交通銀行（香港）
BANK OF COMMUNICATIONS (HONG KONG)

Bank of Communications (Hong Kong) Limited
(Incorporated in Hong Kong with limited liability)

2023 ANNUAL REPORT

CREATE SHARED VALUE

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 "Bank") hereby submit their report with the audited financial statements for the year ended 31 December 2023.

Principal activity

The principal activity of the Bank is provision of banking services in Hong Kong.

Results and appropriations

The results of the Bank for the year are set out in the statement of profit or loss and other comprehensive income on page 9.

The board of directors do not recommend the payment of a dividend in respect of the year ended 31 December 2023.

Business Review

No business review was presented for the year ended 31 December 2023 as the Bank 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 (incorporated in People's Republic of China).

Donations

There were no charitable and other donations made by the Bank during the year (2022: HK$Nil).

Share Capital

There has been no new issue of share capital for the year ended 31 December 2023. Details of the share capital are set out in note 31 to the financial statements.

Directors of the Bank

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

Chairman:

Hao Cheng (appointed on 7 February 2023)

Executive directors:

Meng Yu
Zhu Bin (resigned on 20 June 2023)
Fan Chaorong (resigned on 20 June 2023)

Non-executive directors:

Hao Cheng (appointed on 7 February 2023)
Shan Zengjian (appointed on 20 November 2023)
Wu Ye
Han Yuemin (appointed on 7 March 2023; resigned on 20 June 2023)
Wang Xianjia (appointed on 6 September 2023; resigned on 24 November 2023)

Independent non-executive directors:

Chan Ka Lok
Tang Kwai Chang
Chan Ching Har Eliza
Lam Yim Nam

Directors of the Bank *(continued)*

Zhu Bin and Fan Chaorong resigned on 20 June 2023 as executive directors of the Bank, Han Yuemin resigned on 20 June 2023 as non-executive director of the Bank, and Wang Xianjia resigned on 24 November 2023 as non-executive director of the Bank. Zhu Bin, Fan Chaorong, Han Yuemin and Wang Xianjia had confirmed that they had no disagreement with the Board and nothing relating to the affairs of the Bank needed to be brought to the attention of the shareholders of the Bank.

In accordance with the Bank's Articles of Association, the existing directors except Shan Zengjian shall remain in the office.

Pursuant to Articles 23.2, 23.5 and 24 of the Bank's Articles of Association, Shan Zengjian will retire and, being eligible to offer himself for election as director of the Bank at the forthcoming Annual General Meeting.

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

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

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

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

Management contracts

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

Permitted indemnity provisions

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

Auditor

A resolution for the re-appointment of KPMG as auditor of the Bank is to be proposed at the forthcoming Annual General Meeting.

On behalf of the Board

Meng Yu, Director

Hong Kong, 11 April 2024

Independent Auditor's Report

KPMG

To the members of Bank of Communications (Hong Kong) Limited
(incorporated in Hong Kong with limited liability)

Opinion

We have audited the financial statements of Bank of Communications (Hong Kong) Limited (the "Bank") set out on pages 9 to 97, which comprise the statement of financial position as at 31 December 2023, the statement of profit or loss and other comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended and notes to the financial statements, including material accounting policy information.

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2023 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 of 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 are independent of the Bank 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. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion

Key Audit Matters

Key audit matter is the matter that, in our professional judgement, was of most significance in our audit of the financial statements of the current period. This matter was addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on this matter.

ECL allowances on loans and advances to customers

Refer to note 3.1 and 19 to the financial statements and the accounting policies on page 28.

The Key Audit Matter

The total allowances for expected credit losses ("ECLs") on the bank's loans and advances to customers as at 31 December 2023 amounted to HK$6,227 million, comprising of HK$371 million, HK$216 million and HK$5,640 million in stages 1,2 and 3 respectively. Refer to notes 3.1 and 19 to the Bank's financial statements.

ECL allowances of the Bank are determined based on management's assessment of changes in credit quality of the loans and advances to customers since their initial recognition using a three-stage impairment model. Loan exposures are classified as stage 1 when there is no significant increase in credit risk since initial recognition ("SICR"), for which a 12-month ECL allowance is recognised. Loan exposures that experience a significant increase in credit risk since initial recognition are classified as stage 2 and those that are credit-impaired are classified as stage 3. For loan exposures that are classified as stage 2 or stage 3, the loss allowance is measured at an amount equal to lifetime ECL.

For loans and advances to customers classified as stage 1 or stage 2, a risk parameter modelling approach applies, which considers the probability of default, loss given default, exposure at default, and adjustments for forward-looking information, including management's macro-economic forecasts ("MEFs") and their likelihoods. For loans and advances to customers in stage 3, the ECL allowances are determined based on future cash flows expected to be received from those loans and advances.

The application of the ECL modelling methodology and appropriateness of management's assumptions require ongoing assessment as part of the Bank's governance process and particularly essential under the pandemic situation.

How the matter was addressed in our audit

Our audit procedures to assess the ECL allowance on loans and advances to customers included the following:

- Understanding and assessing the design, implementation and operating effectiveness of key internal controls on the governance process over the ECL methodology and the assumptions used in the ECL models, including assessment of significant management judgements applied over SICR and internal credit ratings and determination of probability weighting assigned to economic scenarios and management judgmental adjustment, if any;

- with the involvement of our information technology specialists, assessing the design, implementation and operating effectiveness of key internal controls over key data inputs into source systems, user access management, and interfaces between the source systems and financial reporting system in relation to the ECL assessment.

- With the assistance of our financial risk management specialists, assessing the appropriateness of the key assumptions in the ECL models, including the criteria used by management in determining loss stages, the probability of default, loss given default, adjustments for forward-looking information and other management adjustments, if any.

- With the assistance of our financial risk management specialists, evaluating the reasonableness and appropriateness of management's estimate of the post-model adjustment, giving specific considerations to the impact of COVID-19 and performing sensitivity analysis.

Key Audit Matters *(continued)*

ECL allowances on loans and advances to customers (continued)

Refer to note 3.1 and 19 to the financial statements and the accounting policies on page 28.

The Key Audit Matter

Determination of significant increase in credit risk, development of the ECL modelling methodology and inputs required significant management judgements.

ECL allowances on loans and advances to customers across the banking industry continues to be an area of elevated focus because of the global economic outlook, including the economies of Hong Kong and Mainland China, and the recovery from the continuing impact of the COVID-19 pandemic.

We identified the measurement of ECL allowances on loans and advances to customers as a key audit matter because of the inherent uncertainty and management judgment involved and because of its significance to the financial results and capital of the Bank.

How the matter was addressed in our audit

- assessing the accuracy of the loan information in the ECL model by comparing individual loan information, on a sample basis, with the underlying agreements and other related documentation;

- assessing, on a sample basis, the reasonableness of the SICR assessment as well as the internal credit ratings which in turn drives the probability of default used in the ECL calculation. Our assessment considered the financial and non-financial information of the borrowers, along with external information available, including adjusting events occurred after the year end of 31 December 2023, if any.

Information other than the financial statements and auditor's report thereon

The directors are responsible for the other information. The other information comprises all the information included in the annual report, other than 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 the directors 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 Bank'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 Bank or to cease operations, or have no realistic alternative but to do so.

The directors are assisted by the Audit Committee in discharging their responsibilities for overseeing the Bank'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. This report is made 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 judgement 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 Bank'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 Bank'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 Bank 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.

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

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

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

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

The engagement partner on the audit resulting in this independent auditor's report is Wong Po Shan.

KPMG
Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

11 April 2024

Statement of Profit or Loss and Other Comprehensive Income

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

	Notes	Year ended 31 December 2023	2022
Interest income calculated using effective interest rate		**22,521,328**	12,062,888
Interest expense		**(13,580,880)**	(6,568,575)
Net interest income	*4*	**8,940,448**	5,494,313
Fee and commission income	*5*	**986,754**	907,045
Fee and commission expense	*6*	**(75,636)**	(66,837)
Net fee and commission income		**911,118**	840,208
Net (losses)/gains arising from trading activities	*8*	**(786,989)**	337,443
Net losses arising from financial investments		**(381,279)**	(334,984)
Dividend income	*7*	**35**	35
Other operating income	*9*	**50,422**	33,237
Change in expected credit losses	*10*	**(4,056,148)**	(1,786,094)
Other operating expenses	*11*	**(1,854,026)**	(1,704,661)
Profit before tax		**2,823,581**	2,879,497
Income tax expenses	*14*	**(417,507)**	(472,064)
Net profit for the year		**2,406,074**	2,407,433
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		**830**	(282)
Items that may be reclassified to profit or loss:			
Loans and advances to customers at fair value through other comprehensive income			
Net gains recorded in equity		**–**	3,473
Debt investments at fair value through other comprehensive income			
Net gains/(losses) recorded in equity		**870,317**	(2,554,881)
Net losses reclassified from equity to profit or loss		**318,368**	279,712
Net gains arising from cash flow hedge		**4,161**	–
Other comprehensive income/(loss) for the year		**1,193,676**	(2,271,978)
Total comprehensive income for the year		**3,599,750**	135,455

The notes on pages 14 to 97 form a part of these financial statements.

Statement of Financial Position

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

		As at 31 December	
	Notes	**2023**	2022
ASSETS			
Cash and balances with central bank	15	**1,694,274**	2,267,480
Due from and placements with banks and other financial institutions	16	**24,176,735**	24,547,060
Financial assets at fair value through profit or loss	17	**10,353,084**	13,577,897
Financial assets at amortized cost	20	**46,685,972**	49,711,258
Financial assets at fair value through other comprehensive income	20	**141,280,949**	161,352,270
Loans and advances to customers	19	**191,991,477**	208,047,769
Property and equipment	21	**75,280**	72,234
Current income tax assets		**5,100**	–
Deferred income tax assets	22	**–**	173,195
Right-of-use assets	23	**253,691**	169,447
Other assets	24	**8,437,802**	7,093,151
Total assets		**424,954,364**	467,011,761
LIABILITIES			
Due to banks and other financial institutions	25	**17,044,251**	58,293,873
Due to customers	26	**333,327,098**	338,218,450
Financial liabilities at fair value through profit or loss	27	**2,703,827**	1,994,313
Certificates of deposits issued	28	**1,788,345**	1,757,007
Current income tax liabilities		**–**	55,143
Deferred income tax liabilities	22	**82,774**	–
Lease liabilities	23	**261,695**	172,297
Debt securities issued	29	**7,809,900**	7,797,780
Other liabilities	30	**7,932,919**	8,172,978
Total liabilities		**370,950,809**	416,461,841
EQUITY			
Share capital	31	**37,900,000**	37,900,000
Other reserves		**1,101,892**	(91,784)
Retained earnings		**11,130,213**	8,870,254
Total equity attributable to shareholders of the Bank		**50,132,105**	46,678,470
Additional equity instrument	32	**3,871,450**	3,871,450
Total equity		**54,003,555**	50,549,920
Total equity and liabilities		**424,954,364**	467,011,761

The financial statements were approved and authorized for issuance by the Board of Directors on 11 April 2024 and signed on its behalf by:

Meng Yu, *Director* **Wu Ye,** *Director*

The notes on pages 14 to 97 form a part of these financial statements.

Statement of Changes in Equity

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

	Notes	Share capital	Other reserves (Note (b))	Retained earnings (Note (a))	Attributable to the shareholder of the Bank	Additional equity instrument	Total
At 1 January 2023		**37,900,000**	**(91,784)**	**8,870,254**	**46,678,470**	**3,871,450**	**50,549,920**
Net profit for the year		**–**	**–**	**2,406,074**	**2,406,074**	**–**	**2,406,074**
Other comprehensive income		**–**	**1,193,676**	**–**	**1,193,676**	**–**	**1,193,676**
		37,900,000	**1,101,892**	**11,276,328**	**50,278,220**	**3,871,450**	**54,149,670**
Dividends paid to additional equity instrument holders	32	**–**	**–**	**(146,115)**	**(146,115)**	**–**	**(146,115)**
At 31 December 2023		**37,900,000**	**1,101,892**	**11,130,213**	**50,132,105**	**3,871,450**	**54,003,555**
At 1 January 2022		37,900,000	2,180,194	6,608,694	46,688,888	3,871,450	50,560,338
Net profit for the year		–	–	2,407,433	2,407,433	–	2,407,433
Other comprehensive income		–	(2,271,978)	–	(2,271,978)	–	(2,271,978)
		37,900,000	(91,784)	9,016,127	46,824,343	3,871,450	50,695,793
Dividends paid to additional equity instrument holders	32	–	–	(145,873)	(145,873)	–	(145,873)
At 31 December 2022		37,900,000	(91,784)	8,870,254	46,678,470	3,871,450	50,549,920

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 Bank subject to consultation with the HKMA. As at 31 December 2023, HK$1,262,639,000 (2022: HK$1,271,308,000) was earmarked as the regulatory reserve from the retained earnings.

Note (b):

Other reserves include HK$4,161,000 (2022: HK$Nil) of hedging reserve as at 31 December 2023.

The notes on pages 14 to 97 form a part of these financial statements.

Statement of Cash Flows

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

	Year ended 31 December	
	2023	2022
Cash flows from operating activities:		
Profit before tax	**2,823,581**	2,879,497
Adjustments for:		
Change in expected credit losses	**4,056,148**	1,786,094
Depreciation and amortization	**42,051**	34,578
Depreciation of right-of-use assets	**155,195**	143,268
Finance costs – lease interest expense	**4,356**	1,751
Interest expense for debt securities issued	**180,397**	180,424
Loss on disposal of property and equipment	**64**	276
Interest income from financial investments	**(7,307,511)**	(6,306,940)
Fair value (gains)/losses	**(4,358,141)**	40,165
Dividend income	**(35)**	(35)
Net losses/(gains) arising from financial investments	**381,279**	(334,984)
Effect of changes in exchange rates	**12,120**	1,090
Release of cash flow hedge reserve to profit or loss	**2,185**	–
Operating cash flows before movements in operating assets and liabilities	**(4,008,311)**	(1,574,816)
Net decrease/(increase) in due from and placements with banks and other financial institutions	**5,470,413**	(11,133,991)
Net decrease/(increase) in financial assets at fair value through profit or loss	**4,675,989**	(9,982,575)
Net decrease/(increase) in loans and advances to customers	**12,212,774**	(21,456,675)
Net increase in other assets	**(1,364,365)**	(3,040,164)
Net (decrease)/increase in due to banks and other financial institutions	**(41,249,622)**	6,395,089
Net increase in financial liabilities at fair value through profit or loss	**709,514**	379,720
Net (decrease)/increase in due to customers	**(4,891,352)**	6,491,316
Net increase/(decrease) in certificates of deposits issued	**32,567**	(1,996,724)
Net decrease in other liabilities	**(247,096)**	(1,277,188)
Income tax paid	**(504,362)**	(579,186)
Net cash outflows from operating activities	**(29,163,851)**	(37,775,194)

The notes on pages 14 to 97 form a part of these financial statements.

Statement of Cash Flows

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

		Year ended 31 December	
	Note	**2023**	2022
Cash flows from investing activities:			
Purchase of financial investments		**(61,598,421)**	(97,094,167)
Disposal or redemption of financial investments		**88,598,278**	123,305,513
Dividend received		**35**	35
Interest received from financial investments		**7,280,369**	5,886,681
Purchase of property and equipment		**(35,389)**	(23,812)
Disposal of property and equipment		**–**	48
Purchase of intangible assets		**(54,730)**	(10,385)
Net cash inflows from investing activities		**34,190,142**	32,063,913
Cash flows from financing activities:			
Principal elements of lease payments		**(150,041)**	(144,382)
Interest paid for lease		**(4,356)**	(1,751)
Interest paid for debt securities issued		**(180,262)**	(180,412)
Dividend paid to additional equity instrument holders		**(146,115)**	(145,873)
Net cash outflows from financing activities		**(480,774)**	(472,418)
Net increase/(decrease) in cash and cash equivalents		**4,545,517**	(6,183,699)
Cash and cash equivalents at the beginning of the year		**14,164,322**	20,348,021
Cash and cash equivalents at the end of the year	34	**18,709,839**	14,164,322
Net cash flows from operating activities include:			
Interest received		**10,530,845**	5,801,870
Interest paid		**(13,375,591)**	(4,217,844)

The notes on pages 14 to 97 form a part of these financial statements.

1 GENERAL

Bank of Communications (Hong Kong) Limited ("the Bank") is a bank 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.

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 MATERIAL 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 Bank adopts the going concern basis in preparing its financial statements.

2.1.1 New and revised HKFRSs effective by 1 January 2023 applied by the Bank

Amendments to HKAS 8 – Definition of Accounting Estimates

The changes to HKAS 8 focus entirely on accounting estimates and clarify the following:

- The definition of a change in accounting estimates is replaced with a definition of accounting estimates. Under the new definition, accounting estimates are "monetary amounts in financial statements that are subject to measurement uncertainty".

- Entities develop accounting estimates if accounting policies require items in financial statements to be measured in a way that involves measurement uncertainty.

- The clarification states that a change in accounting estimate that results from new information or new developments is not the correction of an error. In addition, the effects of a change in an input or a measurement technique used to develop an accounting estimate are changes in accounting estimates if they do not result from the correction of prior period errors.

