NOTES TO THE FINANCIAL STATEMENTS

1. Principal activities

The Company is an investment holding company and its subsidiaries are principally engaged in the provision of banking and related financial services in Hong Kong.

The Company is a limited liability company incorporated and listed in Hong Kong. The address of its registered office is 52/F, Bank of China Tower, 1 Garden Road, Hong Kong.

2. Summary of significant accounting policies

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

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

2.1 Basis of preparation

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

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

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

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

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

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

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

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

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

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

- HKFRS 7 (Amendment), "Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities". The amendments require new disclosures to include information that enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position. New disclosure for the adoption of this amended standard is presented in Note 50.

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

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

- HKFRS 12, "Disclosure of Interests in Other Entities". The standard sets out the required disclosures for entities reporting under the two new standards, HKFRS 10 and HKFRS 11, and the revised standard HKAS 28 (2011). The existing guidance and disclosure requirements for separate financial statements stipulated in HKAS 27 (Revised) are unchanged. HKFRS 12 requires entities to disclose information that helps financial statements users to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. New disclosure for the adoption of this standard is presented in Note 29.

The above HKFRS 10, HKFRS 11, HKFRS 12, HKAS 27 (2011) and HKAS 28 (2011) issued in June 2011 are a group of five new standards that supersede HKAS 27 (Revised), HKAS 28, HKAS 31, HK(SIC)-Int 12 and HK(SIC)-Int 13. The adoption of these standards does not have a material impact on the Group's financial statements.

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

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

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

- HKFRS 13, "Fair Value Measurement". The new standard which was issued in June 2011 replaces the fair value measurement guidance contained in individual HKFRSs by providing a revised definition of fair value and a single source of fair value measurement and disclosure requirements for use across HKFRSs. The requirements do not extend the use of fair value accounting, but provide guidance on how it should be applied when its use is already required or permitted by other standards within HKFRSs. It also requires extensive disclosures which allow users of financial statements to assess the methods and inputs used by the entities when developing the fair value measurements. The new disclosure is presented in Note 5.

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

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

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

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

- HKAS 32 (Amendment), "Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities". The amendment addresses inconsistencies in current practice when applying the offsetting criteria and clarifies the meaning of "currently has a legally enforceable right of set-off"; and the application of offsetting criteria to some gross settlement systems (such as central clearing house systems) that may be considered equivalent to net settlement. The adoption of this amendment does not have a material impact on the Group's financial statements.

- HKAS 36 (Amendment), "Impairment of Assets: Recoverable Amount Disclosures for Non-Financial Assets". The amendment aligns the disclosure requirements with its original intention which does not intend to disclose at level of cash generating unit. It also requires additional disclosure about the fair value measurement when the recoverable amount of impaired assets is based on fair value less costs of disposal. The adoption of this amendment does not affect the disclosure of the Group's financial statements.

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

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

- HKFRS 9, "Financial Instruments". The first part of HKFRS 9 was issued in November 2009 and will replace those parts of HKAS 39 relating to the classification and measurement of financial assets. In November 2010, a further pronouncement was published to address financial liabilities and derecognition. In December 2013, the part related to hedge accounting was further added. Key features are as follows:

  (i) Classification and Measurement

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

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

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

(i) Classification and Measurement (continued)

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

(ii) Financial Liabilities and Derecognition

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

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

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

(iii) Hedge accounting

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

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

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

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

(c) Improvements to HKFRSs

"Improvements to HKFRSs" contains numerous amendments to HKFRSs which the HKICPA considers not urgent but necessary. It comprises amendments that result in accounting changes for presentation, recognition or measurement purpose as well as terminology or editorial amendments related to a variety of individual HKFRSs. The amendments are either effective and adopted for annual periods beginning on or after 1 January 2013 or will be effective on or after 1 July 2014. The adoption of these improvements does not have a material impact on the Group's financial statements.

2.2 Consolidation

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

(1) Subsidiaries

Subsidiaries are entities controlled by the Group. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

(i) Business combinations not under common control

Acquisitions of businesses not under common control are accounted for using the acquisition method. The consideration transferred in a business combination is the fair values at the acquisition date of the assets transferred, the liabilities incurred (including contingent consideration arrangement) and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are expensed in the income statement as incurred.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the Group's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If after assessment, the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the Group's previously held interest in the acquiree (if any), the excess is recognised immediately in the income statement as a bargain purchase gain. Subsequently, goodwill is subject to impairment testing.

