,426**	**96,572**	**(211,910)**	**197,897,782**	**778,392**	**(956,888)**	**223,027,208**	**874,964**	**(1,168,798)**
As at 31 December 2018									
Foreign exchange contracts	–	–	–	189,963,423	1,284,902	(438,645)	189,963,423	1,284,902	(438,645)
Interest rate contracts and others	4,157,440	5,148	(29,119)	–	–	–	4,157,440	5,148	(29,119)
Total amount of derivative instruments recognized	4,157,440	5,148	(29,119)	189,963,423	1,284,902	(438,645)	194,120,863	1,290,050	(467,764)

The tables above provide a breakdown of the contractual or notional amounts and the fair values of the Company's derivative financial instruments outstanding at year end. These instruments, comprising foreign exchange and interest rate derivatives allow the Company and its customers to transfer, modify or reduce their foreign exchange and interest rate risks.

The Company undertakes its transactions in foreign exchange and interest rates contracts with other financial institutions and customers. Management has established limits for these contracts based on counterparty types, industry sectors and countries. Related risks are regularly monitored and controlled by management.

Notional amounts of derivative financial instruments by original currency:

	2019	2018
Renminbi	**42,237,988**	46,222,232
United States Dollar	**107,842,171**	95,597,519
Hong Kong Dollar	**67,861,606**	48,663,814
Others	**5,085,443**	3,637,298
Total	**223,027,208**	194,120,863

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting

The Company applies hedge accounting on hedging its interest rate risk on certain bond investments and loans, as follows:

Interest rate risk on fixed rate financial assets (fair value hedge)

The Company holds a portfolio of long-term fixed rate debt securities and loans and therefore is exposed to changes in fair value due to movements in market rates. The Company manages this risk exposure by entering into pay fixed/receive floating interest rate swaps.

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged by the Company. The interest rate risk component is determined as the change in fair value of the long-term fixed rate debt securities arising solely from changes in the benchmark rate of interest. Such changes are usually the largest component of the overall change in fair value.

This strategy is designated as a fair value hedge and its effectiveness is assessed by comparing changes in the fair value of the debt securities attributable to changes in the benchmark rate of interest with changes in the fair value of the interest rate swaps.

The Company establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged. Following reasons could cause ineffectiveness:

1) Differences between the expected and actual holding amount, as the Company hedges to the expected maturity date but may sell the bond investment according to trading strategies;

2) The credit risk of the counterparty impacts the fair value of interest rate swaps, but has no impacts on hedged items.

a) The following table sets out the maturity profile and average interest rate of the hedging instruments used in the Company's hedging strategies:

	Maturity					
As at 31 December 2019	**Up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 year to 5 years**	**More than 5 years**	**Total**
Fair value hedge						
Interest rate						
Interest rate contract						
Notional	**–**	**1,089,385**	**427,973**	**14,014,934**	**9,597,134**	**25,129,426**
Average fixed interest rate	**–**	**2.38%**	**2.64%**	**3.74%**	**3.92%**	**3.65%**

	Maturity					
As at 31 December 2018	Up to 1 month	1 to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
Fair value hedge						
Interest rate						
Interest rate contract						
Notional	–	–	782,945	2,810,774	563,721	4,157,440
Average fixed interest rate	–	–	2.00%	2.76%	4.35%	2.73%

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting *(continued)*

b) The following table contains details of the hedging instruments used in the Company's hedging strategies:

As at 31 December 2019	Notional	Carrying amount: Assets	Carrying amount: Liabilities	Line item on statement of financial position	Fair value changes of the hedging instruments
Fair value hedge					
Interest rate					
Interest rate contract	**25,129,426**	**96,572**	**(211,910)**	**Financial assets/ liabilities at fair value through profit or loss**	**(97,377)**

As at 31 December 2018	Notional	Carrying amount: Assets	Carrying amount: Liabilities	Line item on statement of financial position	Fair value changes of the hedging instruments
Fair value hedge					
Interest rate					
Interest rate contract	4,157,440	5,148	(29,119)	Financial assets/liabilities at fair value through profit or loss	(23,971)

c) The following table contains details of the hedged exposures covered by the Company's hedging strategies:

As at 31 December 2019	Carrying amount of hedged item	Accumulated amount of fair value adjustments on the hedged item	Line item on statement of financial position	Fair value changes of the hedged items	Ineffectiveness recognized in profit or loss
Fair value hedge					
Interest rate					
Debt investments	**23,691,106**	**84,439**	**Financial asset at fair value through other comprehensive income**	**60,656**	**(6,004)**
Loans and advances to customers	**1,589,928**	**31,434**	**Loans and advances to customers**	**31,434**	**717**

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting *(continued)*

As at 31 December 2018	Carrying amount of hedged item	Accumulated amount of fair value adjustments on the hedged item	Line item on statement of financial position	Fair value changes of the hedged items	Ineffectiveness recognized in profit or loss
Fair value hedge					
Interest rate					
Debt investments	4,184,685	25,302	Financial asset at fair value through other comprehensive income	25,302	(124)

The following table contains information regarding the effectiveness of the hedging relationships designated by the Company, as well as the impacts on profit or loss and other comprehensive income:

For the year ended 31 December 2019	**Gains/(losses) recognized in other comprehensive Income**	**Hedge ineffectiveness recognized in profit and loss**	**Profit and loss line item that includes hedge ineffectiveness**
Fair value hedge			
Interest rate	**–**	**(5,287)**	**Net gains arising from trading activities**

For the year ended 31 December 2018	Gains/(losses) recognized in other comprehensive Income	Hedge ineffectiveness recognized in profit and loss	Profit and loss line item that includes hedge ineffectiveness
Fair value hedge			
Interest rate	–	(124)	Net gains arising from trading activities

(All amounts expressed in thousands of HK$ unless otherwise stated)

19 LOANS AND ADVANCES TO CUSTOMERS

19.1 Loans and advances to customers

	2019	2018
Loans and advances to customers	**79,519,025**	67,920,933
Less: ECL allowance	**(317,410)**	(232,214)
	79,201,615	67,688,719

19.2 Analysis of loans and advances to customers by staging

As at 31 December 2019	**Stage 1 allowance**	**Stage 2 allowance**	**Stage 3 allowance**	**Total**
Gross loans and advances (Note)	**78,885,497**	**571,140**	**62,388**	**79,519,025**
ECL allowance	**(228,363)**	**(60,402)**	**(28,645)**	**(317,410)**
Net loans and advances to customers	**78,657,134**	**510,738**	**33,743**	**79,201,615**

Note: Included in the stage 1 balance is a fair value change of hedging adjustment of HK$31,434,000 which is not subject to ECL allowance.

As at 31 December 2018	Stage 1 allowance	Stage 2 allowance	Stage 3 allowance	Total
Gross loans and advances	67,575,769	280,848	64,316	67,920,933
ECL allowance	(176,698)	(31,962)	(23,554)	(232,214)
Net loans and advances to customers	67,399,071	248,886	40,762	67,688,719

19.3 Credit quality of loans and advances to customers

Loans and advances to customers analyzed by security type

	2019	2018
Unsecured loans	**22,323,157**	17,105,433
Loans secured by guarantee	**15,092,813**	13,737,768
Collateralized and other secured loans	**42,103,055**	37,077,732
Gross amount of loans and advances to customers before ECL allowance	**79,519,025**	67,920,933

(All amounts expressed in thousands of HK$ unless otherwise stated)

19 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

19.4 Overdue loans

Gross advances to customers overdue for more than 3 months

	2019	**% of gross advances to customers**	2018	% of gross advances to customers
Six months or less but over three months	**28,486**	**0.04%**	3,392	0.00%
One year or less but over six months	**3,073**	**0.00%**	30,646	0.05%
Over one year	**15,359**	**0.02%**	15,320	0.02%
Total gross amount of advances overdue for more than three months	**46,918**	**0.06%**	49,358	0.07%
ECL allowance for stage 3	**26,689**		20,996	
Rescheduled advances excluding those overdue for more than three months	**1,271**	**0.00%**	1,523	0.00%

20 FINANCIAL ASSETS AT FAIR VALUE THROUGH COMPREHENSIVE INCOME

	2019	2018
Debt securities at fair value through other comprehensive income		
– Listed	**56,023,727**	235,181
– Unlisted	**66,208,581**	109,069,891
Equity securities at fair value through other comprehensive income		
– Unlisted	**9,965**	9,990
	122,242,273	109,315,062

The Company has designated the investment in equity instrument issued by Joint Electronic Teller Services Limited at fair value through other comprehensive income. The Company chose this presentation alternative because the investment was made for strategic purposes rather than with a view to profit on a subsequent sale, and there is no plan to dispose this investment in short or medium term.

(All amounts expressed in thousands of HK$ unless otherwise stated)

20 FINANCIAL ASSETS AT FAIR VALUE THROUGH COMPREHENSIVE INCOME *(continued)*

The fair value of this investment is HK$9,965,000 as at 31 December 2019 (31 December 2018: HK$9,990,000) and a dividend of HK$35,000 (31 December 2018: HK$700,000) was recognized for the year. There is no transfer of the cumulative loss within equity.

Financial investments analyzed by issuer are as follows:

	2019	2018
Debt securities at fair value through other comprehensive income		
– Governments and central banks	**22,084,902**	14,914,288
– Banks and other financial institutions	**81,900,395**	93,919,607
– Corporate entities	**18,247,011**	471,177
Equity securities at fair value through other comprehensive income		
– Banks and other financial institutions	**9,965**	9,990
	122,242,273	109,315,062

21 PROPERTY AND EQUIPMENT

	Equipment	**Property improvement**	**Total**
Cost			
As at 1 January 2019	**61,892**	**83,417**	**145,309**
Additions	**11,758**	**3,279**	**15,037**
Disposal	**(13,250)**	**(42,436)**	**(55,686)**
As at 31 December 2019	**60,400**	**44,260**	**104,660**
Accumulated depreciation			
As at 1 January 2019	**(31,000)**	**(46,891)**	**(77,891)**
Charge for the year	**(12,072)**	**(16,882)**	**(28,954)**
Disposal	**13,225**	**42,436**	**55,661**
As at 31 December 2019	**(29,847)**	**(21,337)**	**(51,184)**
Net book value			
As at 31 December 2019	**30,553**	**22,923**	**53,476**