- A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods. The effect of the change relating to the current period is recognized as income or expense in the current period. The effect, if any, on future periods is recognized as income or expense in those future periods.

Amendments to HKAS 1 and HKFRS Practice Statement 2 – Disclosure of Accounting Policies

Disclosure of Accounting Policies (Amendments to HKAS 1 and HKFRS Practice Statement 2) amends HKAS 1 in the following ways:

- An entity is now required to disclose its material accounting policy information instead of its significant accounting policies;

- Several paragraphs are added to explain how an entity can identify material accounting policy information and to give examples of when accounting policy information is likely to be material;

- The amendments clarify that accounting policy information may be material because of its nature, even if the related amounts are immaterial;

- The amendments clarify that accounting policy information is material if users of an entity's financial statements would need it to understand other material information in the financial statements; and

- The amendments clarify that if an entity discloses immaterial accounting policy information, such information shall not obscure material accounting policy information.

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

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.1 Basis of preparation *(continued)*

2.1.1 New and revised HKFRSs effective by 1 January 2023 applied by the Bank (continued)

Amendments to HKAS 12 – Deferred Tax related to Assets and Liabilities arising from a Single Transaction

- The amendments require an entity to recognize deferred tax on transactions that, on initial recognition, give rise to equal amounts of taxable and deductible temporary differences. They will typically apply to transactions such as leases and decommissioning liabilities and will require the recognition of additional deferred tax assets and liabilities.

Amendments to HKAS 12 – International Tax Reform – Pillar Two Model Rules

- The amendments provide entities with temporary relief from accounting for deferred taxes arising from the Organisation for Economic Co-operation and Development's Pillar Two model rules. The amendments also introduce targeted disclosure requirements to help investors understand an entity's exposure to income taxes arising from the rules.

HKICPA Guidance on Abolition of the Mandatory Provident Fund ("MPF") – Long Service Payment ("LSP") Offsetting Mechanism

- Hong Kong employees that have been employed continuously for at least five years are entitled to long service payments in accordance with the Hong Kong Employment Ordinance under certain circumstances. The amount of LSP payable is determined with reference to the employee's final salary and the years of service, reduced by the amount of any accrued benefits derived from the employer's contributions to MPF Schemes or Occupational Retirement Schemes Ordinance Schemes, with an overall cap.

- In June 2022, the Hong Kong SAR Government gazetted the Hong Kong Employment and Retirement Schemes Legislation (Offsetting Arrangement) (Amendment) Ordinance 2022, which will eventually abolish the statutory right of an employer to reduce its LSP payable to a Hong Kong employee by drawing on its accrued benefits derived from its mandatory contributions to the schemes.

- In July 2023, the HKICPA issued guidance for accounting for the impact arising from the abolition of the offsetting mechanism. Depending on which approach was chosen, recognition of additional LSP liabilities and/or LSP-related assets may be required if the employer's voluntary contributions are insufficient to offset the LSP.

The amendments listed above did not have any material impacts on the Bank's accounting policies and did not require retrospective adjustments.

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

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2023 reporting periods and have not been early adopted by the Bank. 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.

		Effective for annual period commencing on or after
Amendments to HKAS 1	Classification of Current or Non-current Liabilities	1 January 2024
Amendments to HKAS 1	Non-current Liabilities with Covenants	1 January 2024
Amendments to HKFRS 16	Lease Liability in a Sale and Leaseback	1 January 2024
Amendments to HKAS 7	Supplier Finance Arrangements	1 January 2024

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies

2.2.1 Interest income and expense

Interest income and expense are recognized in profit or loss for interest-bearing financial instruments classified under amortized cost and fair value through other comprehensive income 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 Bank 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.

2.2.2 Fee and commission income

Fee and commission income is recognized when the Bank fulfills its performance obligation, either over time or at a point in time when a customer obtains control of the service.

For the performance obligations satisfied at a point in time, the Bank recognizes revenue when control is passed to the customer at a certain point in time. For the performance obligations satisfied over time, the Bank recognizes revenue according to the progress toward satisfaction of the obligation over the time.

2.2.3 Dividend income

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

2.2.4 Financial assets and liabilities

Measurement methods

Initial recognition and measurement

Financial assets and financial liabilities are recognized when the Bank 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 Bank commits to purchase or sell the asset.

At initial recognition, the Bank 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 ("ECL") allowance is recognized for financial assets measured at amortized cost and debt investments measured at fair value through other comprehensive income, which results in an accounting loss being recognized in profit or loss when an asset is newly originated.

When the fair value of financial assets and liabilities differs from the transaction price on initial recognition, the Bank 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.

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities (continued)

Measurement methods (continued)

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 ECL 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 Bank 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 Bank revises the estimates of future cash flows, the carrying amount of the respective financial asset 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 classified under amortized cost and fair value through other comprehensive income, 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 allowance).

2.2.4.1 Financial assets

(i) Classification and subsequent measurement

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 Bank's business model for managing the asset; and

(ii) The cash flow characteristics of the asset.

Based on these factors, the Bank 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.

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities (continued)

2.2.4.1 Financial assets (continued)

(i) Classification and subsequent measurement (continued)

Debt instruments *(continued)*

- 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.

- 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 included in "Net gains/losses arising from trading activities" in the period in which it arises.

Business model: the business model reflects how the Bank manages the assets in order to generate cash flows. That is, whether the Bank'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 Bank in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Bank assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Bank 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 entirety when determining whether their cash flows are solely payment of principal and interest.

The Bank 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.

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 Bank subsequently measures all equity investments at fair value through profit or loss, except where the Bank's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Bank'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 Bank'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".

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities (continued)

2.2.4.1 Financial assets (continued)

(ii) Impairment

The Bank 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 Bank recognizes an ECL 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 and note 3.1.2 provides details of how the ECL allowance is measured.

(iii) Modification of loans

The Bank sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Bank assesses whether or not the new terms are substantially different to the original terms. The Bank 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 Bank 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 Bank 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 Bank 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 Bank transfers substantially all the risks and rewards of ownership, or (ii) the Bank neither transfers nor retains substantially all the risks and rewards of ownership and the Bank has not retained control.

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities (continued)

2.2.4.1 Financial assets (continued)

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

The Bank 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 Bank:

(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 Bank under standard repurchase agreements and securities lending and borrowing transactions are not derecognized because the Bank 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 Bank retains a subordinated residual interest.

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

2.2.4.2 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 Bank recognizes any expense incurred on the financial liability; when continuing involvement approach applies, see note 2.2.4.1(iv); and

- Financial guarantee contracts and loan commitments (see note 2.2.5).

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities (continued)

2.2.4.2 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 expired).

The exchange between the Bank 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.

2.2.4.3 Offset financial assets and liabilities

Financial assets and liabilities are offsetted 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.

2.2.5 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 ECL allowance; and
- The premium received on initial recognition less income recognized in accordance with the principles of HKFRS 15.

Loan commitments provided by the Bank are measured as the amount of the ECL allowance. The Bank 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 ECL allowance is recognized as provision. However, for contracts that include both a loan and an undrawn commitment and the Bank 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 ECL 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 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.6 Derivatives and hedging activities

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

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 Bank 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:

(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 Bank 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 Bank 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 Bank documents the economic relationship between hedging instruments and hedged items. The Bank documents its risk management objective and strategy for undertaking its hedge transactions. The Bank 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 qualified 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 interest income.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualified 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.

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 recognized in other comprehensive income remains in equity and is recognized in the periods when the hedged item affects profit or loss if the forecast cash flows are still expected to occur. When a forecast cash flows is no longer expected to occur (for example, the recognized hedged asset is disposed of), the cumulative gain or loss recognized in other comprehensive income is immediately reclassified to the statement of profit or loss.

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.6 Derivatives and hedging activities (continued)

Cash flow hedge (continued)

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 "Net gains/losses arising from trading activities".

2.2.7 Assets sold under repurchase agreements

Financial assets sold subject to agreements with a commitment to repurchase at a pre-determined price on a specified future date 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.

2.2.8 Property and equipment

The Bank's property and equipment mainly comprise 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 Bank 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.

The estimated useful lives and depreciation rate of equipment, transportation equipment and property improvement are as follows:

Type of assets	Estimated useful lives
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.

2.2.9 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 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.10 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 Bank 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 derecognition 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.

2.2.11 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 Bank 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.

2.2.12 Leases

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 Bank.

Contracts may contain both lease and non-lease components. The Bank 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 Bank 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 Bank, 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.

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.12 Leases (continued)

To determine the incremental borrowing rate, the Bank:

- 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 Bank is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life.

For short-term leases with a lease term shorter than 12 months, the Bank recognizes relevant rental expenses on a straight-line basis in profit or loss in each lease period rather than recognising the right-of-use assets or lease liabilities.

2.2.13 Cash and cash equivalents

Cash and cash equivalents are assets with a maturity of less than three 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.

2.2.14 Provisions

Provisions are recognized when the Bank 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 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.15 Current and deferred income taxes

Income tax expense represents the sum of the tax currently payable and deferred income 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 Bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

(b) Deferred income tax

Deferred income 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 income tax liabilities are generally recognized for all taxable temporary differences. Deferred income 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. Deferred income 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 income 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 income 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 income tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. Current and deferred income 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 income tax are also recognized in other comprehensive income.

2.2.16 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 Bank. 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.

2.2.17 Fiduciary activities

In activities where the Bank 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 Bank's financial statements.

2.2.18 Acceptances

Acceptances comprise the Bank'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 MATERIAL ACCOUNTING POLICIES *(continued)*

2.2 Material Accounting Policies *(continued)*

2.2.19 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 Bank 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 Bank's employees. Contributions to the schemes by the Bank 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 Bank prior to his/her interest in the Bank's employer non-mandatory contributions vesting with the employee, the ongoing contributions payable by the Bank 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 Bank.

2.2.20 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 that allocates resources to and assesses the performance of the operating segments of an entity. The Bank has determined the senior management team represented by the Chief Executive as its chief operating decision maker.

An operating segment is a component of the Bank 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 Bank. 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.

2.2.21 Foreign currency translation

HK$ is the currency of the primary economic environment in which the Bank operates. Therefore, the Bank 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 (foreign currencies) are recorded in the functional currency 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 fair value through other comprehensive income non-monetary items denominated in foreign currencies and changes in the carrying amounts (other than the amortized cost) of fair value through other comprehensive income monetary items are recognized as other comprehensive income.

2 MATERIAL ACCOUNTING POLICIES *(continued)*

2.3 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 Bank's accounting policies and the key sources of estimation uncertainty were as follow:

(a) Measurement of the 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, 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;
- Applying management judgmental adjustment to take into account for the model and data limitations, and expert judgement applied after management's review and challenge;
- 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 Bank 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.

3 FINANCIAL RISK MANAGEMENT

The Bank'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 Bank's aim is to achieve an appropriate balance between risk and return and minimize potential adverse effects on the Bank's financial performance.

The Bank'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 Bank 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 Bank. 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 Bank 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 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk

Credit risk, the risk that a borrower or counterparty of the Bank will be unable or unwilling to honor a repayment obligation, is one of the key risks encountered by the Bank as the Bank'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 Bank'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 Bank 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 Bank.

3.1.1 Credit risk management

The Bank'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 Financial Management 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 Bank'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 Bank 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 Bank 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 Bank 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 Bank's relationship manager is the person primarily responsible for post-loan management. The Bank 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 Bank 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 Bank adopts categorized management for retail credit assets on the basis of overdue ageing and ways of guarantee. 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.

Credit Card Centre accounted for independently by the Bank is in charge of the operation and management of credit card business. Credit Card Centre of the Bank 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 Bank 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 Bank 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 Bank 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 Bank are subject to the credit granting review and approval of the Global Market Department and credit limits are placed on such issuers.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management (continued)

(b) Treasury business (continued)

As for derivative instruments, the Bank 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 Bank (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 Bank 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 Bank concludes foreign exchange and interest rate contracts with other financial institutions and clients.

The Bank 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.

(d) Credit risk quality

In accordance with the Guideline on Loan Classification System issued by the HKMA, the Bank has established a loan credit risk classification system and performs credit risk management based on loan classification in one of five categories. The Bank classifies loans into the following five categories: pass, 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 Bank 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 Bank'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 Bank expects to sustain a loss of principal and/or interest, taking into account the net realizable value of security.
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 loan and advances to customers is classified into five categories based on five categories of loan classification.

(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

The Bank 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 Bank has compiled a comprehensive set of financial and other related factors to build an internal credit rating model. This model aims to assess the probability of default by means of historical data collection, data statistics and data analysis to evaluate the risk characteristics of the clients/debts prior to any default event. The Internal rating model employs the principle of regression to predict the probability of default. This probability is then aligned with relevant rank of default risk, which is used to determine the borrower's credit ranking within the internal rating system. To improve the accuracy and stability of the model, the Bank evaluates the model every three months and monitors the results by performing back testing and comparing the results from the model with the actual defaults observed from customers.

The above credit risk factors are taken into account to assess potential credit losses that may be incurred, and are integrated into in the Bank's daily operations.

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

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

For debt securities held in the Treasury portfolio, the credit grades assigned by external rating agencies are mapped to the master scale. This mapping process involves the ongoing monitoring and updating of the published grades. The mapping to the master scale will determine the revised internal credit rating and the probability of default.

The Bank's rating method comprises a system of 18 rating levels for instruments that are not in default (ranging from 1.1 to 1.4 and 2 to 15), along with a default class. The master scale designates a specific range of default probabilities for each rating category, which remains consistent over time. The rating methods undergo annual validation and recalibration, aligning them with the latest projections based on all actual observed defaults. For unrated exposures, the management determines an approximated probability of default (PD) to represent the default risk.

The Bank's internal rating scale are set out below:

Internal Rating	PD Range	Description of Grade
1.1 – 4	0.03% – 0.53%	Investment Grade
5 – 11	0.53% – 14.07%	Standard Monitoring
12 – 15	14.07% – 99.99%	Special Monitoring
Default	100.00%	Default

(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

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 Bank.

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 Bank 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 Bank 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 Bank 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.

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 Bank 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	6
1.4 – 2	5
3 – 5	4
6 – 8	3
9 – 10	2
11 – 15	1

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)

(b) Days past due

Different levels of days 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.

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

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 Bank.

3.1.2.2 Definition of default and credit-impaired assets

The Bank 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 Bank'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, 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 Bank expects to be owed at the time of default. For example, for a revolving commitment, the Bank 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 Bank'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.

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)

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 factors 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.

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, LGDs are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGDs are influenced by collection strategies, including contracted debt sales and price

3.1.2.4 Forward-looking information incorporated in the ECL models

Forward-looking information is incorporated in both the assessment of SICR and the calculation of ECL. The Bank has performed historical analysis to identify the key economic variables that impact credit risk and expected credit losses for each portfolio.

These economic variables and their associated impact on the PD, EAD and LGD vary across different financial instruments. Expert judgment has also been employed in this process. To establish the base economic scenario for the next five years, forecasts of these economic variables are collected from different sources, including economics team of the Bank of Communications Co. Ltd., Development Strategy Team of the Bank and the International Monetary Fund (IMF). After five years, it is assumed that the economic variables will remain stable and the last available forecast is used. A statistical regression analysis has been conducted to ascertain the impact of these economic variables on the PD, EAD and LGD. This analysis aims to understand the historical impact changes in these variables on default rates and on the components of LGD and EAD.

In addition to the base economic scenario, the Bank's Risk Management Department and Development Strategy Team have taken into account other economic scenarios. These scenarios and weightings for each of these scenarios are derived from the calculation of historical data. At 31 December 2022 and 31 December 2023, the Bank concluded that three scenarios were used in the calculation process. The scenario weightings are determined based on expert credit judgment, taking account of the range of potential outcomes that each selected scenario represents.

Following this assessment, the Bank 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 the result by the appropriate scenario weighting (the weighting is applied to the ECL outputs, rather than the inputs).

Similar to all economic forecasts, the projections and probabilities associated with the economic scenarios rely on the estimations of future economic conditions. These estimations are sensitive to changes resulting from macro events such as the COVID-19 pandemic and geopolitical developments. They are, therefore, inherently subject to a high degree of uncertainty and as a result, the actual outcomes may deviate significantly from the projected ones. The Bank regards these forecasts as its best estimation of potential outcomes. Analysis has been conducted to assess the variations across the Bank's diverse portfolios to make sure the selected scenarios adequately encompass the range of possible scenarios. The proposed macroeconomic forecasts and probability weightings are subject to review by the management.

(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 global outbreak of the COVID-19 pandemic has presented unparalleled economic and social challenges across all regions. Governments worldwide have taken various measures, such as social distancing and lockdowns, to mitigate the spread of the virus which, however, have led to a significant downturn in global economic activities throughout 2020. At the same time, a variety of relief measures have been rolled out to prevent further deterioration and facilitate economic recovery on an unprecedented scale. After containment measures for the pandemic were loosened, economic activities in most economies have gradually picked up throughout 2022. However, the pace of recovery slowed down in 2023.

The above developments pertaining to the COVID-19 pandemic and changes in the geopolitical environment during 2023 have added complexities to the estimation of economic scenarios. As a result, the Bank has found it necessary to reassess its economic scenarios and probability weightings when calculating ECL.