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

(1) Subsidiaries (continued)

(i) Business combinations not under common control (continued)

Where the consideration transferred by the Group in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at fair value at the acquisition date and considered as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with the corresponding adjustments being made against goodwill or gain on bargain purchase. Measurement period adjustments are adjustments that arise from additional information obtained during the measurement period about facts and circumstances that existed as of the acquisition date. Measurement period does not exceed one year from the acquisition date.

On an acquisition-by-acquisition basis, the Group recognises any non-controlling interests in the acquiree either at fair value or at the non-controlling interests' proportionate share of the fair value of the acquiree's identifiable net assets.

(ii) Business combinations under common control

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

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

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

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

(2) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests without change of control as transactions with equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recognised in equity. Gains or losses on disposals to non-controlling interests are also recognised in equity.

When the Group ceases to have control or significant influence, any retained interest in the entity is re-measured to its fair value, with the change in carrying amount recognised in the income statement. The fair value is the initial carrying amount for the purposes of subsequent accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. Amounts previously recognised in other comprehensive income are reclassified to the income statement.

(3) Associates and joint venture

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

Investments in associates and joint venture are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates and joint venture includes goodwill, net of accumulated impairment loss and any related accumulated foreign currency translation difference.

The Group's share of the post-acquisition profits or losses of associates or joint venture is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The accumulated post-acquisition movements are adjusted against the cost of the investment. When the Group's share of losses in an associate or a joint venture equals or exceeds its interest in the associate or joint venture, the Group does not recognise further losses unless the Group has incurred obligations or made payments on behalf of the associates or joint venture.

Unrealised gains on transactions between the Group and its associates or joint venture are eliminated to the extent of the Group's interest in the associates or joint venture. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred.

If the ownership interest in an associate or a joint venture is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to the income statement where appropriate.

2. Summary of significant accounting policies (continued)

2.3 Segmental reporting

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

2.4 Foreign currency translation

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

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

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

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

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

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

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

2. Summary of significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting

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

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

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

For derivative instruments designated as hedging instrument and are effectively hedged, the method of recognising the resulting fair value gain or loss depends on the nature of the item being hedged. The Group designates certain derivatives as either:

(a) hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge); or

(b) hedges of a particular risk associated with a highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecasted transaction (cash flow hedge).

Hedge accounting is used for derivatives designated in this way.

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

2. Summary of significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting (continued)

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as effective fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

When fair value hedge accounting is applied to fixed rate financial liabilities, the carrying values of the financial liabilities are adjusted for changes in fair value that are attributable to the interest rate risk being hedged with the derivative instruments rather than carried at amortised cost, such carrying value adjustment is recognised in the income statement together with the changes in fair value of the hedging derivatives.

If the hedge relationship no longer meets the criteria for hedge accounting or is terminated for reasons other than derecognition e.g. due to repayment of the hedged item, the unamortised carrying value adjustment (the difference between the carrying value of the hedged item at the time of termination and the value at which it would have been carried had the hedge never existed) to the hedged item is amortised to the income statement over the remaining life of the hedged item by the effective interest method. If the hedged item is derecognised, the unamortised carrying value adjustment is recognised immediately in the income statement.

(b) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualified as cash flow hedges are recognised in other comprehensive income and accumulated in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods when the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any accumulated gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the accumulated gain or loss that was reported in equity is immediately reclassified to the income statement.

(c) Net investment hedge

Hedges of net investments in foreign operations are accounted for in a similar way to cash flow hedges. A gain or loss on the effective portion of the hedging instrument is recognised in other comprehensive income and accumulated in equity; a gain or loss on the ineffective portion is recognised immediately in the income statement. Accumulated gains and losses previously recognised in other comprehensive income are reclassified to the income statement upon disposal of the foreign operation as part of the gain or loss on disposal.

2.6 Offsetting financial instruments

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

2. Summary of significant accounting policies (continued)

2.7 Interest income and expense and fee and commission income and expense

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

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

For all hedge transactions where interest rate is the hedged risk, interest income or interest expense from hedged instruments such as fixed rate debt securities or fixed rate subordinated notes are disclosed on a net basis together with net interest income/expense arising from the hedging instrument such as interest rate swap.