(All amounts expressed in thousands of HK$ unless otherwise stated)

21 PROPERTY AND EQUIPMENT *(continued)*

	Buildings	Equipment	Transportation equipment	Property improvement	Total
Cost					
As at 1 January 2018	518,182	298,827	4,118	134,165	955,292
Additions	–	19,688	–	6,447	26,135
Disposal	–	(7,829)	–	(9,148)	(16,977)
Transfer of Excluded Business to HKBR (Note 2)	(518,182)	(248,794)	(4,118)	(48,047)	(819,141)
As at 31 December 2018	–	61,892	–	83,417	145,309
Accumulated depreciation					
As at 1 January 2018	(328,893)	(173,908)	(1,533)	(59,512)	(563,846)
Charge for the year	(961)	(14,116)	(104)	(17,945)	(33,126)
Disposal	–	5,654	–	9,140	14,794
Transfer of Excluded Business to HKBR (Note 2)	329,854	151,370	1,637	21,426	504,287
As at 31 December 2018	–	(31,000)	–	(46,891)	(77,891)
Net book value					
As at 31 December 2018	–	30,892	–	36,526	67,418

(All amounts expressed in thousands of HK$ unless otherwise stated)

22 DEFERRED INCOME TAX ASSETS/(LIABILITIES)

The movements on the net deferred tax assets/(liabilities) are as follows:

	2019	2018
As at 1 January	**10,978**	11,352
Deferred income tax charged to income statement	**16,690**	39,271
Deferred income tax debited to equity	**(74,574)**	(8,901)
Transfer of Excluded Business to HKBR (Note 2)	**–**	(30,744)
As at 31 December	**(46,906)**	10,978

Deferred tax assets and liabilities are attributable to the following items:

	2019	2018
Deferred tax assets		
ECL allowances	**52,042**	37,701
	52,042	37,701
Deferred tax liabilities		
Accelerated depreciation allowances	**(7,547)**	(9,896)
Revaluation of investment securities	**(91,401)**	(16,827)
	(46,906)	10,978

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The deferred tax assets and liabilities are to be recovered and settled after one year and the following amounts, determined after appropriate offsetting, are shown in the statement of financial position:

	2019	2018
Deferred tax assets	**52,042**	37,701
Deferred tax liabilities	**(98,948)**	(26,723)
	(46,906)	10,978

(All amounts expressed in thousands of HK$ unless otherwise stated)

23 RIGHT-OF-USE ASSETS

	2019
Gross:	
Opening balance	203,642
Additions	263,936
Reductions	(2,469)
Balance at the end of the year	465,109
Accumulated depreciation	
Opening balance	–
Additions	(166,890)
Reductions	190
Balance at the end of the year	(166,700)
Net book value	
As at 1 January 2019	203,642
As at 31 December 2019	298,409

(i) Amounts recognized in the statement of financial position

The statement of financial position shows the following amounts relating to leases:

	As at 31 December 2019	As at 1 January 2019
Right-of-use asset		
Properties	289,945	188,374
Equipment	8,328	15,198
Others	136	70
	298,409	203,642
Lease liabilities	301,488	207,291

(ii) Amounts recognized in the statement of profit or loss

The statement of profit or loss shows the following amounts relating to leases:

Depreciation charge of right-of-use assets (Note 11)	2019	1 January 2019
Properties	159,967	–
Equipment	6,870	–
Others	53	–
	166,890	–

Financial costs-lease interest expense (Note 11)	2019	1 January 2019
Properties	4,663	–
Equipment	136	–
Others	1	–
	4,820	–

The total cash outflow for leases in 2019 was HK$193,453,000 (2018: Nil).

(All amounts expressed in thousands of HK$ unless otherwise stated)

23 RIGHT-OF-USE ASSETS *(continued)*

(iii) The Company's leasing activities and how these are accounted for

The Company leases various retail stores, equipment and advertising spaces. Rental contracts are typically made for fixed periods of 1 year to 8 years, but may have extension options as described in (iv) below.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants but leased assets may not be used as security for borrowing purposes.

(iv) Extension and termination options

Extension and termination options are included in a number of retail stores across the Company. These terms are used to maximise operational flexibility in terms of managing contracts. The majority of extension and termination options held are exercisable only by the Company and not by the respective lessor.

24 OTHER ASSETS

	2019	2018
Interest receivable	**839,730**	755,467
Settlement accounts	**4,563,044**	685,639
Other receivables, prepayments and others	**89,960**	74,213
Less: ECL allowance	**(15,495)**	(13,840)
Intangible asset (a)	**12,198**	1,495
	5,489,437	1,502,974

(a) Intangible asset

	Software
Cost	
As at 1 January 2019	**1,523**
Additions	**12,114**
As at 31 December 2019	**13,637**
Accumulated amortization	
As at 1 January 2019	**(28)**
Amortization expenses	**(1,411)**
As at 31 December 2019	**(1,439)**
Net book value as at 31 December 2019	**12,198**
As at 1 January 2018	–
Additions	1,523
As at 31 December 2018	1,523
Accumulated amortization	
As at 1 January 2018	–
Amortization expenses	(28)
As at 31 December 2018	(28)
Net book value as at 31 December 2018	1,495

(All amounts expressed in thousands of HK$ unless otherwise stated)