The Bank continued to adopt three economic scenarios across all portfolios. These scenarios encompass the "Base" scenario, which is considered the most likely, as well as two additional scenarios known as the "Upside" and "Downside" scenarios. The Upside scenario represents a less likely but more favorable outcome, while the Downside scenario reflects a less likely and less favorable outcome. The "Base" scenario can be described as follows: following a moderate rebound of the global economy in 2022, a mild recovery is anticipated in 2023. This recovery is expected to occur alongside the continuation of contractionary monetary policies in most developed countries, aimed at addressing high levels of inflation. GDP in most regions rebounded moderately in 2022, followed by a further recovery in 2023. However, the extent of recovery is highly uneven within the global economy as China's GDP expanded moderately while a mild recovery is observed in Hong Kong. Furthermore, the unemployment rate is anticipated to decline further in 2023 across most regions, compared with the high levels witnessed in 2020. Forecasts indicate a gradual return to the pre-pandemic growth levels similar to those observed in 2019, over the course of the forthcoming years.

As a result of the above macroeconomic changes observed in 2023, the Bank has revised its forecast about future economic conditions.

Outlined below are the key assumptions at the end of the period used for estimating ECL as at 31 December 2023.

		2024	2025	2026	2027	2028
Hong Kong CPI	Base	**2.0%**	**2.0%**	**2.0%**	**2.0%**	**2.0%**
	Upside	**6.3%**	**5.8%**	**2.8%**	**-4.0%**	**-3.7%**
	Downside	**-1.6%**	**-3.2%**	**-2.5%**	**-0.5%**	**0.9%**
Hong Kong Unemployment rate	Base	**3.0%**	**3.0%**	**3.0%**	**3.0%**	**3.0%**
	Upside	**2.8%**	**2.2%**	**4.7%**	**6.3%**	**4.9%**
	Downside	**5.1%**	**7.3%**	**7.9%**	**6.8%**	**5.6%**
China FI Loans Growth Rate (first difference)	Base	**0.1%**	**0.1%**	**0.1%**	**0.0%**	**0.0%**
	Upside	**0.6%**	**0.1%**	**0.1%**	**0.0%**	**0.0%**
	Downside	**-0.2%**	**0.1%**	**0.1%**	**0.0%**	**0.0%**
US Total investment per nominal GDP (first difference)	Base	**-0.2%**	**0.0%**	**0.2%**	**0.1%**	**0.1%**
	Upside	**0.4%**	**0.7%**	**0.5%**	**0.5%**	**0.3%**
	Downside	**-1.5%**	**-0.5%**	**0.0%**	**0.9%**	**0.7%**

The weightings assigned to each economic scenario as at 31 December 2023 were as follows:

Upside	Base	Downside
10%	80%	10%

(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)

Outlined below are the key assumptions at the end of the period used for estimating ECL as at 31 December 2022.

		2023	2024	2025	2026	2027
Hong Kong CPI	Base	2.5%	3.0%	3.0%	3.0%	3.0%
	Upside	6.3%	5.8%	2.8%	-4.0%	-3.7%
	Downside	-1.6%	-3.2%	-2.5%	-0.5%	0.9%
Hong Kong Unemployment rate	Base	3.5%	3.3%	3.0%	3.0%	3.0%
	Upside	2.8%	2.2%	4.7%	6.3%	4.9%
	Downside	5.1%	7.3%	7.9%	6.8%	5.6%
China FI Loans Growth Rate (first difference)	Base	2.0%	0.8%	0.1%	-0.1%	0.0%
	Upside	17.7%	-14.0%	-9.0%	-1.6%	-0.5%
	Downside	-0.8%	-0.1%	8.8%	-5.1%	-3.4%
US Total investment per nominal GDP (first difference)	Base	-0.2%	-0.1%	0.1%	0.1%	0.0%
	Upside	0.4%	0.7%	0.5%	0.5%	0.3%
	Downside	-1.5%	-0.5%	0.0%	0.9%	0.7%

The weightings assigned to each economic scenario as at 31 December 2022 were as follows:

Upside	Base	Downside
10%	80%	10%

In addition to the scenarios mentioned above, other forward-looking factors, including the impact of any regulatory, legislative or political changes, have been taken into account as well. However, these factors are not deemed to have a material impact and therefore no adjustment has been made to the ECL to account for them. This assessment is reviewed and monitored on a regular basis as to whether it is appropriate.

(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 2023**	As at 31 December 2022
Probability-weighted ECL	**6,595,658**	2,956,301
Base ECL	**6,558,317**	2,902,207
Difference in amount	**37,341**	54,094
Difference in percentage	**0.6%**	1.8%

Management judgmental adjustment

As the local economy began to pick up in 2023 and the Hong Kong government discontinued the relief measures, the potential risks associated with the loans to local Small and Medium Enterprises ("SMEs") in the Bank's loan portfolio were minimized, Consequently, the need for management judgmental adjustment in response to the current situation was no longer applicable. As a result, no management judgmental adjustment was made for the year ended 31 December 2023 (2022: HK$203,175,000).

Regarding HKFRS 9, management judgmental adjustment refers to the short-term upward or downward adjustment in ECL to account for limitations in model and data, as well as the application of expert judgment subsequent to management's review and scrutiny.

Management judgmental adjustment made in estimating the reported ECL at 31 December 2023 and 2022 are set out in the following table. It shows the adjustment applicable to the probability-weighted ECL.

	As at 31 December 2023	As at 31 December 2022
SMEs lending adjustments	–	203,175
Probability-weighted ECL	**6,595,658**	2,956,301
Percentage of adjustments	–	6.9%

(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 which an ECL allowance is recognized.

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

Loans and advances to customers at amortized cost – Corporate Loan	**2023** Stage 1 12 month ECL	**2023** Stage 2 Lifetime ECL	**2023** Stage 3 Lifetime ECL	**2023** Total
Investment Grade	**30,055,851**	**1,565,110**	**–**	**31,620,961**
Standard Monitoring	**56,221,905**	**9,736,839**	**–**	**65,958,744**
Special Monitoring	**314,373**	**1,360,882**	**–**	**1,675,255**
Defaults	**–**	**–**	**6,226,157**	**6,226,157**
Unrated	**25,219,559**	**5,511,750**	**–**	**30,731,309**
Gross carrying amount	**111,811,688**	**18,174,581**	**6,226,157**	**136,212,426**
ECL allowance	**(326,676)**	**(192,786)**	**(5,609,384)**	**(6,128,846)**
Carrying amount	**111,485,012**	**17,981,795**	**616,773**	**130,083,580**

Loans and advances to customers at amortized cost – Corporate Loan	2022 Stage 1 12 month ECL	2022 Stage 2 Lifetime ECL	2022 Stage 3 Lifetime ECL	2022 Total
Investment Grade	43,157,927	4,689,895	–	47,847,822
Standard Monitoring	54,499,232	6,525,882	–	61,025,114
Special Monitoring	816,817	843,756	–	1,660,573
Defaults	–	–	5,752,876	5,752,876
Unrated	33,233,682	752,712	–	33,986,394
Gross carrying amount	131,707,658	12,812,245	5,752,876	150,272,779
ECL allowance	(526,961)	(92,350)	(1,982,779)	(2,602,090)
Carrying amount	131,180,697	12,719,895	3,770,097	147,670,689

(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)

	2023			
Loans and advances to customers at amortized cost – Retail Loan	**Stage 1 12 month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Investment Grade	**60,983,504**	**176,306**	**–**	**61,159,810**
Standard Monitoring	**607,814**	**122,554**	**–**	**730,368**
Special Monitoring	**–**	**69,809**	**–**	**69,809**
Defaults	**–**	**–**	**94,162**	**94,162**
Gross carrying amount	**61,591,318**	**368,669**	**94,162**	**62,054,149**
ECL allowance	**(44,170)**	**(23,860)**	**(30,618)**	**(98,648)**
Carrying amount	**61,547,148**	**344,809**	**63,544**	**61,955,501**

	2022			
Loans and advances to customers at amortized cost – Retail Loan	Stage 1 12 month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Investment Grade	59,841,951	35,230	–	59,877,181
Standard Monitoring	114,516	496,945	–	611,461
Special Monitoring	–	34,782	–	34,782
Defaults	–	–	48,072	48,072
Gross carrying amount	59,956,467	566,957	48,072	60,571,496
ECL allowance	(27,606)	(47,299)	(29,141)	(104,046)
Carrying amount	59,928,861	519,658	18,931	60,467,450

	2023			
Due from and placements with banks and other financial institutions	**Stage 1 12 month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Investment Grade	**20,801,837**	**–**	**–**	**20,801,837**
Standard Monitoring	**3,395,496**	**–**	**–**	**3,395,496**
Unrated	**–**	**–**	**–**	**–**
Gross carrying amount	**24,197,333**	**–**	**–**	**24,197,333**
ECL allowance	**(20,598)**	**–**	**–**	**(20,598)**
Carrying amount	**24,176,735**	**–**	**–**	**24,176,735**

	2022			
Due from and placements with banks and other financial institutions	Stage 1 12 month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Investment Grade	21,951,402	–	–	21,951,402
Standard Monitoring	2,442,621	–	–	2,442,621
Unrated	155,000	–	–	155,000
Gross carrying amount	24,549,023	–	–	24,549,023
ECL allowance	(1,963)	–	–	(1,963)
Carrying amount	24,547,060	–	–	24,547,060

(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)

	2023			
	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	**80,847,710**	**–**	**–**	**80,847,710**
Standard Monitoring	**–**	**–**	**–**	**–**
Unrated	**59,170,984**	**1,252,837**	**–**	**60,423,821**
Carrying amount	**140,018,694**	**1,252,837**	**–**	**141,271,531**
ECL allowance	**(207,716)**	**(7,864)**	**–**	**(215,580)**

	2022			
	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	99,048,954	–	–	99,048,954
Standard Monitoring	113,126	–	–	113,126
Unrated	61,560,755	620,848	–	62,181,603
Carrying amount	160,722,835	620,848	–	161,343,683
ECL allowance	(184,196)	(2,177)	–	(186,373)

	2023			
	Stage 1	Stage 2	Stage 3	
Debt securities at amortized cost	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	**30,762,042**	**–**	**–**	**30,762,042**
Standard Monitoring	**–**	**–**	**–**	**–**
Unrated	**16,609,659**	**44,690**	**–**	**16,654,349**
Gross carrying amount	**47,371,701**	**44,690**	**–**	**47,416,391**
ECL allowance	**(47,281)**	**(587)**	**–**	**(47,868)**
Carrying amount	**47,324,420**	**44,103**	**–**	**47,368,523**

	2022			
	Stage 1	Stage 2	Stage 3	
Debt securities at amortized cost	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	42,305,970	–	–	42,305,970
Standard Monitoring	–	–	–	–
Unrated	8,048,839	199,301	–	8,248,140
Gross carrying amount	50,354,809	199,301	–	50,554,110
ECL allowance	(23,869)	(693)	–	(24,562)
Carrying amount	50,330,940	198,608	–	50,529,548

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

(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)

3.1.3.2 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	
	2023	2022
Financial assets at fair value through profit or loss		
Derivative financial instruments	**9,790,562**	13,133,770
Debt securities	**562,522**	444,127
Total	**10,353,084**	13,577,897

3.1.3.3 Collateral and other credit enhancements

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

The Bank 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 reviews, 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 Bank employs a range of policies and practices to mitigate credit risk. The most useful practice is to accept collaterals. The Bank 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;
- 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 Bank 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 Bank 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 Bank closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Bank 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 2023:	**Gross exposure**	**ECL allowance**	**Carrying amount**	**Fair value of collateral held**
Loans to individuals	**94,162**	**(30,618)**	**63,544**	**63,082**
Loans to corporate entities	**6,226,157**	**(5,609,384)**	**616,773**	**211,827**
	6,320,319	**(5,640,002)**	**680,317**	**274,909**

As at 31 December 2022:	Gross exposure	ECL allowance	Carrying amount	Fair value of collateral held
Loans to individuals	48,072	(29,141)	18,931	17,489
Loans to corporate entities	5,752,876	(1,982,779)	3,770,097	44,586
	5,800,948	(2,011,920)	3,789,028	62,075

(b) Master netting arrangements

The Bank 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 Bank'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 ECL 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;
- Applying management judgmental adjustment to take into account for the model and data limitations, and expert judgement applied after management's review and challenge;
- 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 ECL allowance between the beginning and the end of the annual period due to these factors:

Movement of gross amount – Loans and advances to customers at amortized cost

Corporate Loan	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount as at 1 January 2023	**131,707,658**	**12,812,245**	**5,752,876**	**150,272,779**
Transfers:				
Transfer from Stage 1 to Stage 2	**(2,131,201)**	**2,131,201**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(57,410)**	**–**	**57,410**	**–**
Transfer from Stage 2 to Stage 1	**278,472**	**(278,472)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(544,746)**	**544,746**	**–**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending (Note)	**(18,044,414)**	**4,049,334**	**459,769**	**(13,535,311)**
Write-offs	**–**	**–**	**(591,942)**	**(591,942)**
Foreign exchange and other movements	**58,583**	**5,019**	**3,298**	**66,900**
Gross carrying amount as at 31 December 2023	**111,811,688**	**18,174,581**	**6,226,157**	**136,212,426**

Note: The balances include the corporate loans originated or purchased in the year and subsequently transferred between stage 1, stage 2 and stage 3 during the year.

Corporate Loan	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2022	125,182,867	8,362,962	129,154	133,674,983
Transfers:				
Transfer from Stage 1 to Stage 2	(4,167,466)	4,167,466	–	–
Transfer from Stage 1 to Stage 3	(1,580,696)	–	1,580,696	–
Transfer from Stage 2 to Stage 1	97,150	(97,150)	–	–
Transfer from Stage 2 to Stage 3	–	(3,744,613)	3,744,613	–
Transfer from Stage 3 to Stage 1	5,986	–	(5,986)	–
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending (Note)	12,171,972	4,123,875	304,402	16,600,249
Write-offs	–	–	–	–
Foreign exchange and other movements	(2,155)	(295)	(3)	(2,453)
Gross carrying amount as at 31 December 2022	131,707,658	12,812,245	5,752,876	150,272,779

Note: The balances include the corporate loans originated or purchased in the year and subsequently transferred between stage 1, stage 2 and stage 3 during the year.

(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 at amortized cost

Corporate loan	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance as at 1 January 2023	**526,961**	**92,350**	**1,982,779**	**2,602,090**
Transfers:				
Transfer from Stage 1 to Stage 2	**(33,913)**	**33,913**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(2,223)**	**–**	**2,223**	**–**
Transfer from Stage 2 to Stage 1	**12,773**	**(12,773)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(13,382)**	**13,382**	**–**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**(25,772)**	**47,917**	**671,823**	**693,968**
Changes in PDs/LGDs/EADs	**(151,429)**	**41,817**	**3,291,781**	**3,182,169**
Unwind of discount	**–**	**2,921**	**–**	**2,921**
Recoveries of loans and advances written-off in previous years	**–**	**–**	**238,424**	**238,424**
Write-offs	**–**	**–**	**(591,942)**	**(591,942)**
Foreign exchange and other movements	**279**	**23**	**914**	**1,216**
ECL allowance amount as at 31 December 2023	**326,676**	**192,786**	**5,609,384**	**6,128,846**

Corporate loan	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance as at 1 January 2022	614,132	78,712	53,131	745,975
Transfers:				
Transfer from Stage 1 to Stage 2	(14,714)	14,714	–	–
Transfer from Stage 1 to Stage 3	(9,151)	–	9,151	–
Transfer from Stage 2 to Stage 1	14,735	(14,735)	–	–
Transfer from Stage 2 to Stage 3	–	(19,909)	19,909	–
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	32,936	29,415	17,022	79,373
Changes in PDs/LGDs/EADs	(110,904)	2,780	1,883,568	1,775,444
Unwind of discount	–	1,374	–	1,374
Write-offs	–	–	–	–
Foreign exchange and other movements	(73)	(1)	(2)	(76)
ECL allowance amount as at 31 December 2022	526,961	92,350	1,982,779	2,602,090

(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 – Loans and advances to customers at amortized cost

Retail Loan	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2023	**59,956,467**	**566,957**	**48,072**	**60,571,496**
Transfers:				
Transfer from Stage 1 to Stage 2	**(284,597)**	**284,597**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(46,937)**	**–**	**46,937**	**–**
Transfer from Stage 2 to Stage 1	**372,268**	**(372,268)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(21,885)**	**21,885**	**–**
Transfer from Stage 3 to Stage 1	**1,155**	**–**	**(1,155)**	**–**
Transfer from Stage 3 to Stage 2	**–**	**791**	**(791)**	**–**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending (Note)	**1,592,665**	**(89,522)**	**(8,062)**	**1,495,081**
Write-offs	**–**	**–**	**(12,724)**	**(12,724)**
Foreign exchange and other movements	**297**	**(1)**	**–**	**296**
Gross carrying amount as at 31 December 2023	**61,591,318**	**368,669**	**94,162**	**62,054,149**

Note: The balances include the retail loans originated or purchased in the year and subsequently transferred between stage 1, stage 2 and stage 3 during the year.