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

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

2.8 Financial assets

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

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

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

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

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

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

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

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

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

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

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

Gains and losses from changes in the fair value of such assets (excluding the interest component) are reported in net trading gain/loss or net gain/loss on financial instruments designated at fair value through profit or loss. The interest component is reported as part of interest income. Dividends on equity instruments of this category are also recognised in net trading gain/loss or net gain/loss on financial instruments designated at fair value through profit or loss when the Group's right to receive payment is established.

(2) Loans and receivables

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

(3) Held-to-maturity

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

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

(4) Available-for-sale

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

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

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

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

2.9 Financial liabilities

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

(1) Trading liabilities

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

2. Summary of significant accounting policies (continued)

2.9 Financial liabilities (continued)

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

A financial liability can be designated at fair value through profit or loss if it is so designated at inception. Financial liabilities so designated include certain certificates of deposit issued and certain deposits received from customers that are embedded with derivatives. A financial liability is so designated if it meets one of the following criteria:

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

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

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

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

(3) Deposits, debt securities in issue, subordinated liabilities and other liabilities

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

2.10 Financial guarantee contracts

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

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

2.11 Recognition and derecognition of financial instruments

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

2. Summary of significant accounting policies (continued)

2.11 Recognition and derecognition of financial instruments (continued)

Trading liabilities, financial liabilities designated at fair value through profit or loss and debt securities in issue are recognised on the trade date. Deposits that are not trading liabilities are recognised when money is received from customers, other liabilities are recognised when such obligations arise. Financial liabilities are derecognised from the balance sheet when and only when the obligation specified in the contract is discharged, cancelled or expires. If the Group purchases its own debt, it is removed from the balance sheet, and the difference between the carrying amount of a liability and the consideration paid is included in net trading gain/loss.

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

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

2.12 Fair value measurement

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

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

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

If the market for assets or liabilities is not active, the Group uses valuation techniques, include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants, that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

2.13 Precious metals

Precious metals comprise gold, silver and other precious metals. Precious metals are initially recognised and subsequently re-measured at fair value. Mark-to-market gains or losses on precious metals are included in net trading gain/loss.

2. Summary of significant accounting policies (continued)

2.14 Impairment of financial assets

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

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

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

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

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

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

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

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

(1) Assets carried at amortised cost

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

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

2. Summary of significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

(1) Assets carried at amortised cost (continued)

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

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

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

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

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

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

(2) Assets classified as available-for-sale

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

2. Summary of significant accounting policies (continued)

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

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

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

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

2.16 Investment properties

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

Investment properties are recognised initially at cost, including related transaction costs. After initial recognition, investment properties are measured at fair value.

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

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

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

2. Summary of significant accounting policies (continued)

2.17 Properties, plant and equipment

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

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

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

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

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

- Properties — Over the life of government land leases
- Plant and equipment — 3 to 15 years

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

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

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

2. Summary of significant accounting policies (continued)

2.18 Leases

(1) Operating leases

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

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

(2) Finance leases

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

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

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

2.19 Insurance contracts

(1) Insurance contracts classification, recognition and measurement

The Group follows the local regulatory requirements to measure its insurance contract liabilities.

The Group issues insurance contracts, which are contracts that transfer significant insurance risk. As a general guideline, the Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefit payable if the insured event did not occur. The Group issues long term business insurance contracts, which insure events covered by life policies (for example death, survival, or total permanent disability) over a long duration. A liability for contractual benefits that are expected to be incurred in the future is recorded when premiums are recognised.

For linked long term insurance contracts with embedded derivatives (which are closely related to the host insurance contracts) linking payments on the contract to units of the investment funds which the Group has invested with the consideration received from the contract holders, the liability is adjusted for all changes in the fair value of the underlying assets, and includes a liability for contractual benefits that are expected to be incurred in the future which is recorded when the premiums are recognised.

2. Summary of significant accounting policies (continued)

2.19 Insurance contracts (continued)

(1) Insurance contracts classification, recognition and measurement (continued)

Retirement scheme management category III insurance contracts, as defined in the Insurance Companies Ordinance, insure events associated with the cessation of employment due to death. A liability for contractual benefits that are expected to be incurred in the future is recorded when premiums are recognised. The portion of the premium received on in-force contracts that relates to unexpired risks at the end of the reporting period is reported as the unearned premium liability, which is included in insurance liabilities.