25 DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	2019	2018
Deposits from banks and other financial institutions	**16,276,758**	18,876,951
Subordinated loan from the ultimate holding company	**2,000,000**	2,000,000
Financial assets sold under repurchase agreements (Note 32)	**10,459,812**	250,000
Total	**28,736,570**	21,126,951

26 DUE TO CUSTOMERS

	2019	2018
Demand deposits and current accounts	**7,904,693**	7,533,053
Saving deposits	**49,071,727**	50,960,428
Time, call, notice and other deposits	**113,778,869**	103,581,202
	170,755,289	162,074,683
Including:		
Deposits pledged as collateral	**2,240,493**	2,480,149

27 FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	2019	2018
Derivative financial instruments (Note 18)	**1,168,798**	467,764

For the year ended 31 December 2019 and 2018, there were no significant changes in the fair value of the Company's financial liabilities designated as at fair value through profit or loss that were attributable to the changes in credit risk.

28 OTHER LIABILITIES

	2019	2018
Interest payable	**727,400**	840,072
Settlement accounts	**2,471,380**	3,462,534
Withholding tax	**58,064**	59,363
Provision for ECL allowances on financial guarantee and credit related commitment	**14,872**	10,941
Others	**1,211,293**	1,049,184
Total	**4,483,009**	5,422,094

(All amounts expressed in thousands of HK$ unless otherwise stated)

29 SHARE CAPITAL

	Number of shares	Share capital
As at 31 December 2019 and 31 December 2018	17,900,000,000	17,900,000

30 FINANCIAL GUARANTEES AND CREDIT RELATED COMMITMENTS AND OTHER COMMITMENTS

Financial guarantees and credit related commitments

The following tables indicate the contractual amounts of the Company's financial guarantees and credit related commitments which the Company has committed to its customers:

	2019	2018
Letters of guarantee	**41,215**	66,874
Letters of credit commitments	**138,802**	87,858
Acceptances bills	**13,620**	27,149
Credit card commitments	**6,034,752**	6,420,292
Other credit-related commitments		
– Under 1 year	**3,048,907**	2,796,298
– More than 1 year	**2,512,765**	2,723,227
	11,790,061	12,121,698

Capital expenditure commitments

	2019	2018
Contracted but not provided for	**7,170**	16,095

Operating lease commitments

As at 31 December 2019 and 2018, the Company has no non-cancellable operating lease commitments related to short-term leases, which are the leases with a lease term of 12 months or less.

(All amounts expressed in thousands of HK$ unless otherwise stated)

31 NOTES TO STATEMENT OF CASH FLOWS

Analysis of the balance of cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with original maturities of less than or equal to 90 days used for the purpose of meeting short-term cash commitments:

	2019	2018
Cash and balances with central bank (Note 15)	**1,094,956**	2,353,780
Due from banks and other financial institutions	**4,939,639**	9,351,210
	6,034,595	11,704,990

32 COLLATERALS

Financial assets sold under repurchase agreements included certain transactions under which, title of the pledged securities has been transferred to counterparties.

Sales and repurchase agreements are transactions in which the Company sells a security and simultaneously agrees to repurchase it (or an asset that is substantially the same) at a fixed price on a future date. Since the repurchase prices are fixed, the Company is still exposed to substantially all the credit risks and market risks and rewards of those securities sold. These securities, which the Company does not have the ability to use during the term of the arrangements, are not derecognized from the financial statements but regarded as "collateral" for the secured lending from these because the Company retains substantially all the risks and rewards of these securities. In addition, it recognizes a financial liability for cash received.

As at 31 December 2019 and 2018, the Company entered into repurchase agreements with certain counterparties. The proceeds from selling such securities were presented as "financial assets sold under repurchase agreements" (see Note 25).

	Transferred assets		**Associated liabilities**	
	2019	2018	**2019**	2018
Investment securities	**11,067,402**	250,842	**(10,459,812)**	(250,000)

(All amounts expressed in thousands of HK$ unless otherwise stated)

33 MATERIAL RELATED PARTY TRANSACTIONS

(a) Parent entity

The Company is controlled by the following entity:

Name	Type	Place of incorporation	Ownership interest	
			2019	2018
Bank of Communications Co., Ltd	Ultimate parent entity and controlling party	People's Republic of China	**100%**	100%

(b) Key management personnel compensation

	2019	2018
Short-term employee benefits	**14,780**	14,434
Post-employment benefits	**1,179**	1,248
	15,959	15,682

(c) Transactions with the Ministry of Finance of the People's Republic of China ("MOF")

As at 31 December 2019, the MOF holds 17,732 million (31 December 2018: 19,703 million) shares of the ultimate holding company of the Company which represents 23.88% (31 December 2018: 26.53%) of equity interest of the ultimate holding company of the Company.

The MOF is a Chinese government ministry, primarily responsible for managing state fiscal revenue and expenditures, and establishing and enforcing taxation policies. The Company enters into banking transactions with the MOF under normal course of business and they mainly include the purchase and redemption of financial investments issued by the MOF and the deposits from the MOF.