Retail Loan	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2022	52,457,668	159,961	72,815	52,690,444
Transfers:				
Transfer from Stage 1 to Stage 2	(428,781)	428,781	–	–
Transfer from Stage 1 to Stage 3	(20,755)	–	20,755	–
Transfer from Stage 2 to Stage 1	87,001	(87,001)	–	–
Transfer from Stage 2 to Stage 3	–	(9,609)	9,609	–
Transfer from Stage 3 to Stage 1	34,043	–	(34,043)	–
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending (Note)	7,827,727	74,827	(15,525)	7,887,029
Write-offs	–	–	(5,537)	(5,537)
Foreign exchange and other movements	(436)	(2)	(2)	(440)
Gross carrying amount as at 31 December 2022	59,956,467	566,957	48,072	60,571,496

Note: The balances include the retail loans originated or purchased in the year and subsequently transferred between stage 1, stage 2 and stage 3 during the year.

(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 at amortized cost

Retail Loan	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2023	**27,606**	**47,299**	**29,141**	**104,046**
Transfers:				
Transfer from Stage 1 to Stage 2	**(159)**	**159**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(50)**	**–**	**50**	**–**
Transfer from Stage 2 to Stage 1	**38,033**	**(38,033)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(1,934)**	**1,934**	**–**
Transfer from Stage 3 to Stage 1	**762**	**–**	**(762)**	**–**
Transfer from Stage 3 to Stage 2	**–**	**178**	**(178)**	**–**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**5,728**	**77**	**(730)**	**5,075**
Changes in PDs/LGDs/EADs	**(27,750)**	**14,714**	**12,571**	**(465)**
Unwind of discount	**–**	**1,387**	**–**	**1,387**
Recoveries of loans and advances written-off in previous years	**–**	**–**	**1,316**	**1,316**
Write-offs	**–**	**–**	**(12,724)**	**(12,724)**
Foreign exchange and other movements	**–**	**13**	**–**	**13**
ECL allowance amount as at 31 December 2023	**44,170**	**23,860**	**30,618**	**98,648**

Retail Loan	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2022	85,088	30,376	23,584	139,048
Transfers:				
Transfer from Stage 1 to Stage 2	(957)	957	–	–
Transfer from Stage 1 to Stage 3	(61)	–	61	–
Transfer from Stage 2 to Stage 1	16,601	(16,601)	–	–
Transfer from Stage 2 to Stage 3	–	(1,716)	1,716	–
Transfer from Stage 3 to Stage 1	1	–	(1)	–
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	(6,843)	13,196	3,081	9,434
Changes in PDs/LGDs/EADs	(66,221)	20,681	5,888	(39,652)
Unwind of discount	–	407	–	407
Recoveries of loans and advances written-off in previous years	–	–	351	351
Write-offs	–	–	(5,537)	(5,537)
Foreign exchange and other movements	(2)	(1)	(2)	(5)
ECL allowance amount as at 31 December 2022	27,606	47,299	29,141	104,046

(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 at amortized cost (continued)

Loans and advances to customers	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2023	**554,567**	**139,649**	**2,011,920**	**2,706,136**
Transfers:				
Transfer from Stage 1 to Stage 2	**(34,072)**	**34,072**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(2,273)**	**–**	**2,273**	**–**
Transfer from Stage 2 to Stage 1	**50,806**	**(50,806)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(15,316)**	**15,316**	**–**
Transfer from Stage 3 to Stage 1	**762**	**–**	**(762)**	**–**
Transfer from Stage 3 to Stage 2	**–**	**178**	**(178)**	**–**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**(20,044)**	**47,994**	**671,093**	**699,043**
Changes in PDs/LGDs/EADs	**(179,179)**	**56,531**	**3,304,352**	**3,181,704**
Unwind of discount	**–**	**4,308**	**–**	**4,308**
Recoveries of loans and advances written-off in previous years	**–**	**–**	**239,740**	**239,740**
Write-offs	**–**	**–**	**(604,666)**	**(604,666)**
Foreign exchange and other movements	**279**	**36**	**914**	**1,229**
ECL allowance amount as at 31 December 2023	**370,846**	**216,646**	**5,640,002**	**6,227,494**

Loans and advances to customers	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2022	699,220	109,088	76,715	885,023
Transfers:				
Transfer from Stage 1 to Stage 2	(15,671)	15,671	–	–
Transfer from Stage 1 to Stage 3	(9,212)	–	9,212	–
Transfer from Stage 2 to Stage 1	31,336	(31,336)	–	–
Transfer from Stage 2 to Stage 3	–	(21,625)	21,625	–
Transfer from Stage 3 to Stage 1	1	–	(1)	–
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	26,093	42,611	20,103	88,807
Changes in PDs/LGDs/EADs	(177,125)	23,461	1,889,456	1,735,792
Unwind of discount	–	1,781	–	1,781
Recoveries of loans and advances written-off in previous years	–	–	351	351
Write-offs	–	–	(5,537)	(5,537)
Foreign exchange and other movements	(75)	(2)	(4)	(81)
ECL allowance amount as at 31 December 2022	554,567	139,649	2,011,920	2,706,136

(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 – Loans and advances to customers at fair value through other comprehensive income

Loans and advances to customers at fair value through other comprehensive income	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount as at 1 January 2023	**–**	**–**	**–**	**–**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**–**	**–**	**–**	**–**
Gross carrying amount as at 31 December 2023	**–**	**–**	**–**	**–**

Loans and advances to customers at fair value through other comprehensive income	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2022	2,862,977	–	–	2,862,977
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	(2,862,977)	–	–	(2,862,977)
Gross carrying amount as at 31 December 2022	–	–	–	–

Movement of ECL allowance – Loans and advances to customers at fair value through other comprehensive income

Loans and advances to customers at fair value through other comprehensive income	**Stage 1 12-month ECL allowance**	**Stage 2 Lifetime ECL allowance**	**Stage 3 Lifetime ECL allowance**	**Total**
ECL allowance amount as at 1 January 2023	**–**	**–**	**–**	**–**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**–**	**–**	**–**	**–**
ECL allowance amount as at 31 December 2023	**–**	**–**	**–**	**–**

Loans and advances to customers at fair value through other comprehensive income	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2022	839	–	–	839
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	(839)	–	–	(839)
ECL allowance amount as at 31 December 2022	–	–	–	–

(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 and placements with banks and other financial institutions

Due from and placements with banks and other financial institutions	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount as at 1 January 2023	**24,549,023**	**–**	**–**	**24,549,023**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**(341,008)**	**–**	**–**	**(341,008)**
Foreign exchange and other movements	**(10,682)**	**–**	**–**	**(10,682)**
Gross carrying amount as at 31 December 2023	**24,197,333**	**–**	**–**	**24,197,333**

Due from and placements with banks and other financial institutions	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2022	10,959,607	–	–	10,959,607
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	13,795,111	–	–	13,795,111
Foreign exchange and other movements	(205,695)	–	–	(205,695)
Gross carrying amount as at 31 December 2022	24,549,023	–	–	24,549,023

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

Due from and placements with banks and other financial institutions	**Stage 1 12-month ECL allowance**	**Stage 2 Lifetime ECL allowance**	**Stage 3 Lifetime ECL allowance**	**Total**
ECL allowance amount as at 1 January 2023	**1,963**	**–**	**–**	**1,963**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**17,687**	**–**	**–**	**17,687**
Change in PDs/LGDs/EADs	**948**	**–**	**–**	**948**
Foreign exchange and other movements	**–**	**–**	**–**	**–**
ECL allowance amount as at 31 December 2023	**20,598**	**–**	**–**	**20,598**

Due from and placements with banks and other financial institutions	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2022	291	–	–	291
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	1,878	–	–	1,878
Change in PDs/LGDs/EADs	(184)	–	–	(184)
Foreign exchange and other movements	(22)	–	–	(22)
ECL allowance amount as at 31 December 2022	1,963	–	–	1,963

(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 carrying 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**
Carrying amount as at 1 January 2023	**160,722,835**	**620,848**	**–**	**161,343,683**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**(20,724,649)**	**631,547**	**–**	**(20,093,102)**
Foreign exchange and other movements	**20,508**	**442**	**–**	**20,950**
Carrying amount as at 31 December 2023	**140,018,694**	**1,252,837**	**–**	**141,271,531**

Debt securities at fair value through other comprehensive income	Stage 1	Stage 2	Stage 3	Total
Carrying amount as at 1 January 2022	222,722,671	247,991	–	222,970,662
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	(58,991,647)	372,885	–	(58,618,762)
Foreign exchange and other movements	(3,008,189)	(28)	–	(3,008,217)
Carrying amount as at 31 December 2022	160,722,835	620,848	–	161,343,683

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**
ECL allowance amount as at 1 January 2023	**184,196**	**2,177**	**–**	**186,373**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**132**	**832**	**–**	**964**
Changes in PDs/LGDs/EADs	**23,137**	**4,800**	**–**	**27,937**
Unwind of discount	**–**	**53**	**–**	**53**
Foreign exchange and other movements	**251**	**2**	**–**	**253**
ECL allowance amount as at 31 December 2023	**207,716**	**7,864**	**–**	**215,580**

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
ECL allowance amount as at 1 January 2022	233,854	3,056	–	236,910
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	(3,751)	(1,948)	–	(5,699)
Changes in PDs/LGDs/EADs	(44,486)	976	–	(43,510)
Unwind of discount	–	94	–	94
Foreign exchange and other movements	(1,421)	(1)	–	(1,422)
ECL allowance amount as at 31 December 2022	184,196	2,177	–	186,373

(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 – Debt securities at amortized cost

Debt securities at amortized cost	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount as at 1 January 2023	**50,354,809**	**199,301**	**–**	**50,554,110**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**(2,920,166)**	**(154,921)**	**–**	**(3,075,087)**
Foreign exchange and other movements	**(62,942)**	**310**	**–**	**(62,632)**
Gross carrying amount as at 31 December 2023	**47,371,701**	**44,690**	**–**	**47,416,391**

Debt securities at amortized cost	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2022	16,710,918	–	–	16,710,918
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	33,644,039	199,301	–	33,843,340
Foreign exchange and other movements	(148)	–	–	(148)
Gross carrying amount as at 31 December 2022	50,354,809	199,301	–	50,554,110

Movement of ECL allowance – Debt securities at amortized cost

Debt securities at amortized cost	**Stage 1 12-month ECL allowance**	**Stage 2 Lifetime ECL allowance**	**Stage 3 Lifetime ECL allowance**	**Total**
ECL allowance amount as at 1 January 2023	**23,869**	**693**	**–**	**24,562**
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	**11,808**	**587**	**–**	**12,395**
Changes in PDs/LGDs/EADs	**11,614**	**(728)**	**–**	**10,886**
Unwind of discount	**–**	**34**	**–**	**34**
Foreign exchange and other movements	**(10)**	**1**	**–**	**(9)**
ECL allowance amount as at 31 December 2023	**47,281**	**587**	**–**	**47,868**

Debt securities at amortized cost	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2022	10,790	–	–	10,790
New financial assets originated or purchased, assets remeasurement, derecognized, repayments and further lending	12,683	693	–	13,376
Changes in PDs/LGDs/EADs	396	–	–	396
ECL allowance amount as at 31 December 2022	23,869	693	–	24,562

(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)

Financial guarantees and credit related commitment	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 31 December 2023	**20,969,578**	**8,504,024**	**–**	**29,473,602**
Gross carrying amount as at 31 December 2022	29,775,586	1,897,619	–	31,673,205

Financial guarantees and credit related commitment	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 31 December 2023	**20,958**	**908**	**–**	**21,866**
ECL allowance amount as at 31 December 2022	13,405	1,559	–	14,964

3.1.5 Write-off policy

The Bank writes off financial assets when all practical efforts to recover the assets have been exhausted and a reasonable expectation of recovery is deemed unlikely. Indicators that there is no reasonable expectation of recovery include but not limited to (i) discontinuation of enforcement activity and (ii) where the Bank's recovery method is foreclosing on collateral but the value of the collateral is such that there is no reasonable expectation of full recovery.

The Bank may write-off financial assets that are still subject to enforcement activity. While the Bank still seeks to recover amounts it is legally owed in full, write-off may be necessary when there is no reasonable expectation of full recovery.

3.1.6 Derivative instruments

The Bank 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 Bank's market transactions on any single day.

3.1.7 Repossessed assets

Repossessed assets are collateral of the outstanding indebtedness that the Bank takes possession of the collateral assets through 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 2023 and 2022, there was no repossessed asset that being held by the Bank.

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

The Bank 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	2023	2022
Mainland China	**21,038,012**	15,984,468
Hong Kong	**175,663,271**	193,495,552
Others	**1,517,688**	1,273,885
	198,218,971	210,753,905

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

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk

3.2.1 Overview

The Bank assumes exposure to market risks, which are triggered by the volatility in the fair value of or future cash flow of financial instruments due to fluctuations in market prices. These market risks emerge from the Bank's 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 price.

The Bank established a management model that comprises of "large and small middle offices" to manage its market risks. This model is a centralized control framework overseen by the Board of Directors and senior management. By implementing a segregation of duties, the Risk Management Department is responsible for formulating market risk policies and ensuring the Bank's exposure remains within the risk appetite set by the Board of Directors. On the other hand, the Global Markets Department serves as the execution unit for market risk management. The Internal Audit Department is responsible for conducting independent verification of the policies and processes for the market risk management system.

The Bank 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 trading account. The non-trading account consists of the investments purchased by the Bank 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 Bank 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 Bank to monitor the market risk of its overall businesses. In addition, through adequate pricing management and asset allocation, the Bank strived to maximize its rate of return while keeping its risks under control.

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

As part of market risk management, the Bank 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 Bank 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 Bank's portfolios is as follows:

	For the year ended 31 December 2023			
Items	**31 December 2023**	**Average**	**Maximum**	**Minimum**
VaR	**25,971**	**30,297**	**62,930**	**895**
– Interest rate risk	**87**	**2,466**	**8,873**	**87**
– Foreign exchange risk	**25,927**	**31,283**	**63,120**	**945**

	For the year ended 31 December 2022			
Items	31 December 2022	Average	Maximum	Minimum
VaR	47,735	13,895	50,653	455
– Interest rate risk	459	772	6,461	111
– Foreign exchange risk	48,071	13,781	51,479	442

(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

Interest rate sensitivity test

The Bank performs interest rate sensitivity analysis on net interest income for the Bank 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 Bank 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 Bank based on the structure of interest bearing assets and liabilities as at 31 December 2023 and 31 December 2022, caused by a parallel shift of 100 basis points of RMB, USD and HKD interest rates.

	Expected changes in net interest income	
	As at 31 December 2023	As at 31 December 2022
+100 basis points parallel shift in yield curves	**(718,128)**	(838,035)
-100 basis points parallel shift in yield curves	**718,128**	838,035

The interest rate sensitivity tests presented in the table above are provided for illustrative purposes only and are derived from simplified scenarios. The figures represent the projected impact on the net interest income resulting from the projected movement of yield curves within the current interest risk structure. However, these calculations do not take into account any potential actions that the Bank may take to mitigate the impact of interest rate fluctuations. The projections above also make an assumption that interest rates across all maturities, except for demand deposits, will move by an equal extent. As a result, these projections do not reflect the potential impact on net interest income that may arise from changes in certain rates while others remain unchanged. These projections incorporate other simplifying assumptions as well, such as the expectation that, all positions are to be held to maturity. If positions are not held to maturity, changes to the projections may occur. Nevertheless, these changes are not expected to have a significant impact.

Foreign exchange sensitivity test

The Bank performs exchange rate sensitivity analysis on net profit and equity for the Bank 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, GBP, AUD and EUR spot and forward rates against HK$ by 5%, the Bank calculates the changes in net profit and other comprehensive income for the year on a monthly basis.

(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)

Foreign exchange sensitivity test (continued)

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

	Expected changes in net profit and equity	
	As at 31 December 2023	As at 31 December 2022
5% appreciation of RMB	**(496,982)**	(1,646,982)
5% depreciation of RMB	**496,982**	1,646,982
5% appreciation of GBP	**(22,484)**	(38,296)
5% depreciation of GBP	**22,484**	38,296
5% appreciation of AUD	**785,700**	332,974
5% depreciation of AUD	**(785,700)**	(332,974)
5% appreciation of EUR	**146,275**	120,522
5% depreciation of EUR	**(146,275)**	(120,522)

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 Bank 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.