Premiums are recognised as revenue when they become payable by the contract holders before the deduction of commissions. Benefits and claims are recorded as an expense when they are incurred.

The Group does not separately measure embedded derivatives that meet the definition of an insurance contract or options to surrender insurance contracts for a fixed amount (or an amount based on a fixed amount and an interest rate).

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirement for insurance contracts as noted above are classified as reinsurance contracts held.

The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These reinsurance assets consist of short-term amounts due from reinsurers as well as longer term receivables that are dependent on the expected claims and benefits arising from the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the underlying insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

(2) Liability adequacy test

At the end of each reporting period, liability adequacy tests are performed to ensure the adequacy of the insurance contract liabilities. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to the consolidated income statement, with a provision established for losses arising from the liability adequacy test.

2.20 Cash and cash equivalents

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

2.21 Provisions

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

2. Summary of significant accounting policies (continued)

2.22 Employee benefits

(1) Retirement benefit costs

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

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

(2) Leave entitlements

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

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

(3) Bonus plans

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

2.23 Current and deferred income taxes

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

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

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

2. Summary of significant accounting policies (continued)

2.23 Current and deferred income taxes (continued)

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

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

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

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

2.24 Repossessed assets

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

2.25 Fiduciary activities

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

2.26 Contingent liabilities and contingent assets

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

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

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

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

2. Summary of significant accounting policies (continued)

2.27 Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if (i) that party controls, jointly controls or has significant influence over the Group; (ii) is a member of the same financial reporting group, such as parents, subsidiaries and fellow subsidiaries; (iii) is an associate or a joint venture of the Group or parent reporting group; (iv) is a key management personnel of the Group or parents; (v) the party is subject to common control with the Group; and (vi) an entity in which a person identified in (iv) controls. Related parties may be individuals or entities.

3. Critical accounting estimates and judgements in applying accounting policies

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

3.1 Impairment allowances on loans and advances

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

Carrying amounts of loans and advances as at 31 December 2013 are shown in Note 25.

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

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

Carrying amounts of investment in securities as at 31 December 2013 are shown in Note 27.

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

3.3 Fair values of derivative financial instruments

The fair values of derivative financial instruments that are not quoted in active markets are determined by using valuation techniques. Valuation techniques used include discounted cash flows analysis and models with built-in functions available in externally acquired financial analysis or risk management systems widely used by the industry such as option pricing models. To the extent practical, the models use observable data. In addition, valuation adjustments may be adopted if factors such as credit risk are not considered in the valuation models. Management judgement and estimates are required for the selection of appropriate valuation parameters, assumptions and modeling techniques. Further details will be discussed in Note 5.

Carrying amounts of derivative financial instruments as at 31 December 2013 are shown in Note 24.

3.4 Held-to-maturity securities

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

Carrying amounts of held-to-maturity securities as at 31 December 2013 are shown in Note 27.

3.5 Estimate of future benefit payments and premiums arising from long term insurance contracts

In determining the Group's long term business fund liabilities (a component of insurance contract liabilities), the Group follows the Insurance Companies (Determination of Long Term Liabilities) Regulation under the Insurance Companies Ordinance and makes prudent assumptions which include appropriate margins for adverse deviation of the relevant factors. Estimates are made as to the expected number of deaths for each of the years in which the Group is exposed to risk. The Group bases these estimates on Hong Kong Assured Lives Mortality Table HKA01 that reflect recent historical mortality experience, adjusted where appropriate to reflect the Group's own experience. For contracts that insure the risk of longevity, appropriate prudent allowances are made for expected mortality improvements. The estimated number of deaths determines the value of the benefit payments and the value of the valuation premiums. The main source of uncertainty is that epidemics such as AIDS, SARS, avian flu and wide-ranging lifestyle changes, such as in eating, smoking and exercise habits, could result in future mortality being significantly worse than in the past for the age groups in which the Group has significant exposure to mortality risk. However, continuing improvements in medical care and social conditions could result in improvements in longevity in excess of those allowed for in the estimates used to determine the liability for contracts where the Group is exposed to longevity risk.