Details of transactions and outstanding balances are summarized below:

	2019	2018
Bonds issued by MOF	**5,263,457**	4,039,010
Other assets	**16,737**	20,939
Interest income	**141,272**	86,811

(All amounts expressed in thousands of HK$ unless otherwise stated)

33 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(d) Transactions with The Hong Kong and Shanghai Banking Corporation Limited and its subsidiaries ("HSBC")

As at 31 December 2019, HSBC holds 13,886 million (31 December 2018: 13,886 million) shares of the ultimate holding company of the Company which represents 18.70% (31 December 2018: 18.70%) of total share capital of the ultimate holding company of the Company. Transactions between the Company and HSBC are carried out under normal commercial terms and paid at market rates.

Details of transactions and outstanding balances are summarized below:

	2019	2018
Due from banks and other financial institutions	**3,852**	3,664
Financial assets at fair value through other comprehensive income	**1,455,631**	770,991
Derivative financial assets	**97,336**	564
Other assets	**9,677**	8,937
Due to banks and other financial institutions	**17,643**	11,860
Derivative financial liabilities	**165,107**	4,189
Interest income	**39,418**	15,220
Interest expense	**78**	990
Net gains arising from trading activities	**201,031**	–
Net gains arising from financial investments	**2,497**	–

(e) Transactions with fellow subsidiaries

The pricing of the transactions with fellow subsidiaries is determined based on normal commercial banks.

Details of transactions and outstanding balances are summarized below:

	2019	2018 (restated)
Loans and advances to customers	**433,679**	438,541
Other assets	**173**	185
Due to customers	**471,755**	377,741
Other liabilities	**10,517**	12,425
Fee and commission income	**12,578**	1,657
Interest income	**15,698**	16,540
Interest expense	**618**	312
Fee and commission expense	**13,623**	12,048
Rental expense	**26,522**	27,879
Other operating expenses	**31,204**	20,606

(All amounts expressed in thousands of HK$ unless otherwise stated)

33 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(f) Transactions with directors and senior management

	2019	2018
Loans and advances to customers	**324**	811
Due to customers	**46,804**	39,720
Interest income	**3**	9
Interest expense	**294**	672

Particular of loans made to directors of the Company pursuant to section 383 of the Hong Kong Companies Ordinance and Part 3 of the Companies (Disclosure of Information about Benefits of Directors) Regulation for the year ended 31 December 2019 and 2018 are as follows:

	2019	2018
Aggregate amount of relevant transactions outstanding at year end	**47**	99
Maximum aggregate amount of relevant transactions outstanding during the year	**386**	468

(g) Transactions with the ultimate holding company

Transactions between the Company and the ultimate holding company are carried out under normal commercial terms and paid at market price.

Details of transactions and outstanding balances are summarized below:

	2019	2018
Due from banks and other financial institutions	**11,548,722**	12,686,398
Other assets	**177,089**	5,565
Derivative financial assets	**602,306**	932,323
Due to banks and other financial institutions	**17,659,827**	20,167,573
Other liabilities	**276,231**	115,009
Derivative financial liabilities	**475,004**	411,154
Interest income	**280,609**	696,390
Interest expense	**357,593**	329,703
Other operating expenses	**409,833**	324,824
Other operating income	**6,565**	6,684
Purchase of debt securities	**51,155,354**	115,281,247
Disposal of debt securities	**18,796,221**	–
Purchase of loan and advances	**16,420,942**	29,501,670
Disposal of loan and advances	**1,020,712**	–
Net (losses)/gains arising from trading activities	**(343,520)**	465,835
Net gains arising from financial investments	**282,266**	–

(All amounts expressed in thousands of HK$ unless otherwise stated)

34 SEGMENTAL ANALYSIS

The Company manages the business mainly from a operating segment perspective and the majority of the Company's revenues, profits before tax and assets are derived from Hong Kong. The Company is engaged predominantly in banking and related financial activities. It comprises corporate banking, personal banking, treasury and other business. Corporate banking mainly comprises corporate loans, bills, trade finance, corporate deposits and remittance. Personal banking mainly comprises individual loans, individual deposits, credit cards and remittance. Treasury mainly comprises money market placements and takings, financial investment, and securities sold under repurchase agreements. The "Others" segment mainly comprises unallocated revenue and expenses and corporate expenses.

The business information of the Company is summarized as follows:

	2019				
	Corporate Banking	Personal Banking	Treasury	Others	Total
External net interest income	894,701	(1,325,869)	3,352,337	–	2,921,169
Inter-segment net interest income/ (expense)	(397,424)	2,807,313	(2,409,889)	–	–
Net interest income	497,277	1,481,444	942,448	–	2,921,169
Net fee and commission income	15,604	713,986	(39,503)	–	690,087
Net gains arising from trading activities	–	–	76,413	–	76,413
Net gains arising from financial investments	–	–	425,804	–	425,804
Dividend income	–	–	35	–	35
Other operating income	(81)	20,818	9	795	21,541
Total operating income	512,800	2,216,248	1,405,206	795	4,135,049
Change in expected credit losses	(14,668)	(81,797)	(63,495)	(28)	(159,988)
Other operating expense					
– Depreciation and amortization	(4,903)	(188,005)	(106)	(4,241)	(197,255)
– Others	(78,264)	(792,743)	(72,517)	(405,448)	(1,348,972)
Profit before tax	414,965	1,153,703	1,269,088	(408,922)	2,428,834
Income tax expense	–	–	–	(366,160)	(366,160)
Net profit for the year	414,965	1,153,703	1,269,088	(775,082)	2,062,674
Depreciation and amortization	(4,903)	(188,005)	(106)	(4,241)	(197,255)
Capital expenditure	(2,683)	(22,865)	(10)	(1,593)	(27,151)
Segment assets	44,332,957	36,638,607	145,994,973	–	226,966,537
Unallocated assets	–	–	–	146,463	146,463
Total assets	44,332,957	36,638,607	145,994,973	146,463	227,113,000
Segment liabilities	(17,600,926)	(156,060,154)	(31,263,776)	–	(204,924,856)
Unallocated liabilities	–	–	–	(1,102,136)	(1,102,136)
Total liabilities	(17,600,926)	(156,060,154)	(31,263,776)	(1,102,136)	(206,026,992)