(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)*

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

	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non-interest bearing	Total
As at 31 December 2023							
Assets							
Cash and balances with central bank	–	–	–	–	–	1,694,274	1,694,274
Due from and placements with banks and other financial institutions	12,807,186	503,742	6,681,698	–	–	4,184,109	24,176,735
Financial assets at fair value through profit or loss	–	–	148	562,374	–	9,790,562	10,353,084
Financial assets at amortized cost	4,914,085	8,829,836	9,407,654	12,969,183	10,565,214	–	46,685,972
Financial assets at fair value through other comprehensive income	10,660,494	18,296,277	15,623,322	62,375,595	34,315,843	9,418	141,280,949
Loans and advances to customers	174,308,666	14,189,085	756,660	2,460,239	50,836	225,991	191,991,477
Other financial assets	1,416,750	–	–	–	–	6,878,543	8,295,293
Total financial assets	204,107,181	41,818,940	32,469,482	78,367,391	44,931,893	22,782,897	424,477,784
Liabilities							
Due to banks and other financial institutions	9,918,986	715,083	5,868,008	–	–	542,174	17,044,251
Due to customers	154,175,871	129,935,411	47,662,038	97,470	106	1,456,202	333,327,098
Financial liabilities at fair value through profit or loss	–	–	–	–	–	2,703,827	2,703,827
Certificates of deposits issued	–	138,590	1,649,755	–	–	–	1,788,345
Lease liabilities	13,081	26,049	105,546	117,019	–	–	261,695
Debt securities issued	–	–	–	–	7,809,900	–	7,809,900
Other financial liabilities	–	–	–	–	–	7,849,918	7,849,918
Total financial liabilities	164,107,938	130,815,133	55,285,347	214,489	7,810,006	12,552,121	370,785,034
Total interest sensitivity gap	39,999,243	(88,996,193)	(22,815,865)	78,152,902	37,121,887	10,230,776	53,692,750

(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 2022							
Assets							
Cash and balances with central bank	–	–	–	–	–	2,267,480	2,267,480
Due from and placements with banks and other financial institutions	15,794,972	5,698,314	3,053,774	–	–	–	24,547,060
Financial assets at fair value through profit or loss	–	–	–	444,127	–	13,133,770	13,577,897
Financial assets at amortized cost	2,609,015	5,092,439	15,249,386	21,839,103	4,921,315	–	49,711,258
Financial assets at fair value through other comprehensive income	14,906,230	24,512,048	18,129,926	67,141,477	36,654,002	8,587	161,352,270
Loans and advances to customers	185,518,222	18,849,329	1,753,460	1,823,113	103,645	–	208,047,769
Other financial assets	–	973,172	–	–	–	5,667,921	6,641,093
Total financial assets	218,828,439	55,125,302	38,186,546	91,247,820	41,678,962	21,077,758	466,144,827
Liabilities							
Due to banks and other financial institutions	11,814,279	14,587,304	31,892,290	–	–	–	58,293,873
Due to customers	141,806,945	104,353,450	89,637,397	263,544	205	2,156,909	338,218,450
Financial liabilities at fair value through profit or loss	–	–	–	–	–	1,994,313	1,994,313
Certificates of deposits issued	–	–	1,757,007	–	–	–	1,757,007
Lease liabilities	11,835	22,781	60,465	77,216	–	–	172,297
Debt securities issued	–	–	–	–	7,797,780	–	7,797,780
Other financial liabilities	–	–	–	–	–	8,007,543	8,007,543
Total financial liabilities	153,633,059	118,963,535	123,347,159	340,760	7,797,985	12,158,765	416,241,263
Total interest sensitivity gap	65,195,380	(63,838,233)	(85,160,613)	90,907,060	33,880,977	8,918,993	49,903,564

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

	HK$	RMB (HK$ Equivalent)	USD (HK$ Equivalent)	Others (HK$ Equivalent)	Total
As at 31 December 2023					
Assets					
Cash and balances with central bank	1,610,894	51,490	15,860	16,030	1,694,274
Due from and placements with banks and other financial institutions	12,953,064	1,078,248	9,648,914	496,509	24,176,735
Financial assets at fair value through profit or loss	1,029,968	119,431	9,203,454	231	10,353,084
Financial assets at amortized cost	8,442,152	6,756,066	25,354,673	6,133,081	46,685,972
Financial assets at fair value through other comprehensive income	6,273,322	12,812,933	107,864,736	14,329,958	141,280,949
Loans and advances to customers	152,976,782	11,022,985	26,476,755	1,514,955	191,991,477
Other financial assets	1,219,805	1,050,474	5,827,088	197,926	8,295,293
Total financial assets	184,505,987	32,891,627	184,391,480	22,688,690	424,477,784
Liabilities					
Due to banks and other financial institutions	3,982,382	6,417,577	6,495,259	149,033	17,044,251
Due to customers	212,875,670	33,253,956	80,477,594	6,719,878	333,327,098
Financial liabilities at fair value through profit or loss	1,923,402	1,723	739,689	39,013	2,703,827
Certificates of deposits issued	–	1,788,345	–	–	1,788,345
Lease liabilities	261,695	–	–	–	261,695
Debt securities issued	–	–	7,809,900	–	7,809,900
Other financial liabilities	2,768,496	1,369,673	3,592,138	119,611	7,849,918
Total financial liabilities	221,811,645	42,831,274	99,114,580	7,027,535	370,785,034
Net position	(37,305,658)	(9,939,647)	85,276,900	15,661,155	53,692,750

(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 2022					
Assets					
Cash and balances with central bank	2,218,669	20,186	13,383	15,242	2,267,480
Due from and placements with banks and other financial institutions	9,055,765	3,282,909	10,422,567	1,785,819	24,547,060
Financial assets at fair value through profit or loss	1,617,087	403	11,959,417	990	13,577,897
Financial assets at amortized cost	13,241,516	7,430,806	24,341,710	4,697,226	49,711,258
Financial assets at fair value through other comprehensive income	4,875,065	19,942,901	122,552,453	13,981,851	161,352,270
Loans and advances to customers	170,560,829	311,394	36,133,540	1,042,006	208,047,769
Other financial assets	853,636	681,610	5,001,823	104,024	6,641,093
Total financial assets	202,422,567	31,670,209	210,424,893	21,627,158	466,144,827
Liabilities					
Due to banks and other financial institutions	4,083,383	30,864,881	16,266,164	7,079,445	58,293,873
Due to customers	215,121,779	30,981,032	83,969,060	8,146,579	338,218,450
Financial liabilities at fair value through profit or loss	1,614,977	827	378,506	3	1,994,313
Certificates of deposits issued	–	1,570,739	186,268	–	1,757,007
Lease liabilities	172,297	–	–	–	172,297
Debt securities issued	–	–	7,797,780	–	7,797,780
Other financial liabilities	2,617,529	1,133,953	4,119,231	136,830	8,007,543
Total financial liabilities	223,609,965	64,551,432	112,717,009	15,362,857	416,241,263
Net position	(21,187,398)	(32,881,223)	97,707,884	6,264,301	49,903,564

3.2.6 Other price risk

The Bank is exposed to other price risk arising from financial assets such as equity investments and derivatives linked to commodity price. The Bank 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 Bank 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 Bank'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 Bank 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 Bank 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 Bank'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 Bank's capacity to support deposit withdrawal or drawdown on loan commitments. Effective liquidity risk management helps to sustain the expansion of the Bank's business with liquidity cost and risk under control. The Bank 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 Bank 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. Financial 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 Bank's funding sources is customer deposits. In order to strengthen its financing capabilities, the Bank focuses on building up core deposits while diversifying its funding sources via various channels. Additionally, the Bank maintains a liquidity arrangement with its parent bank, engaging in regular funding transfers to ensure a reliable supply of intragroup backup funding, should the need arise. Monitoring and control of intragroup funding transactions are in line with the same standard as those applied to transactions with third parties. Moreover, the parent bank has implemented internal limits across the group to regulate the extent to which the Bank relies on funding from the parent bank.

The majority of the liquidity risk associated with the Bank arises from the mismatch in maturity between its assets and liabilities. To address this, the Bank conducts regular cash flow analysis and projections for both on- and off-balance sheet items, categorizing them according to different maturity buckets to make sure the Bank can meet its funding requirement. Moreover, the Bank closely monitors off-balance sheet funding obligations (such as commitments or letters of guarantee) and assesses their impact on its liquidity capacity. Furthermore, the Bank strives to maintain a high level of marketability within its the asset portfolio, enabling swift monetization in the event of an unforeseen liquidity crunch in the market.

The Bank has implemented a range of limits and indicators to effectively identify and manage liquidity risk. These include liquidity coverage ratio, loan-to-deposit ratio, concentration limits on customer deposits, interbank borrowing utilization ratio, etc. Relevant management information systems are employed to manage liquidity risk on a daily basis to assess liquidity under normal circumstances, and regular stress tests are carried out at least on a monthly basis to evaluate the Bank's ability to withstand significant stress conditions. These stress test scenarios are designed with reference to the HKMA's Supervisory Policy Manuals as well as the historical liquidity stress scenarios. Taking into account historical data and plausible stress conditions, the Bank's stress test assesses the potential impact on all assets, liabilities and off-balance sheet positions, and allows for the estimation of potential funding short-falls. The results of these stress tests will be scrutinized, and appropriate measures will be taken if necessary.

The Bank has set up an early warning indicator system for closely monitoring the movement of relevant indicators on a regular basis. In case of a liquidity crisis, Crisis Management Committee will be formed promptly to devise an appropriate contingency funding plan aimed at resolving the crisis. Moreover, drills are conducted on a regular basis to ensure readiness and feasibility of contingency funding plan in times of crisis.

To address unforeseen liquidity requirements, the Bank has set up a liquidity buffer consisting of a robust portfolio of highly liquid assets, such as cash, Exchange Fund Bills/Notes, unencumbered sovereign bonds and other high quality bonds. The liquidity buffer is managed by the Financial Management Department and operated by the 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 Bank 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 Bank'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	Total
As at 31 December 2023							
Financial liabilities							
Due to banks and other financial institutions	**1,692,133**	**6,826,331**	**718,777**	**6,009,028**	**2,033,712**	**–**	**17,279,981**
Due to customers	**64,728,698**	**91,909,422**	**131,328,792**	**48,512,928**	**110,631**	**108**	**336,590,579**
Certificates of deposits issued	**–**	**–**	**141,969**	**1,681,150**	**–**	**–**	**1,823,119**
Lease liabilities	**–**	**13,469**	**26,770**	**107,883**	**118,647**	**–**	**266,769**
Debt securities issued	**–**	**–**	**–**	**–**	**–**	**7,896,356**	**7,896,356**
Other financial liabilities	**1,668,278**	**3,595,627**	**1,461,522**	**988,252**	**27,917**	**86,456**	**7,828,052**
Total financial liabilities	**68,089,109**	**102,344,849**	**133,677,830**	**57,299,241**	**2,290,907**	**7,982,920**	**371,684,856**

	On Demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
As at 31 December 2022							
Financial liabilities							
Due to banks and other financial institutions	1,158,577	8,711,990	14,688,751	32,622,064	–	2,028,324	59,209,706
Due to customers	76,137,244	67,872,598	104,640,649	90,363,751	265,198	209	339,279,649
Certificates of deposits issued	–	–	–	1,772,232	–	–	1,772,232
Lease liabilities	–	11,966	23,016	61,244	77,992	–	174,218
Debt securities issued	–	–	–	–	–	7,884,101	7,884,101
Other financial liabilities	202,705	5,710,565	715,003	1,255,131	70	109,104	7,992,578
Total financial liabilities	77,498,526	82,307,119	120,067,419	126,074,422	343,260	10,021,738	416,312,484

(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 Bank's derivative financial instruments are either settled on a net basis or a gross basis.

The Bank'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 Bank 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 2023						
Derivative financial instruments settled on net basis	**139,476**	**571,183**	**3,142,975**	**3,667,301**	**1,172,479**	**8,693,414**
Derivative financial instruments settled on a gross basis						
– Outflow	**(109,458,459)**	**(99,083,383)**	**(60,989,271)**	**–**	**–**	**(269,531,113)**
– Inflow	**108,954,268**	**98,926,381**	**60,572,538**	**–**	**–**	**268,453,187**
Total	**(504,191)**	**(157,002)**	**(416,733)**	**–**	**–**	**(1,077,926)**

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2022						
Derivative financial instruments settled on net basis	97,052	511,684	3,255,266	6,061,938	2,396,748	12,322,688
Derivative financial instruments settled on a gross basis						
– Outflow	(92,821,687)	(79,667,865)	(64,692,551)	(4,094)	–	(237,186,197)
– Inflow	92,738,928	79,888,147	64,187,089	4,100	–	236,818,264
Total	(82,759)	220,282	(505,462)	6	–	(367,933)

(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 Bank'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 2023									
Assets									
Cash and balances with central banks	1,694,274	–	–	–	–	–	–	–	1,694,274
Due from and placements with banks and other financial institutions	2,689,533	14,301,762	403,769	6,681,698	99,973	–	–	–	24,176,735
Financial assets at fair value through profit or loss	–	217,999	456,794	445,658	4,902,498	4,330,135	–	–	10,353,084
Financial assets at amortized cost	–	694,719	4,484,405	8,626,771	21,533,979	11,346,098	–	–	46,685,972
Financial assets at fair value through other comprehensive income	–	3,269,535	4,895,870	23,184,226	75,269,009	34,652,891	–	9,418	141,280,949
Loans and advances to customers	2,873,444	1,472,379	10,979,921	31,245,968	81,301,805	56,181,150	7,936,810	–	191,991,477
Other financial assets	1,459,449	3,242,994	905,885	482,566	1,402,158	599,344	202,897	–	8,295,293
Total financial assets	8,716,700	23,199,388	22,126,644	70,666,887	184,509,422	107,109,618	8,139,707	9,418	424,477,784
Liabilities									
Due to banks and other financial institutions	1,692,133	6,769,027	715,083	5,868,008	2,000,000	–	–	–	17,044,251
Due to customers	64,728,698	90,903,375	129,935,411	47,662,038	97,470	106	–	–	333,327,098
Financial liabilities at fair value through profit or loss	–	735,731	527,988	562,632	464,592	412,884	–	–	2,703,827
Certificates of deposit issued	–	–	138,590	1,649,755	–	–	–	–	1,788,345
Lease liabilities	–	13,081	26,049	105,546	117,019	–	–	–	261,695
Debt securities issued	–	–	–	–	–	7,809,900	–	–	7,809,900
Other financial liabilities	1,690,144	3,595,627	1,461,522	988,252	27,917	86,456	–	–	7,849,918
Total financial liabilities	68,110,975	102,016,841	132,804,643	56,836,231	2,706,998	8,309,346	–	–	370,785,034
Net amount on liquidity gap	(59,394,275)	(78,817,453)	(110,677,999)	13,830,656	181,802,424	98,800,272	8,139,707	9,418	53,692,750

(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 2022									
Assets									
Cash and balances with central banks	2,267,480	–	–	–	–	–	–	–	2,267,480
Due from and placements with banks and other financial institutions	3,070,116	12,724,856	5,698,314	3,053,774	–	–	–	–	24,547,060
Financial assets at fair value through profit or loss	–	276,144	534,556	739,256	5,802,703	6,225,238	–	–	13,577,897
Financial assets at amortized cost	–	80,508	561,824	15,522,436	28,625,176	4,921,314	–	–	49,711,258
Financial assets at fair value through other comprehensive income	–	1,914,457	6,437,584	33,663,067	82,476,145	36,852,429	–	8,588	161,352,270
Loans and advances to customers	2,935,774	1,551,425	8,997,578	29,801,195	98,527,177	59,877,658	6,356,962	–	208,047,769
Other financial assets	1,024,345	3,050,955	127,017	432,190	1,377,538	570,702	58,346	–	6,641,093
Total financial assets	9,297,715	19,598,345	22,356,873	83,211,918	216,808,739	108,447,341	6,415,308	8,588	466,144,827
Liabilities									
Due to banks and other financial institutions	1,158,577	8,655,703	14,587,304	31,892,289	–	2,000,000	–	–	58,293,873
Due to customers	76,137,244	67,826,611	104,353,450	89,637,397	263,544	204	–	–	338,218,450
Financial liabilities at fair value through profit or loss	–	333,240	271,004	887,545	320,472	182,052	–	–	1,994,313
Certificates of deposit issued	–	–	–	1,757,007	–	–	–	–	1,757,007
Lease liabilities	–	11,835	22,781	60,465	77,216	–	–	–	172,297
Debt securities issued	–	–	–	–	–	7,797,780	–	–	7,797,780
Other financial liabilities	217,669	5,710,565	715,003	1,255,131	70	109,105	–	–	8,007,543
Total financial liabilities	77,513,490	82,537,954	119,949,542	125,489,834	661,302	10,089,141	–	–	416,241,263
Net amount on liquidity gap	(68,215,775)	(62,939,609)	(97,592,669)	(42,277,916)	216,147,437	98,358,200	6,415,308	8,588	49,903,564

(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 Bank 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 2023					
Loan commitments and credit related commitments	**8,957,612**	**7,196,616**	**11,263,044**	**1,399,276**	**28,816,548**
Guarantees, acceptances and letters of credit	**421,910**	**210,620**	**19,718**	**4,806**	**657,054**
Total	**9,379,522**	**7,407,236**	**11,282,762**	**1,404,082**	**29,473,602**

	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2022					
Loan commitments and credit related commitments	7,869,076	11,188,206	10,281,427	1,415,084	30,753,793
Guarantees, acceptances and letters of credit	831,783	78,133	3,634	5,862	919,412
Total	8,700,859	11,266,339	10,285,061	1,420,946	31,673,205