Were the number of deaths in future years to differ by 10% from the Management's estimate, the long term business fund liability would increase by approximately HK$79 million (2012: approximately HK$103 million), which accounts for 0.14% (2012: 0.2%) of the liability. In this case, it is assumed there is no relief arising from reinsurance contracts held.

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

3.5 Estimate of future benefit payments and premiums arising from long term insurance contracts (continued)

For linked long term insurance contracts with a life cover component, it is assumed that the Group will be able to increase mortality risk charges in future years in line with emerging mortality experience.

Estimates are also made as to future investment income arising from the assets backing long term insurance contracts. These estimates are based on current market returns as well as expectations about future economic and financial developments. Were the average future investment returns to decrease by 50 basis points from the Management's estimates, the long term business fund liability would increase by approximately HK$941 million (2012: approximately HK$1,410 million). In this case, it is assumed there is no relief arising from reinsurance contracts held.

The Group has also assessed whether a provision for expense is necessary in accordance with the Insurance Companies Ordinance. A provision for expense is the amount required to meet the total net cost that would likely be incurred in fulfilling contracts if the Group were to cease to transact new business 12 months after the valuation date.

A resilience reserve was set up and included in long term business fund liabilities in accordance with the Insurance Companies (Determination of Long Term Liabilities) Regulation to provide a prudent provision against the effects of possible future changes to the value of the assets to meet the liabilities. The resilience reserve was set up based on the appointed actuary's advice of a 35 basis points (2012: 16 basis points) change in market yield of the underlying assets and valuation interest rates. The amount of resilience reserve set up depends on the degree of change in interest rate assumed.

4. Financial risk management

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

Financial risk management framework

The Group's risk management governance structure is designed to cover all business processes and ensures various risks are properly managed and controlled in the course of conducting business. The Group has a robust risk management organisational structure with a comprehensive set of policies and procedures to identify, measure, monitor and control various risks that may arise. These risk management policies and procedures are regularly reviewed and updated to reflect changes in markets and business strategies. Various groups of risk takers assume their respective responsibilities for risk management.

The Board of Directors, representing the interests of shareholders, is the highest decision-making authority of the Group and has the ultimate responsibility for risk management. The Board, with the assistance of its committees, has the primary responsibility for the formulation of risk management strategies and ensuring that the Group has an effective risk management system to implement these strategies.

The RC, a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, approving high-level risk-related policies and monitoring their implementation, reviewing significant or high risk exposures or transactions and exercising its power of veto if it considers that any transaction should not proceed. The Audit Committee assists the Board in fulfilling its role in overseeing the internal control system.

4. Financial risk management (continued)

Financial risk management framework (continued)

The Chief Executive ("CE") is responsible for managing the Group's various types of risks, approving detailed risk management policies, and material risk exposures or transactions within his authority delegated by the Board of Directors. The Chief Risk Officer ("CRO") assists the CE in fulfilling his responsibilities for the day-to-day management of risks. The CRO is responsible for initiating new risk management strategies, projects and measures that will enable the Group to better monitor and manage new risk issues or areas that may arise from time to time from new businesses, products and changes in the operating environment. The CRO will also take appropriate initiatives in response to regulatory changes. The CRO is also responsible for reviewing material risk exposures or transactions within his delegated authority and exercising his power of veto if he believes that any transaction should not proceed.

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

The Group's principal banking subsidiaries, NCB, NCB (China) and Chiyu, are subject to risk policies that are consistent with those of the Group. Moreover, the Group's non-banking subsidiaries, such as BOCG Life, are subject to the Group's risk management requirements. These subsidiaries are required to formulate their respective risk management policies based on the characteristics of their own industries, perform daily risk management responsibilities and report to BOCHK on a regular basis. Risk management units of BOCHK monitor the risk management status of these subsidiaries respectively.

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

Product development and risk monitoring

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

In accordance with the strategic objectives set by the Board and the Management, respective product management units are responsible for formulating business and product development plans, and proceeding to specific product development activities. The department of strategic development shall ensure the plans are aligned with the Group's overall strategies. Departments that are responsible for risk management, legal, compliance and finance etc. are accountable for risk assessment and review.

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

A prudent approach is adopted in offering treasury products to our clients. All treasury products, regardless brand new or modified, require approval from a special committee before launching.