(All amounts expressed in thousands of HK$ unless otherwise stated)

34 SEGMENTAL ANALYSIS *(continued)*

	2018				
	Corporate Banking	Personal Banking	Treasury	Others	Total
External net interest income	310,288	(1,112,676)	2,659,198	17	1,856,827
Inter-segment net interest income/ (expense)	142,634	2,622,393	(2,765,017)	(10)	–
Net interest income	452,922	1,509,717	(105,819)	7	1,856,827
Net fee and commission income	109,624	630,242	(7,210)	–	732,656
Net gains arising from trading activities	1,198	23,771	341,853	–	366,822
Net losses arising from financial investments	–	–	(9,851)	–	(9,851)
Dividend income	–	–	700	–	700
Other operating income	132	15,957	2,513	2,380	20,982
Total operating income	563,876	2,179,687	222,186	2,387	2,968,136
Change in expected credit losses	(123,831)	10,754	(78,442)	(21,070)	(212,589)
Other operating expense					
– Depreciation and amortization	(1,635)	(27,443)	(221)	(3,855)	(33,154)
– Others	(96,768)	(930,353)	(69,893)	(373,604)	(1,470,618)
Profit before tax	341,642	1,232,645	73,630	(396,142)	1,251,775
Income tax expense	–	–	–	(268,758)	(268,758)
Net profit for the year	341,642	1,232,645	73,630	(664,900)	983,017
Depreciation and amortization	(1,635)	(27,443)	(221)	(3,855)	(33,154)
Capital expenditure	(265)	(18,620)	(636)	(6,614)	(26,135)
Segment assets	33,113,049	35,889,221	138,735,707	–	207,737,977
Unallocated assets	–	–	–	138,745	138,745
Total assets	33,113,049	35,889,221	138,735,707	138,745	207,876,722
Segment liabilities	(8,324,919)	(156,349,405)	(23,908,166)	–	(188,582,490)
Unallocated liabilities	–	–	–	(660,999)	(660,999)
Total liabilities	(8,324,919)	(156,349,405)	(23,908,166)	(660,999)	(189,243,489)

35 NON-ADJUSTING EVENT AFTER REPORTING PERIOD

35.1 Coronavirus and impact on ECL

The economic impact of the coronavirus outbreak for business and the world economy is expected to gradually unfold. Economic fallout from coronavirus in China, being the world's second-largest economy and leading trading nation, is expected to greatly impact the global economy and local community. Factory shutdowns in China is slowing the flow of products and parts exported, which affecting companies around the world. Nevertheless the impact is expected to be controllable as the Chinese government has stepped up efforts to support different industries, such as bank facilities, tax reduction and rent exemption.

In terms of risk management, the Company will continue to closely monitor the development of the coronavirus outbreak during 2020 through on-going comprehensive risk assessment and stressed testing, and will consider the impact on key economic indicators and scenarios when determining ECL estimate under HKFRS 9, as well as update its risk management measures for principal risks as necessary.

In addition, the Company has introduced corresponding contingency measures such as adopting flexible working hours, split operation for key function of business units. The Company has also introduced work-from-home arrangement whereby staff can use secured equipment provided by the Company to perform certain work remotely. The Company has suspended all travel to China and discourages all other travel unless business critical and has introduced quarantined at home arrangement for staff returning from overseas travel. The health of our staff and our customers is our top priority and is closely monitored. The Company provides disposable surgical masks, cleaning supplies to ensure enough protection to staff when work in office, as well as suspends all staff social gatherings activities. The Company also flexibly adjusts the number of branches and business centers for the temporary closure to reduce the chance of potential infection of the coronavirus in the community.

35.2 Issuance of Capital instruments

The Company issued USD500 million non-cumulative subordinated additional Tier 1 capital securities on 3 March 2020.

36 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to current year presentation.

Unaudited Supplementary Financial Information

For the year ended 31 December 2019

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

1 Corporate Governance

Sound corporate governance is the system guarantee for sustainable development and the key for prudent operation of a commercial bank. The Company was committed to fulfill the responsibilities of corporate governance and continuously moved forward the establishment of the corporate governance policy and mechanism. The Company also refined the assignment of duties and authorities of Specialized Committees under the Board of Directors ("Board") which continuously enhance the effectiveness of corporate governance.

The Company has complied with, in material respects, the requirements set out in the Supervisory Policy Manual Module, CG-1 "Corporate Governance of Locally Incorporated Authorised Institutions" issued by the Hong Kong Monetary Authority ("HKMA").