3.4 Fair value of financial assets and liabilities

(a) Determination of fair value and valuation techniques

Certain financial assets and liabilities of the Bank 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 Bank 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 2023				
Financial assets at fair value through profit or loss				
Debt securities				
– Governments and central banks	**119,448**	**–**	**–**	**119,448**
– Banks and other financial institutions	**242,207**	**–**	**–**	**242,207**
– Corporate entities	**200,867**	**–**	**–**	**200,867**
Derivative financial instruments				
– Foreign exchange contracts	**–**	**877,680**	**–**	**877,680**
– Interest rate contracts and others	**–**	**8,912,882**	**–**	**8,912,882**
	562,522	**9,790,562**	**–**	**10,353,084**
Financial assets at fair value through other comprehensive income				
Debt securities				
– Governments and central banks	**21,113,727**	**816,151**	**–**	**21,929,878**
– Banks and other financial institutions	**51,450,504**	**6,567,732**	**–**	**58,018,236**
– Corporate entities	**60,303,246**	**1,020,171**	**–**	**61,323,417**
Equity securities				
– Banks and other financial institutions	**–**	**–**	**9,418**	**9,418**
	132,867,477	**8,404,054**	**9,418**	**141,280,949**
Total financial assets measured at fair value	**133,429,999**	**18,194,616**	**9,418**	**151,634,033**
Financial liabilities at fair value through profit or loss				
Certificates of deposits issued	**–**	**1,788,345**	**–**	**1,788,345**
Derivative financial instruments				
– Foreign exchange contracts	**–**	**1,772,210**	**–**	**1,772,210**
– Interest rate contracts and others	**–**	**931,617**	**–**	**931,617**
Total financial liabilities measured at fair value	**–**	**4,492,172**	**–**	**4,492,172**

(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 2022				
Financial assets at fair value through profit or loss				
Debt securities				
– Governments and central banks	233	–	–	233
– Banks and other financial institutions	230,896	–	–	230,896
– Corporate entities	212,998	–	–	212,998
Derivative financial instruments				
– Foreign exchange contracts	–	1,244,122	–	1,244,122
– Interest rate contracts and others	–	11,889,648	–	11,889,648
	444,127	13,133,770	–	13,577,897
Financial assets at fair value through other comprehensive income				
Debt securities				
– Governments and central banks	13,990,493	1,749,792	–	15,740,285
– Banks and other financial institutions	71,803,617	9,621,833	–	81,425,450
– Corporate entities	63,433,127	744,821	–	64,177,948
Equity securities				
– Banks and other financial institutions	–	–	8,587	8,587
	149,227,237	12,116,446	8,587	161,352,270
Total financial assets measured at fair value	149,671,364	25,250,216	8,587	174,930,167
Financial liabilities at fair value through profit or loss				
Certificates of deposits issued	–	1,757,007	–	1,757,007
Derivative financial instruments				
– Foreign exchange contracts	–	1,367,784	–	1,367,784
– Interest rate contracts and others	–	626,529	–	626,529
Total financial liabilities measured at fair value	–	3,751,320	–	3,751,320

(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)*

(c) Financial instruments not measured at fair value

The table below summarizes the carrying amounts and fair values where there are obvious variances from the carrying amounts, of those financial assets and liabilities that are not presented on the statement of financial position at their fair value:

	As at 31 December 2023		As at 31 December 2022	
	Carrying amount	**Fair value**	Carrying amount	Fair value
Financial assets				
Financial assets at amortized cost	**46,685,972**	**46,924,302**	49,711,258	49,341,253
Financial liabilities				
Debt securities issued	**7,809,900**	**7,242,896**	7,797,780	7,776,336

Fair value hierarchy of financial instruments not measured at fair value:

	Level 1	**Level 2**	**Level 3**	**Total**
As at 31 December 2023				
Financial assets				
Financial assets at amortized cost	**36,113,102**	**10,811,200**	**–**	**46,924,302**
Financial liabilities				
Debt securities issued	**7,242,896**	**–**	**–**	**7,242,896**
As at 31 December 2022				
Financial assets				
Financial assets at amortized cost	31,441,672	17,899,581	–	49,341,253
Financial liabilities				
Debt securities issued	7,776,336	–	–	7,776,336

Other financial instruments not carried at fair value are typically short-term in nature or repriced to current market rates frequently. Accordingly, their carrying amounts are reasonable approximations of their fair values.

(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 Bank are subject to enforceable master netting arrangements or similar agreements. The agreement between the Bank 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 Bank 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 2023 and 31 December 2022. The column "net amount" shows the impact on the Bank'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	
2023						
Financial assets						
Derivative financial instruments	**9,790,562**	**–**	**9,790,562**	**(1,261,037)**	**(817,382)**	**7,712,143**
Financial assets at fair value through other comprehensive income	**3,500,593**	**–**	**3,500,593**	**(3,288,027)**	**–**	**212,566**
Total	**13,291,155**	**–**	**13,291,155**	**(4,549,064)**	**(817,382)**	**7,924,709**

	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	
Financial liabilities						
Derivative financial instruments	**2,703,827**	**–**	**2,703,827**	**(1,275,512)**	**(2,558,964)**	**(1,130,649)**
Due to banks and other financial institutions	**3,288,027**	**–**	**3,288,027**	**(3,288,027)**	**–**	**–**
Total	**5,991,854**	**–**	**5,991,854**	**(4,563,539)**	**(2,558,964)**	**(1,130,649)**

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

3 FINANCIAL RISK MANAGEMENT *(continued)*

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

	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)	Cash collateral received	Net amount
2022						
Financial assets						
Derivative financial instruments	13,133,770	–	13,133,770	(2,176,791)	(1,584,708)	9,372,271
Financial assets at fair value through other comprehensive income	23,615,867	–	23,615,867	(21,882,034)	–	1,733,833
Total	36,749,637	–	36,749,637	(24,058,825)	(1,584,708)	11,106,104

	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)	Cash collateral advanced	Net amount
Financial liabilities						
Derivative financial instruments	1,994,313	–	1,994,313	(2,176,791)	(1,131,683)	(1,314,161)
Due to banks and other financial institutions	21,882,034	–	21,882,034	(21,882,034)	–	–
Total	23,876,347	–	23,876,347	(24,058,825)	(1,131,683)	(1,314,161)

3.6 Capital management

The Bank'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 Bank operates;
- To ensure the Bank'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.

The Bank monitors its capital structure through the capital adequacy ratio in alignment with prevailing industry standards. During the year, no material changes were made to the Bank's policy on capital management.

The Bank has complied with all externally imposed capital requirements during 2023.

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

4 NET INTEREST INCOME

	2023	2022
Interest income		
Due from and placements with banks and other financial institutions	**1,476,388**	569,930
Loans and advances to customers	**9,303,516**	5,186,018
Financial assets at amortized cost	**2,300,047**	921,199
Financial assets at fair value through other comprehensive income	**9,441,377**	5,385,741
	22,521,328	12,062,888
Interest expense		
Due to banks and other financial institutions	**(1,395,141)**	(1,268,688)
Due to customers	**(11,958,660)**	(5,114,407)
Debt securities and certificates of deposit issued at amortized cost	**(227,079)**	(185,480)
	(13,580,880)	(6,568,575)
Net interest income	**8,940,448**	5,494,313

5 FEE AND COMMISSION INCOME

	2023	2022
Settlement service	**48,401**	46,739
Interchange service	**24,925**	20,843
Credit facilities, guarantee and commitment	**30,557**	22,630
Agency service	**815,192**	750,894
Depositary service	**61,607**	60,372
Others	**6,072**	5,567
	986,754	907,045
Of which arise from:		
Financial assets/liabilities not at fair value through profit or loss	**30,557**	22,630
Trust and other fiduciary activities	**46,540**	45,167

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

6 FEE AND COMMISSION EXPENSE

	2023	2022
Settlement and brokerage service	**51,102**	49,770
Interchange service	**11,001**	9,684
Others	**13,533**	7,383
	75,636	66,837
Of which arise from:		
Financial assets/liabilities not at fair value through profit or loss	**11,001**	9,684

7 DIVIDEND INCOME

	2023	2022
Financial assets at fair value through other comprehensive income – unlisted investments	**35**	35

8 NET (LOSSES)/GAINS ARISING FROM TRADING ACTIVITIES

	2023	2022
Foreign exchange	**(652,656)**	377,608
Interest rate instruments and others	**(114,622)**	(249,892)
Debt securities at fair value through profit or loss	**(37,330)**	(57,076)
Net gains of interest rate instruments and items under fair value hedge (note 18)	**17,977**	264,460
Others	**(358)**	2,343
	(786,989)	337,443

Net (losses)/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 losses 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

	2023	2022
Management fee received from a branch of the ultimate holding company (note 36 (g))	**3,501**	2,754
Others	**46,921**	30,483
	50,422	33,237

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

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

10 CHANGE IN EXPECTED CREDIT LOSSES

	2023	2022
Change in ECL allowance		
Loans and advances to customers	**3,886,284**	1,825,460
Financial investments at amortized cost	**23,306**	13,772
Debt investments at fair value through other comprehensive income	**29,207**	(50,537)
Cash and balances with central bank	**1,432**	(46)
Other receivables	**90,382**	3,706
Due from and placements with banks and other financial institutions	**18,635**	1,672
Financial guarantees and credit related commitments	**6,902**	(7,933)
	4,056,148	1,786,094

11 OTHER OPERATING EXPENSES

	2023	2022
Staff costs		
– salaries and other allowances	**579,924**	528,172
– retirement benefit costs (note 12)	**49,498**	44,580
Loss on disposal of property and equipment	**64**	276
General operational and administrative expenses	**286,159**	268,583
Depreciation and amortization	**42,051**	34,578
Depreciation of right-of-use assets (note 23)	**155,195**	143,268
Auditor's remuneration	**3,948**	3,825
Buildings administration fee	**12,154**	11,133
Rental expenses	**52,001**	49,467
Repairs and maintenance	**38,542**	34,795
Printing, postage and telegram	**46,159**	43,280
Directors', senior management's and key personnel's emoluments	**20,764**	20,416
Management fee paid to a branch of the ultimate holding company	**541,433**	500,730
Finance costs – lease interest expense (note 23)	**4,356**	1,751
Others	**21,778**	19,807
	1,854,026	1,704,661

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

12 RETIREMENT BENEFIT COSTS

	2023	2022
Pension costs – defined contribution plans	**49,498**	44,580

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 Bank in respect of their services rendered for the Bank are as follows:

	2023	2022
Directors' fees	**2,760**	2,650
Salaries, allowances and benefits in kind	**1,876**	1,451
Bonuses	**1,023**	691
Retirement benefit costs	**–**	–
	5,659	4,792

For the year ended 31 December 2023 and 2022, some of the executive directors received emoluments and emoluments receivable from Bank of Communications Co., Ltd. Hong Kong Branch ("HKBR"), amounting to HK$4,580,000 (2022: HK$7,730,000), in respect of their service to the Bank and HKBR. The portion of the directors' emoluments in relation to the services to the Bank of HK$2,290,000 (2022: HK$4,100,000) 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 Bank's business to which the Bank was a party and in which a director of the Bank had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

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

14 INCOME TAX EXPENSES

	2023	2022
Current income tax		
– Hong Kong profits tax	**444,011**	448,986
– Under provision in prior years	**108**	54
	444,119	449,040
Deferred income tax	**(26,612)**	23,024
Income tax expense	**417,507**	472,064

The current tax provision for the year ended 31 December 2023 and 2022 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:

	2023	2022
Profit before tax	**2,823,581**	2,879,497
Tax calculated at a tax rate of 16.5%	**465,891**	475,117
Tax effect of expense not deductible for tax purpose	**30,440**	31,392
Tax effect arising from income not subject to tax	**(39,111)**	(34,448)
Under provision in prior years	**108**	54
Others	**(39,821)**	(51)
	417,507	472,064

15 CASH AND BALANCES WITH CENTRAL BANK

	2023	2022
Cash	**445,655**	710,229
Balances with central bank	**1,250,053**	1,557,253
Less: ECL allowances	**(1,434)**	(2)
	1,694,274	2,267,480

16 DUE FROM AND PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	2023	2022
Due from and placements with banks and other financial institutions	**2,768,315**	3,070,118
Placements with and loans to banks	**21,429,018**	21,478,905
Less: ECL allowances	**(20,598)**	(1,963)
	24,176,735	24,547,060

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

17 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2023	2022
Derivative financial instruments (note 18)	**9,790,562**	13,133,770
Debt securities at fair value through profit or loss		
– Listed	**248,325**	–
– Unlisted	**314,197**	444,127
	10,353,084	13,577,897

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

	2023	2022
Debt securities at fair value through profit or loss		
– Governments and central banks	**119,448**	233
– Banks and other financial institutions	**242,207**	230,896
– Corporate entities	**200,867**	212,998
	562,522	444,127

18 DERIVATIVE FINANCIAL INSTRUMENTS

The following derivative instruments are utilized by the Bank 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 Bank'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 Bank 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 Bank and a customer (over the-counter market).

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

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

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 Bank'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.

	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 2023									
Foreign exchange contracts	**6,445,459**	**2,127**	**(152)**	**262,628,974**	**875,553**	**(1,772,058)**	**269,074,433**	**877,680**	**(1,772,210)**
Interest rate contracts and others	**121,064,808**	**8,235,377**	**(333,888)**	**36,356,132**	**677,505**	**(597,729)**	**157,420,940**	**8,912,882**	**(931,617)**
Total amount of derivative instruments recognized	**127,510,267**	**8,237,504**	**(334,040)**	**298,985,106**	**1,553,058**	**(2,369,787)**	**426,495,373**	**9,790,562**	**(2,703,827)**
As at 31 December 2022									
Foreign exchange contracts	–	–	–	237,747,294	1,244,122	(1,367,784)	237,747,294	1,244,122	(1,367,784)
Interest rate contracts and others	113,486,400	11,217,237	(3,705)	36,690,366	672,411	(622,824)	150,176,766	11,889,648	(626,529)
Total amount of derivative instruments recognized	113,486,400	11,217,237	(3,705)	274,437,660	1,916,533	(1,990,608)	387,924,060	13,133,770	(1,994,313)

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

The Bank 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:

	2023	2022
Renminbi	**39,498,482**	47,658,390
United States Dollar	**222,637,145**	191,426,511
Hong Kong Dollar	**150,899,588**	142,328,142
Others	**13,460,158**	6,511,017
Total	**426,495,373**	387,924,060

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

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting

(i) Fair value hedge

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

The Bank 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 Bank 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 Bank. 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 Bank 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) the effect of the counterparty and the Bank's own credit risk on the fair value of the interest rate swap, which is not reflected in the fair value of the hedged item attributable to the change in interest rate;

2) differences in maturities of the interest rate swap and the debt securities.

(a) The following table contains details of the hedging instruments used in the Bank's hedging strategies:

		Carrying amount			
As at 31 December 2023	**Notional amount**	**Assets**	**Liabilities**	**Line item on statement of financial position**	**Fair value changes of the hedging instruments**
Fair value hedge					
Interest rate					
Interest rate contract	**121,064,808**	**8,235,377**	**(333,888)**	**Financial assets/ liabilities at fair value through profit or loss**	**(2,889,735)**

		Carrying amount			
As at 31 December 2022	Notional amount	Assets	Liabilities	Line item on statement of financial position	Fair value changes of the hedging instruments
Fair value hedge					
Interest rate					
Interest rate contract	113,486,400	11,217,237	(3,705)	Financial assets/ liabilities at fair value through profit or loss	10,315,164

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

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting *(continued)*

(i) Fair value hedge (continued)

(b) The following table contains details of the hedged exposures covered by the Bank's hedging strategies:

As at 31 December 2023	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	**93,562,285**	**(7,323,183)**	**Financial asset at fair value through other comprehensive income**	**2,729,041**	**19,748**
Debt investments	**18,170,929**	**(682,551)**	**Financial asset at amortized cost**	**135,905**	**(1,061)**
Loans and advances to customers	**1,510,889**	**(47,604)**	**Loans and advances to customers**	**42,766**	**(710)**

As at 31 December 2022	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	90,108,108	(10,496,907)	Financial asset at fair value through other comprehensive income	(9,069,824)	271,083
Debt investments	10,765,407	(818,290)	Financial asset at amortized cost	(820,810)	(6,681)
Loans and advances to customers	1,468,123	(90,370)	Loans and advances to customers	(160,070)	58

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

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting *(continued)*

(i) Fair value hedge (continued)

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

For the year ended 31 December 2023	**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	**–**	**17,977**	**Net gains arising from trading activities**

For the year ended 31 December 2022	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	–	264,460	Net gains arising from trading activities

(ii) Cash flow hedge

The Bank uses foreign exchange contracts to hedge against exposures to cash flow variability primarily resulting from foreign exchange risks. The hedged items include debt investments at FVOCI, due from and placements with banks and other financial institutions. The Bank mainly uses critical terms methodologies to evaluate the effectiveness of hedging. With the supporting of testing results, the Bank's management considers the hedging relationship to be highly effective.

For the year ended 31 December 2023, the Bank recognized HK$4,161,000 (31 December 2022: HK$Nil) in the hedging reserve.