The Company has established a corporate governance structure comprising the Sole Shareholder, the Board of Directors, the Specialized Committees, Management-level Committee and Senior Management, with clearly defined authorities and responsibilities, balanced equilibrium, and coordinated and independent operation.

The Board has set up four (4) Specialized Committees, namely Audit Committee, Nomination Committee, Remuneration Committee and Risk Management Committee since June 2017. The Specialized Committees are responsible for reporting its work to the Board, and to assist the Board to perform their duties in accordance with authorization from the Board.

2 Board of Directors

The Board is at the core of the Company's corporate governance framework and has the ultimate responsibilities to the shareholder, depositors, creditors, employees, banking supervisors and other stakeholders of the Company. In discharging its responsibilities, the Board strives to establish sound risk management and internal control systems for ensuring the business and operations are managed in a prudent, professional and competent manner and in conformity with relevant laws and regulations.

Generally, the key responsibilities of the Board are as follows:

(1) To formulate the objectives and strategies as well as monitoring the implementation thereof;

(2) To review and monitor the risk management and internal control system;

(3) To appoint senior management and monitor its performance;

(4) To set corporate values and standards to promote ethical and responsible professional behavior amongst staff;

(5) To oversee and monitor Senior Management's implementation of remuneration system; and

(6) To review and approve the annual business plans and financial budgets.

2 Board of Directors *(continued)*

During the year, the Board had held seven (7) meetings and major works performed by the Board include:

(1) Approval of appointment of Chief Risk Officer;

(2) Approval of annual financial budget and financial accounts;

(3) Approval of the appointment of one Executive Director;

(4) Approval of the appointments of 2 Independent Non-executive Directors and the appointment of chairman and member of the Specialized Committees;

(5) Review and approval of the risk appetite, the recovery plan, report of Internal Capital Adequacy Assessment Process ("ICAAP") as well as various risk management and capital management policies;

(6) Review of the work carried out by Specialized Committees; and

(7) Review of the annual statement of business continuity plan and the business continuity drill report.

3 Audit Committee

The Audit Committee, established and authorized by the Board, is primarily responsible for monitoring the effectiveness of the Company's Internal Audit function and work performed by external auditors. The main duties of the Audit Committee are as follows:

(1) To draw up, review and update periodically the Terms of Reference of the Audit Committee for the Board's approval;

(2) To establish the responsibility and independence of the Internal Audit function, and to provide guidance to the Audit Department of the Company;

(3) To approve the Audit Charter drawn up and updated periodically by the Audit Department of the Company;

(4) To approve the annual Audit Plan and the related manpower and financial resources required after identifying the areas of risk within the Company's operations to be covered;

(5) To assess all major aspects of the Internal Audit function periodically, and to make suggestions for improvement on its effectiveness;

(6) To receive audit reports and review significant recommendations and implementation plans and furthermore, to ensure that the Senior Management has taken timely remedial actions as necessary to tackle the internal control weaknesses, the areas of non-compliance with the laws, regulations and policies and issues identified by external auditors;

(7) To review ad-hoc non-compliance incident reports and HKMA on-site examination reports, etc.;

(8) To recommend to the Board with regard to the appointment, remuneration and termination of external auditors, to consider their audit work plans, and to review their audit conclusions and significant recommendations;

(9) To review accounting policies, financial conditions and financial reporting process; and

(10) To provide opportunities for external and internal auditors to meet and discuss their respective findings.

3 Audit Committee *(continued)*

According to the Terms of Reference of the Audit Committee, all Audit Committee members should be Non-executive Directors appointed by the Board. Besides, the majority of whom (including the Chairman) should be Independent Non-executive Directors. All current members of the Audit Committee are Independent Non-executive Directors; namely Mr. Tang Kwai Chang (Chairman of the Audit Committee), Mr. Chan Ka Lok and Ms. Chan Ching Har Eliza. Ms. Chan Ching Har Eliza was appointed as a member of Audit Committee on 3 September 2019.

During the year, the Audit Committee had held four (4) meetings.

4 Nomination Committee

The main duties of the Nomination Committee are as follows:

(1) To identify individuals suitably qualified to become members of the Board or of Senior Management, and to select, or to make recommendations to the Board on the selection of, individuals nominated for directorships and Senior Management positions; and to ensure objectivity and independence in the selection process for Board members and Senior Management;

(2) To make recommendations to the Board on the appointment or re-appointment of Directors and succession planning for Directors;

(3) To review the independence of the Independent Non-executive Directors;

(4) To undertake regular assessments of the Board performance to assist the Board in reviewing the efficiency and effectiveness of the functioning of the Board; and

(5) To undertake regular assessments of the ongoing suitability of each Board member.

The Nomination Committee comprises at least three members. The majority of members shall be Independent Non-executive Directors. All current members of the Nomination Committee are Independent Non-executive Directors, namely Ms. Chan Ching Har Eliza (Chairman of the Nomination Committee), Mr. Chan Ka Lok and Mr. Lam Yim Nam. Mr. Shou Fugang resigned as the Chairman of the Nomination Committee on 27 February 2019, and Mr. Wang Feng was appointed as the Chairman of the Nomination Committee on the same day. Mr. Wang Feng resigned as the Chairman of the Nomination Committee on 3 September 2019, and Ms. Chan Ching Har Eliza was appointed as the Chairman of the Nomination Committee on the same day. Mr. Lam Yim Nam was appointed as a member of the Nomination Committee on 23 December 2019.