Exposures to interbank offered rates

In response to the global regulatory decision to phase out Interbank Offered Rates ("IBORs") and replace them with Alternative Reference Rates ("ARRs"), the Bank has established a project to manage the transition process for any of its contracts that could be affected. The project is coordinated by Deputy Chief Executive and involved senior representatives from various functions across the Bank including the asset and liability management, front line business and product management, legal and compliance, finance, risk management, operations and technology.

During 2023, the Bank has successfully completed the transition of its IBOR exposure to the ARRs. Comprehensive plans, processes and procedures were already established to facilitate the ongoing transition of the remaining exposures.

As at 31 December, 2023, the Bank no longer held any IBOR exposure. But a small number of assets, specifically a loan balance totalling to HK$0.937 billion and bond investment holdings with a total market value for HK$1.816 billion still rely on Synthetic LIBOR without fall-back provisions. These assets are in the process of transitioning to ARRs eventually.

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

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Exposures to interbank offered rates *(continued)*

As at 31 December 2023 and 31 December 2022, the details of derivative instruments designated in fair value hedge accounting relationships linked to IBORs, excluding the derivative instruments that will expire on the transition date, are as follows:

	Notional amount	
	As at 31 December 2023	As at 31 December 2022
Fair value hedge		
Interest rate contract		
USD London Interbank Offered Rate	**–**	90,791,432

The following table shows outstanding amounts of financial instruments referencing the IBOR benchmark rates as at 31 December 2023 and 31 December 2022. The amounts of financial assets and liabilities are shown at gross carrying amounts, and derivatives are shown at notional amounts.

	Non-derivative financial assets carrying value	**Non-derivative financial liabilities carrying value**	**Derivatives nominal amounts (note a)**
USD London Interbank Offered Rate with different tenors			
As at 31 December 2023	**–**	**–**	**–**
As at 31 December 2022	35,778,701	159,812	98,961,418

Note a: The IBOR exposures for derivatives nominal amounts include loan commitments.

19 LOANS AND ADVANCES TO CUSTOMERS

19.1 Loans and advances to customers

	2023	2022
Loans and advances to customers at amortized cost		
Loans and advances to customers	**198,218,971**	210,753,905
Less: ECL allowance	**(6,227,494)**	(2,706,136)
	191,991,477	208,047,769
Loans and advances to customers at fair value through other comprehensive income		
Loans and advances to customers	**–**	–
Total	**191,991,477**	208,047,769

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

19 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

19.2 Analysis of loans and advances to customers by staging

As at 31 December 2023	**Stage 1 allowance**	**Stage 2 allowance**	**Stage 3 allowance**	**Total**
Loans and advances to customers				
– Carried at amortized cost (Note)	**173,355,402**	**18,543,250**	**6,320,319**	**198,218,971**
– Carried at fair value through other comprehensive income	**–**	**–**	**–**	**–**
Less: ECL allowance	**(370,846)**	**(216,646)**	**(5,640,002)**	**(6,227,494)**
Net loans and advances to customers	**172,984,556**	**18,326,604**	**680,317**	**191,991,477**

Note: Included in the stage 1 balance is a fair value loss of hedging adjustment of HK$47,604,000 which is not subject to ECL allowance (note 18 (b)).

As at 31 December 2022	Stage 1 allowance	Stage 2 allowance	Stage 3 allowance	Total
Loans and advances to customers				
– Carried at amortized cost (Note)	191,573,755	13,379,202	5,800,948	210,753,905
– Carried at fair value through other comprehensive income	–	–	–	–
Less: ECL allowance	(554,567)	(139,649)	(2,011,920)	(2,706,136)
Net loans and advances to customers	191,019,188	13,239,553	3,789,028	208,047,769

Note: Included in the stage 1 balance is a fair value loss of hedging adjustment of HK$90,370,000 which is not subject to ECL allowance (note 18 (b)).

19.3 Credit quality of loans and advances to customers

Loans and advances to customers analyzed by security type

	2023	2022
Unsecured loans	**38,885,581**	44,552,577
Guaranteed loans	**60,153,353**	67,523,538
Loans secured by collateral	**99,180,037**	98,677,790
Gross amount of loans and advances to customers before ECL allowance	**198,218,971**	210,753,905

(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

	2023	**% of gross advances to customers**	2022	% of gross advances to customers
Six months or less but over three months	**561,675**	**0.28%**	2,403,079	1.27%
One year or less but over six months	**1,038,732**	**0.52%**	1,595,963	0.84%
Over one year	**4,364,198**	**2.21%**	171,351	0.09%
Total gross amount of advances overdue for more than three months	**5,964,605**	**3.01%**	4,170,393	2.20%
ECL allowance for stage 3	**5,385,915**		1,678,135	
Rescheduled advances excluding those overdue for more than three months	**98,799**	**0.05%**	1,367	0.00%

20 FINANCIAL INVESTMENTS

	2023	2022
Financial assets at amortized cost		
Debt securities at amortized cost (Note)		
– Listed	**18,213,506**	12,015,178
– Unlisted	**28,520,334**	37,720,642
Less: ECL allowance	**(47,868)**	(24,562)
	46,685,972	49,711,258
Financial assets at fair value through other comprehensive income		
Debt securities at fair value through other comprehensive income		
– Listed	**88,891,006**	72,389,534
– Unlisted	**52,380,525**	88,954,149
Equity securities at fair value through other comprehensive income		
– Unlisted	**9,418**	8,587
	141,280,949	161,352,270
	187,966,921	211,063,528

Note: Included in the debt securities at amortized cost is a fair value loss of hedging adjustment of HK$682,551,000 (2022: HK$818,290,000) which is not subject to ECL allowance (note 18 (b)).

The Bank has designated the investment in equity instrument at fair value through other comprehensive income. The Bank chose this presentation alternative because the investment was made as a pre-requisite for the provision of the bank's certain normal banking business 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 INVESTMENTS *(continued)*

Financial investments analyzed by issuer are as follows:

	2023	2022
Financial assets at amortized cost		
Debt securities at amortized cost		
– Governments and central banks	**14,298,435**	20,756,228
– Banks and other financial institutions	**24,772,755**	25,610,986
– Corporate entities	**7,614,782**	3,344,044
	46,685,972	49,711,258
Financial assets at fair value through other comprehensive income		
Debt securities at fair value through other comprehensive income		
– Governments and central banks	**21,929,878**	15,740,285
– Banks and other financial institutions	**58,018,236**	81,425,450
– Corporate entities	**61,323,417**	64,177,948
Equity securities at fair value through other comprehensive income		
– Banks and other financial institutions	**9,418**	8,587
	141,280,949	161,352,270
	187,966,921	211,063,528

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

21 PROPERTY AND EQUIPMENT

	Equipment	Property improvement	Transportation equipment	Total
Cost				
As at 1 January 2023	**98,429**	**89,250**	**3,126**	**190,805**
Additions	**13,703**	**21,686**	**–**	**35,389**
Disposals	**(4,459)**	**–**	**–**	**(4,459)**
As at 31 December 2023	**107,673**	**110,936**	**3,126**	**221,735**
Accumulated depreciation				
As at 1 January 2023	**(62,416)**	**(55,547)**	**(608)**	**(118,571)**
Charge for the year	**(12,539)**	**(18,698)**	**(1,042)**	**(32,279)**
Disposals	**4,395**	**–**	**–**	**4,395**
As at 31 December 2023	**(70,560)**	**(74,245)**	**(1,650)**	**(146,455)**
Net book value				
As at 31 December 2023	**37,113**	**36,691**	**1,476**	**75,280**

	Equipment	Property improvement	Transportation equipment	Total
Cost				
As at 1 January 2022	85,340	83,253	–	168,593
Additions	14,689	5,997	3,126	23,812
Disposals	(1,600)	–	–	(1,600)
As at 31 December 2022	98,429	89,250	3,126	190,805
Accumulated depreciation				
As at 1 January 2022	(50,774)	(41,566)	–	(92,340)
Charge for the year	(12,918)	(13,981)	(608)	(27,507)
Disposals	1,276	–	–	1,276
As at 31 December 2022	(62,416)	(55,547)	(608)	(118,571)
Net book value				
As at 31 December 2022	36,013	33,703	2,518	72,234

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

22 DEFERRED INCOME TAX ASSETS/(LIABILITIES)

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

	2023	2022
As at 1 January	**173,195**	(301,937)
Deferred income tax credited/(debited) to income statement (note 14)	**26,612**	(23,024)
Deferred income tax (debited)/credited to equity	**(282,581)**	498,156
As at 31 December	**(82,774)**	173,195

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

	2023	2022
Deferred income tax assets		
ECL allowances	**113,179**	121,932
Revaluation of investment securities	**–**	56,844
Deferred income tax liabilities		
Accelerated depreciation allowances	**(14,861)**	(5,581)
Revaluation of investment securities	**(181,092)**	–
	(82,774)	173,195

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The deferred income 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:

	2023	2022
Deferred income tax assets	**113,179**	178,776
Deferred income tax liabilities	**(195,953)**	(5,581)
	(82,774)	173,195

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

23 RIGHT-OF-USE ASSETS

	2023	2022
Gross:		
As at 1 January	**808,594**	711,611
Additions	**250,796**	98,500
Reductions	**(642,940)**	(1,517)
As at 31 December	**416,450**	808,594
Accumulated depreciation		
As at 1 January	**(639,147)**	(496,448)
Charge for the year (note 11)	**(155,195)**	(143,268)
Reductions	**631,583**	569
As at 31 December	**(162,759)**	(639,147)
Net book value		
As at 1 January	**169,447**	215,163
As at 31 December	**253,691**	169,447

(i) Amounts recognized in the statement of financial position

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

Right-of-use asset	2023	2022
Properties	**250,938**	168,959
Equipment	**2,446**	442
Others	**307**	46
	253,691	169,447
Lease liabilities	**261,695**	172,297

(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)	2023	2022
Properties	**150,789**	138,004
Equipment	**4,262**	5,125
Others	**144**	139
	155,195	143,268

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

Finance costs-lease interest expense (note 11)	2023	2022
Properties	**4,261**	1,732
Equipment	**89**	18
Others	**6**	1
	4,356	1,751

The total cash outflow for leases in 2023 was HK$206,398,000 (2022:HK$195,600,000).

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

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

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

The Bank 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 Bank. 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 Bank and not by the respective lessor.

24 OTHER ASSETS

	2023	2022
Interest receivable	**2,994,218**	2,701,048
Less: ECL allowances	**(60,766)**	(22,249)
	2,933,452	2,678,799
Other receivables, prepayments and others	**3,223,272**	2,408,791
Less: ECL allowances	**(6)**	(6)
	3,223,266	2,408,785
Settlement accounts	**2,208,468**	1,977,909
Intangible assets (a)	**72,616**	27,658
	8,437,802	7,093,151

(a) Intangible assets

	2023	2022
Cost		
As at 1 January	**44,654**	34,269
Additions	**54,730**	10,385
As at 31 December	**99,384**	44,654
Accumulated amortization		
As at 1 January	**(16,996)**	(9,925)
Amortization expenses	**(9,772)**	(7,071)
As at 31 December	**(26,768)**	(16,996)
Net book value as at 31 December	**72,616**	27,658

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

25 DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	2023	2022
Deposits from banks and other financial institutions	**11,756,224**	34,411,839
Subordinated loan from the ultimate holding company	**2,000,000**	2,000,000
Financial assets sold under repurchase agreements (note 35)	**3,288,027**	21,882,034
Total	**17,044,251**	58,293,873

On 19 January 2018, the Bank had drawn down a HK$2,000 million Tier 2 capital subordinated loan from the ultimate holding company due 19 January 2028. It has a floating rate of interest payable quarterly per annum in arrears for each interest period at the aggregate of 1.50% per annum and three month HIBOR.

26 DUE TO CUSTOMERS

	2023	2022
Demand deposits and current accounts	**9,547,573**	12,142,424
Saving deposits	**55,181,125**	63,994,819
Time, call, notice and other deposits	**268,598,400**	262,081,207
	333,327,098	338,218,450
Including:		
Deposits pledged as collateral	**3,551,453**	3,349,966

27 FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	2023	2022
Derivative financial instruments (note 18)	**2,703,827**	1,994,313

For the year ended 31 December 2023 and 2022, there were no significant changes in the fair value of the Bank's financial liabilities designated as at fair value through profit or loss that were attributable to the changes in credit risk.

28 CERTIFICATES OF DEPOSITS ISSUED

	2023	2022
Carried at fair value through profit and loss	**1,788,345**	1,757,007

29 DEBT SECURITIES ISSUED

	2023	2022
Tier 2 capital bonds	**7,809,900**	7,797,780

On 8 July 2021, the Bank issued USD1,000 million Tier 2 capital bonds due 2031. These bonds have an initial distribution rate of 2.304% per annum, payable semi-annually in arrear from year 1 to year 5, and resettable on year 5 at the then-prevailing 5-year U.S. Treasury yield plus 1.4% per annum.

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

30 OTHER LIABILITIES

	2023	2022
Interest payable	**2,729,582**	2,630,783
Settlement accounts	**1,314,903**	1,235,493
Withholding tax	**–**	58,419
Provision for impairment allowances on financial guarantees and credit related commitment	**21,866**	14,964
Others	**3,866,568**	4,233,319
Total	**7,932,919**	8,172,978

31 SHARE CAPITAL

	2023	2022
Share capital as at 1 January and 31 December	**37,900,000**	37,900,000
Number of Shares	**37,900,000,000**	37,900,000,000

32 ADDITIONAL EQUITY INSTRUMENT

	2023	2022
Undated non-cumulative subordinated Additional Tier 1 capital securities with US$500 million	**3,871,450**	3,871,450

In March 2020, the Bank issued USD500 million undated non-cumulative subordinated Additional Tier 1 capital securities. These capital securities are perpetual securities and listed on the Stock Exchange of Hong Kong Limited. The Bank has the option to redeem these securities on 3 March 2025, and every six months thereafter, or on the occurrence of certain other events. These capital securities have an initial distribution rate of 3.725% per annum, payable semi-annually in arrear from year 1 to year 5, and resettable on year 5 and every 5 years thereafter, at the then-prevailing 5-year U.S. Treasury yield plus 2.525% per annum. The Bank has paid dividends of HK$146,115,000 to the holders of additional equity instrument for the year ended 31 December 2023 (31 December 2022: HK$145,873,000). The equity instrument will be written down at the point of non-viability on the occurrence of a trigger event as defined in the Banking (Capital) Rules. It ranks higher than ordinary shares in the event of a winding-up.

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

33 FINANCIAL GUARANTEES AND CREDIT RELATED COMMITMENTS AND OTHER COMMITMENTS

Financial guarantees and credit related commitments

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

	2023	2022
Letters of guarantee	**57,124**	16,321
Letters of credit commitments	**469,737**	810,900
Acceptances bills	**130,193**	92,191
Credit card commitments	**4,737,491**	4,849,698
Other credit-related commitments		
– Under 1 year	**11,416,737**	14,207,584
– More than 1 year	**12,662,320**	11,696,511
	29,473,602	31,673,205

Capital expenditure commitments

	2023	2022
Contracted but not provided for	**7,795**	19,540

Operating lease commitments

As at 31 December 2023, the Bank has non-cancellable operating lease commitments of HK$2,147,000 (31 December 2022: HK$1,626,000) related to short-term leases, which are the leases with a lease term of 12 months or less.

34 NOTES TO STATEMENT OF CASH FLOWS

(a) 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:

	2023	2022
Cash and balances with central bank (note 15)	**1,694,274**	2,267,480
Due from and placements with banks and other financial institutions	**17,015,565**	11,896,842
	18,709,839	14,164,322

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

34 NOTES TO STATEMENT OF CASH FLOWS *(continued)*

(b) Reconciliation of liabilities arising from financing activities

	Debt securities issued	
	2023	2022
At 1 January	**7,797,780**	7,796,690
Non-cash changes:		
Exchange difference	**12,120**	1,090
At 31 December	**7,809,900**	7,797,780

	Lease liabilities	
	2023	2022
At 1 January	**172,297**	219,127
Cash flows:		
Payment of lease liabilities	**(154,397)**	(146,133)
Non-cash changes:		
Additions	**232,093**	98,500
Interest expense	**4,356**	1,751
Early termination	**(730)**	(948)
Lease modifications	**8,076**	–
At 31 December	**261,695**	172,297

35 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 Bank 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 Bank is still exposed to substantially all the credit risks and market risks and rewards of those securities sold. These securities, which the Bank 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 Bank retains substantially all the risks and rewards of these securities. In addition, it recognizes a financial liability for cash received.

As at 31 December 2023 and 2022, the Bank 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	
	2023	2022	**2023**	2022
Investment securities	**3,500,593**	23,615,867	**(3,288,027)**	(21,882,034)

36 MATERIAL RELATED PARTY TRANSACTIONS

(a) Parent entity

The Bank is controlled by the following entity:

Name	Type	Place of incorporation	Ownership interest	
			2023	2022
Bank of Communications Co., Ltd.	Ultimate parent entity and controlling party	People's Republic of China	**100%**	100%

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

36 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(b) Key management personnel compensation

	2023	2022
Short-term employee benefits	**16,641**	16,273
Post-employment benefits	**1,362**	1,493
	18,003	17,766

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

As at 31 December 2023, the MOF holds 17,732 million (31 December 2022: 17,732 million) shares of the ultimate holding company of the Bank which represents 23.88% (31 December 2022: 23.88%) of equity interest of the ultimate holding company of the Bank.