Six (6) Nomination Committee meetings were held during the year. Major works performed during the year include:

(1) Consideration of the matters relating to the adjustment and appointment of Directors and Senior Management;

(2) Review and amendment to the Terms of Reference of the Nomination Committee;

(3) Review and amendment to policies related to the succession and appointment of Directors and Senior Management; and

(4) Evaluation of the performance of the Board, its Specialized Committees and the Board members.

5 Remuneration Committee

The main duties of the Remuneration Committee are as follows:

(1) To make recommendations to the Board on the Company's remuneration policy and structure for all Directors, Chief Executive (including Alternate Chief Executives), Senior Management and Key Personnel and on the establishment of a formal and transparent procedure for developing a remuneration policy;

(2) To make recommendations to the Board on the remuneration by reference to corporate goals and objectives resolved by the Board, and on the remuneration packages of Directors, Chief Executive, Senior Management and Key Personnel;

(3) To make recommendations in respect of remuneration policy and practices to the Board, and to ensure that the remuneration policy is consistent with the principles set out in the Supervisory Policy Manual Module, CG-5"Guideline on a Sound Remuneration System" of HKMA and any other legal or regulatory requirements;

(4) To develop and promote a sound bank culture according to the "Bank Culture Reform" guidance issued by HKMA, to support prudent risk management and to contribute towards promoting proper staff behavior leading to positive customer outcomes and high ethical standards in the banking industry; to lay down the Company's ethical standards and promote them to all levels of staff; to review and approve the proposed amendment of the Code of Conduct; to ensure the Company has adequate systems to enforce the Code of Conduct; to resolve complex ethical dilemmas;

(5) To exercise competent and independent judgement on remuneration policies and practices, as well as the incentives thereby created for managing risk, capital and liquidity; to work closely with other relevant Board Committees and consulting compliance function in the evaluation of the incentives created by the remuneration system; and

(6) To ensure that a regular review of the Company's remuneration system and its operation, either internally conducted or externally commissioned, is carried out independently of management and the result is submitted to the HKMA.

The Remuneration Committee comprises at least three members. The Committee shall be chaired by an Independent Non-executive Director, and the majority of members shall be Independent Non-executive Directors. Current members of the Remuneration Committee are Mr. Chan Ka Lok (Chairman of the Remuneration Committee), Mr. Tang Kwai Chang and Ms. Zhu Chen.

Five (5) Remuneration Committee meetings were held during the year. Major works performed during the year include:

(1) Review and amendment to remuneration policies;

(2) Review and amendment to the Terms of Reference of the Remuneration Committee;

(3) Review and amendment to the Staff Code of Conduct;

(4) Consideration of the deferred remuneration mechanism;

(5) Consideration of the proposal on staff bonus for year 2018 and of the proposal on salary adjustment for year 2019;

(6) Consideration of remuneration relating to the adjustment and appointment of Senior Management;

(7) Consideration of the report on independent compliance review of HKMA CG-5 prepared by consultancy firm;

(8) Listening to the report of the annual audit review on remuneration policies; and

(9) Listening to the audit report and implementation report on bank culture reform.

6 Risk Management Committee

The function of Risk Management Committee is as follow:

(1) Establish the risk appetite and the strategy in risk management for the Company, judge the risk level in each kind of risk;

(2) Identify, assess, and manage different kind of risk faced by the Company;

(3) Review and access the risk management process of the Company, and the adequacy of system and internal control;

(4) Review and monitor the compliance of risk management policies, procedures, system and internal control; and

(5) Annually review the ICAAP procedure and report of the Company. After considering the business and risk strategy, ensure the Company has adequate capital to cater for major risk.

Risk Management Committee is composed of 3 independent non-executive directors and 1 executive director. Four (4) Risk Management Committee meetings were held in the year 2019. The major task completed by Risk Management Committee included the following:

(1) Review and recommend risk management strategy, and risk level/appetite that could be accepted by the Company for Board approval;

(2) Review and access whether the Company's risk management structure and policies is able to identify, measure, monitor and control the risk faced by the Company; and if the risk management structure and policies function effectively;

(3) Review the report from Comprehensive Risk Management Committee about the risk exposures and risk management activities;

(4) Review, approve and monitor high level risk policies and measures;

(5) Approve various risk management limits; and

(6) Review and recommend the Recovery Plan for Board approval.

The Risk Management Committee comprises at least three members. Current members of the risk Management Committee are Mr. Lam Yim Nam (Chairman of the Risk Management Committee), Mr. Tang Kwai Chang, Ms. Chan Ching Har Eliza and Mr. Fan Chaorong. Mr. Lam Yim Nam was appointed as the Chairman of the Risk Management Committee on 23 December 2019. Ms. Chan Ching Har Eliza and Mr. Fan Chaorong were appointed as a member of the Risk Management Committee on 3 September 2019 and 20 September 2019 respectively. Mr. Cheng Man Wang resigned as the member of the Risk Management Committee on 20 September 2019.