The MOF is a Chinese government ministry, primarily responsible for managing state fiscal revenue and expenditures, and establishing and enforcing taxation policies. The Bank 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:

	2023	2022
Bonds issued by MOF	**4,425,463**	4,288,659
Other assets	**15,034**	18,910
Interest income	**81,430**	160,891
Net gains arising from financial investments	**6,085**	262,786

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

As at 31 December 2023, HSBC holds 13,886 million (31 December 2022: 13,886 million) shares of the ultimate holding company of the Bank which represents 18.7% (31 December 2022: 18.7%) of total share capital of the Bank. Transactions between the Bank and HSBC are carried out under normal commercial terms and paid at market rates.

Details of transactions and outstanding balances are summarized below:

	2023	2022
Due from and placements with banks and other financial institutions	**695,162**	1,138,618
Derivative financial assets	**26,794**	99,292
Financial assets at amortized cost and fair value through other comprehensive income	**2,059,346**	1,639,755
Other assets	**8,332**	5,565
Due to banks and other financial institutions	**1,509,635**	11,261,017
Derivative financial liabilities	**171,798**	49,761
Other liabilities	**15,079**	100,395
Interest income	**102,924**	40,914
Interest expense	**4,711**	3,548
Net (losses)/gains arising from trading activities	**(60,733)**	339,791
Net losses arising from financial investments	**9,348**	3,181

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

36 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(e) Transactions with fellow subsidiaries

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

Details of transactions and outstanding balances are summarized below:

	2023	2022
Financial assets at fair value through profit or loss	**200,867**	195,421
Financial assets at fair value through other comprehensive income	**657,376**	1,382,054
Loans and advances to customers	**412,699**	418,065
Other assets	**140,291**	17,152
Due to customers	**1,644,530**	1,406,814
Due to banks and other financial institutions	**–**	39,065
Other liabilities	**6,965**	6,713
Interest income	**67,428**	41,628
Interest expense	**7,857**	1,283
Fee and commission income	**14,477**	12,471
Fee and commission expense	**15,290**	12,839
Net gains arising from trading activities	**4,671**	4,532
Rental expenses	**22,048**	21,982
Other operating expenses	**23,478**	29,964

(f) Transactions with directors and senior management

	2023	2022
Loans and advances to customers	**26,404**	21,169
Due to customers	**106,532**	89,616
Interest income	**343**	220
Interest expense	**2,932**	1,516

Particular of loans made to directors of the Bank 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 2023 and 2022 are as follows:

	2023	2022
Aggregate amount of relevant transactions outstanding at year end	**91**	446
Maximum aggregate amount of relevant transactions outstanding during the year	**397**	846

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

36 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(g) Transactions with the ultimate holding company

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

Details of transactions and outstanding balances are summarized below:

	2023	2022
Due from and placements with banks and other financial institutions	**6,422,100**	1,244,807
Derivative financial assets	**8,081,257**	10,494,774
Other assets	**1,065,955**	1,086,590
Due to banks and other financial institutions	**9,679,503**	33,602,497
Derivative financial liabilities	**228,628**	1,008,799
Other liabilities	**951,687**	1,448,509
Interest income	**115,069**	52,045
Interest expense	**596,888**	767,170
Net gains arising from trading activities	**1,354,169**	9,361,556
Net losses arising from financial investments	**–**	21
Other operating income (note 9)	**3,501**	2,754
Other operating expenses	**593,619**	552,974
Purchase of loan and advances	**3,851,817**	8,041,506
Disposal of loan and advances	**2,779,917**	–

37 SEGMENTAL ANALYSIS

The Bank manages the business mainly from an operating segment perspective and the majority of the Bank's revenues, profits before tax and assets are derived from Hong Kong. The Bank 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.

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

37 SEGMENTAL ANALYSIS *(continued)*

The business information of the Bank is summarized as follows:

	2023				
	Corporate Banking	Personal Banking	Treasury	Others	Total
External net interest income/(expense)	4,306,551	(6,592,826)	11,226,723	–	8,940,448
Inter-segment net interest income/(expense)	(2,900,556)	8,804,495	(5,903,939)	–	–
Net interest income	1,405,995	2,211,669	5,322,784	–	8,940,448
Net fee and commission income/(expense)	285,112	628,345	(26,917)	24,578	911,118
Net losses arising from trading activities	–	–	(786,989)	–	(786,989)
Net losses arising from financial investments	–	–	(381,279)	–	(381,279)
Dividend income	–	–	–	35	35
Other operating income	1,691	37,593	1,372	9,766	50,422
Total operating income	1,692,798	2,877,607	4,128,971	34,379	8,733,755
Change in expected credit losses	(3,908,247)	(7,796)	(129,578)	(10,527)	(4,056,148)
Other operating expense					
– Depreciation and amortization	(623)	(186,787)	(59)	(9,777)	(197,246)
– Others	(172,970)	(1,399,886)	(90,163)	6,239	(1,656,780)
Profit/(loss) before tax	(2,389,042)	1,283,138	3,909,171	20,314	2,823,581
Income tax expense	–	–	–	(417,507)	(417,507)
Net profit/(loss) for the year	(2,389,042)	1,283,138	3,909,171	(397,193)	2,406,074
Depreciation and amortization	(623)	(186,787)	(59)	(9,777)	(197,246)
Capital expenditure	(8,154)	(80,658)	–	(2,197)	(91,009)
As at 31 December 2023					
Segment assets	130,578,530	62,787,460	230,321,876	–	423,687,866
Unallocated assets	–	–	–	1,266,498	1,266,498
Total assets	130,578,530	62,787,460	230,321,876	1,266,498	424,954,364
Segment liabilities	(68,899,490)	(269,185,297)	(31,907,747)	–	(369,992,534)
Unallocated liabilities	–	–	–	(958,275)	(958,275)
Total liabilities	(68,899,490)	(269,185,297)	(31,907,747)	(958,275)	(370,950,809)

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

37 SEGMENTAL ANALYSIS *(continued)*

	2022				
	Corporate Banking	Personal Banking	Treasury	Others	Total
External net interest income/(expense)	2,626,533	(2,387,790)	5,255,586	(16)	5,494,313
Inter-segment net interest income/ (expense)	(1,567,521)	4,289,018	(2,721,497)	–	–
Net interest income/(expense)	1,059,012	1,901,228	2,534,089	(16)	5,494,313
Net fee and commission income/ (expense)	386,950	679,537	(226,279)	–	840,208
Net gains arising from trading activities	–	74	337,369	–	337,443
Net losses arising from financial investments	–	–	(334,984)	–	(334,984)
Dividend income	–	35	–	–	35
Other operating income	966	29,524	2,614	133	33,237
Total operating income	1,446,928	2,610,398	2,312,809	117	6,370,252
Change in expected credit losses	(1,834,178)	29,421	18,967	(304)	(1,786,094)
Other operating expense					
– Depreciation and amortization	(2,427)	(166,628)	(136)	(8,655)	(177,846)
– Others	(84,406)	(881,756)	(79,794)	(480,859)	(1,526,815)
Profit/(loss) before tax	(474,083)	1,591,435	2,251,846	(489,701)	2,879,497
Income tax expense	–	–	–	(472,064)	(472,064)
Net profit/(loss) for the year	(474,083)	1,591,435	2,251,846	(961,765)	2,407,433
Depreciation and amortization	(2,427)	(166,628)	(136)	(8,655)	(177,846)
Capital expenditure	(267)	(25,425)	(32)	(8,471)	(34,195)
As at 31 December 2022					
Segment assets	147,900,578	62,147,187	256,837,612	–	466,885,377
Unallocated assets	–	–	–	126,384	126,384
Total assets	147,900,578	62,147,187	256,837,612	126,384	467,011,761
Segment liabilities	(110,016,502)	(232,553,581)	(73,495,216)	–	(416,065,299)
Unallocated liabilities	–	–	–	(396,542)	(396,542)
Total liabilities	(110,016,502)	(232,553,581)	(73,495,216)	(396,542)	(416,461,841)

38 NON-ADJUSTING EVENT AFTER REPORTING PERIOD

There are no significant events after the reporting period.

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 serves as a mechanism for assuring sustainable development, it is essential for the prudent operation of a commercial bank as well. The Bank aims to fulfil its corporate governance responsibilities and pushes for the establishment of a corporate governance policy and mechanism on an ongoing basis. To this end, the allocation of duties and authorities was refined within the Specialized Committees under the Board of Directors ("Board") to enhance the effectiveness in corporate governance practices on an ongoing basis.

The Bank has complied with, in all material aspects, the requirements set out in the Supervisory Policy Manual Module, CG-1 "Corporate Governance of Locally Incorporated Authorized Institutions" issued by the Hong Kong Monetary Authority ("HKMA"). The Bank has established a corporate governance structure comprising the Sole Shareholder, the Board of Directors, the Specialized Committees, Management-level Committee and Senior Management. This structure is characterized by well-defined authorities and responsibilities, balanced equilibrium in the composition as well as coordinated and independent operations.

Six (6) Specialized Committees were set up under the Board. They are Strategy and Corporate Governance Committee set up in September 2023, Green Finance Management Committee set up in December 2022 as well as Audit Committee, Nomination Committee, Remuneration Committee and Risk Management Committee set up in June 2017. These committees are responsible for reporting their activities to the Board, and assisting the Board in executing their duties as authorized by the Board.

2 Board of Directors

The Board plays a core role within the Bank's corporate governance framework, it assumes the ultimate responsibilities towards the shareholders, depositors, creditors, employees, other stakeholders and supervisors of the Bank. In discharging its responsibilities, the Board strives to establish a set of sound risk management and internal control systems that safeguard the Bank's business and operations managed in a prudent, professional and competent manner and in conformity with relevant laws and regulations.

Generally, the Board discharges the key responsibilities as follows:

(1) Develop objectives and strategies, and oversee their execution;

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

(3) Appoint senior management members and oversee their performance;

(4) Establish corporate values and standards to promote ethical and responsible professional conduct among staff;

(5) Oversee and supervise Senior Management's implementation of the remuneration system; and

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

2 Board of Directors *(continued)*

During the year, seven (7) Board meetings were convened and the following major tasks were performed by the Board:

(1) Reviewed and approved the Outline Development Plan for the Medium and Long-term Strategy;

(2) Reviewed and approved the annual financial budget and financial accounts;

(3) Reviewed and approved the establishment of the Strategy and Corporate Governance Committee under the Board along with its terms of reference, and appointed the chairman and members of the Committee;

(4) Approved the appointment of 4 Non-executive Directors upon receipt of consent in writing from the HKMA;

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

(6) Received a briefing on the report on the implementation of bank culture, and reviewed and approved the remuneration policies;

(7) Reviewed the tasks carried out by the Specialized Committees; and

(8) Received a briefing on the annual statement of the business continuity plan and the business continuity drill report.

3 Strategy and Corporate Governance Committee

The Strategy and Corporate Governance Committee is responsible for assisting the Board of Directors in providing strategic and corporate governance direction to the Bank. This includes the following responsibilities:

(1) Review the Bank's strategy and development plan as well as major equity investments and asset acquisitions, etc.;

(2) Monitor and evaluate the execution of the Bank's strategies and development plans as well as major equity investments and asset acquisitions, etc., and make recommendations to the Board of Directors;

(3) Review the Bank's major organizational restructuring and layout plans and make recommendations to the Board of Directors; and

(4) Develop and regularly review the Bank's compliance with legal, regulatory and corporate governance standards, and make recommendations to the Board of Directors.

According to the terms of reference of the Strategy and Corporate Governance Committee, the Committee shall be chaired by the Chairman of the Board. The members of the committee consist of both executive directors and non-executive directors, as well as any person who is deemed appropriate and necessary according to the Board. The current members of the Committee are Mr. Hao Cheng, Mr. Meng Yu, Mr. Shan Zengjian and Ms. Wu Ye.

During the year, no meetings of the Strategy and Corporate Governance Committee were convened.

4 Audit Committee

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

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

(2) Establish the responsibility and independence of the Internal Audit function, and to provide guidance to the Audit Department of the Bank;

(3) Approve the Audit Charter drawn up and updated periodically by the Audit Department of the Bank;

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

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

(6) 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) Review ad-hoc non-compliance incident report and HKMA on-site examination reports, etc.;

(8) 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) Review accounting policies, financial conditions and financial reporting process; and

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

According to the Terms of Reference of the Audit Committee, all Audit Committee members shall 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.

During the year, four (4) meetings of the Audit Committee were convened.

5 Nomination Committee

The Nomination Committee discharges the following main duties:

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

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

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

(4) Undertake regular assessments of the Board's performance to assist the Board in reviewing the efficiency and effectiveness of the functioning of the Board; and

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

The Nomination Committee shall be chaired by an Independent Non-executive Director, and the majority of the 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.

During the year, four (4) meetings of the Nomination Committee were convened and the following major tasks were performed:

(1) Considered the matters related to the change and appointment of Directors and Senior Management;

(2) Reviewed the Terms of Reference of the Nomination Committee;

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

(4) Evaluated the independence of the Independent Non-executive Directors, performance of the Board, its Specialized Committees and the Board members.

6 Remuneration Committee

The Remuneration Committee discharges the following main duties:

(1) Make recommendations to the Board on the Bank'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) Make recommendations to the Board on the remuneration by reference to corporate goals and objectives resolved by the Board, and on the remuneration of Directors, Chief Executive, Senior Management and Key Personnel;

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

(5) Exercise competent and independent judgment on remuneration policies and practices, as well as the incentives thereby created for managing risk, capital and liquidity; work closely with other relevant Board Committees and consulting risk control functions in the evaluation of the incentives created by the remuneration system; and

(6) Ensure that a regular review of the Bank'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 shall be chaired by an Independent Non-executive Director, and the majority of the members shall be Independent Non-executive Directors. Current members of the Remuneration Committee are Mr. Chan Ka Lok (Chairman of the Remuneration Committee) and Mr. Tang Kwai Chang. Mr. Han Yuemin resigned as the member of the Remuneration Committee on 20 June 2023.

During the year, seven (7) meetings of the Remuneration Committee were convened and the following major tasks were performed:

(1) Reviewed the remuneration policies;

(2) Reviewed the Terms of Reference of the Remuneration Committee;

(3) Reviewed the Staff's Code of Conduct;

(4) Considered the proposal on staff bonus for year 2022 and the proposal on salary adjustment for year 2023;

(5) Considered the report of independent assessment on internal control of remuneration system prepared by a consultancy firm;

(6) Listened to the report of annual audit review on remuneration policies; and

(7) Listened to the report of bank culture implementation.

7 Risk Management Committee

The Risk Management Committee discharges the following functions:

(1) Review the Bank's risk appetite and risk management strategy and evaluate the level of each type of risk;

(2) Identify, assess and manage different risks faced by the Bank;

(3) Review and assess whether the Bank's risk management process and system as well as internal control are adequate or not;

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

(5) Review the ICAAP procedure and report annually and ensure the Bank has adequate capital to mitigate major risks after assessing the business and risk strategy.

Currently all members of the Risk Management Committee are Independent Non-executive Directors, namely Mr. Lam Yim Nam (Chairman of the Risk Management Committee), Mr. Tang Kwai Chang and Ms. Chan Ching Har Eliza.

During the year, five (5) meetings of the Risk Management Committee were convened and the following major tasks were performed:

(1) Reviewed and recommended risk management strategy, as well as risk level/appetite acceptable by the Bank for Board's approval;

(2) Reviewed and assessed whether the risk management structure and policies are capable to identify, measure, monitor and control the risks posed to the Bank; and whether the risk management structure and policies function effectively;

(3) Reviewed the reports from the Comprehensive Risk Management and Internal Control Committee on risk exposures and risk management activities;

(4) Reviewed, approved and oversaw major risk management policies and measures;

(5) Reviewed major/high-risk exposures or transactions, including major disposals, transactions, write-offs of non-performing assets;

(6) Reviewed risk appetite and risk limits; and

(7) Reviewed and recommended the Annual Recovery Plan for Board's approval.

8 Green Finance Management Committee

The Green Finance Management Committee discharges the following main duties:

(1) Oversee the implementation of the development and innovation initiatives in the field of green finance across all units and departments;

(2) Review or receive a briefing on the relevant green finance reports and other major issues;

(3) Review and approve green finance-related policies as well as major rules; and

(4) Assess green finance governance and development on a regular basis.

According to the terms of reference of the Green Finance Management Committee, the Committee shall be chaired by the Chief Executive, and the members of the Committee shall be all Deputy Chief Executives. The current members of the Committee are Mr. Meng Yu (Chairman of the Green Finance Management Committee), Mr. Ip Tsz Kin, Mr. Zhu Bin, Mr. Fan Chaorong, Mr. Zhang Weizhong and Mr. Yang Hao.

During the year, one (1) meeting of the Green Finance Management Committee was convened and the following major tasks were performed:

(1) Reviewed and approved the build-up of the Bank's Green Finance Brand;

(2) Reviewed the report on green finance compliance; and

(3) Received a briefing on the report on green finance development and climate risk management.