4. Financial risk management (continued)

4.1 Credit Risk

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

Credit risk management framework

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

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

The Chief Credit Officer, who reports directly to the CRO, takes charge of credit risk management and is also responsible for the control of credit risk exposure of subsidiaries in line with the credit risk management principles and requirements set by the Group. The Chief Analytics Officer, who also reports directly to the CRO, is responsible for the development and maintenance of internal rating models and establishing the rating criteria. Various units of the Group have their respective credit risk management responsibilities. Business units act as the first line of defence. The Risk Management Department ("RMD"), which is independent from the business units, is responsible for the day-to-day management of credit risks and has the primary responsibility for providing an independent due diligence through identifying, measuring, monitoring and controlling credit risk to ensure an effective checks and balances, as well as drafting, reviewing and updating credit risk management policies and procedures. It is also responsible for the design of the Group's internal rating system and ensuring the system complies with the relevant regulatory requirements.

In accordance with Group's operating principle, the Group's principal banking subsidiaries, NCB, NCB (China) and Chiyu, have also formulated their own credit risk policies that are consistent with those of the Group. These subsidiaries execute their risk management strategies independently and report to the Group's Management on a regular basis.

The Board of Directors delegates credit approval authority to the CE. The CE can further delegate to the subordinates within his limit authorised by the Board of Directors. The Group sets the limits of credit approval authority according to the business nature, rating, the level of transaction risk, and the extent of the credit exposure.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Credit risk measurement and control

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

Advances

Different credit approval and control procedures are adopted according to the level of risk associated with the customer, counterparty or transaction. The Credit Risk Assessment Committee, comprising experts from credit and other functions, is responsible for making an independent assessment of material credit which require the approval of Deputy Chief Executives ("DCE") or above. Credit applications for non-retail exposures are independently reviewed and objectively assessed by risk management units. Obligor ratings (in terms of probability of default) and facility ratings (in terms of loss given default) are assigned to these portfolios to support credit approval. Retail internal rating systems are deployed in the risk assessment of retail credit transactions, including small business retail exposures, residential mortgage loans, personal loans and credit cards. Loan grades, obligor and facility ratings as well as loss estimates (if applicable) are used to support credit approval.

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

The Group employs a credit master scale for internal rating purpose that can be mapped to Standard & Poor's external credit ratings. The credit master scale for internal rating is in compliance with the Banking (Capital) Rules under the Hong Kong Banking Ordinance on internal rating structure.

RMD provides regular credit management information reports and ad hoc reports to the MC, RC and Board of Directors to facilitate their continuous monitoring of credit risk.

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

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

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

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

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

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

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Credit risk measurement and control (continued)

Debt securities and derivatives

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

The methodology and assumptions used for impairment assessments are reviewed regularly. In evaluating impairment of asset backed securities ("ABS") and mortgage backed securities ("MBS"), the Group continued to use a significant decline in market price and credit deterioration of the underlying assets to be the key indicators of impairment. The Group also considered other objective evidences of impairment, taking into account the impact of liquidity on market prices and the movement in loss coverage ratios of individual ABS and MBS held by the Group.

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 Group's market transactions on any single day.

Collateral held as security and other credit enhancements

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

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

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

(A) Credit exposures

The maximum credit exposure is the worst case scenario of exposure to the Group without taking into account any collateral held or other credit enhancements. For on-balance sheet assets, the maximum exposure to credit risk equals their carrying amount. For letters of guarantee issued, the maximum exposure to credit risk is the maximum amount that the Group could be required to pay if the guarantees are called upon. For loan commitment and other credit related liabilities, the maximum exposure to credit risk is the full amount of the committed facilities.

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(A) Credit exposures (continued)

Balances and placements with banks and other financial institutions

These exposures are generally considered to be low risk due to the nature of the counterparties. Collateral is generally not sought on these assets.

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

Collateral is generally not sought on debt securities.

Derivative financial instruments

The International Swaps and Derivatives Association Master Agreement is the preferred agreement for documenting derivatives activities of the Group. It provides the contractual framework within which dealing activities of OTC products are conducted, and contractually bind both parties to apply close-out netting on outstanding transactions covered by an agreement if either party defaults or another pre-agreed termination event occurs.

Advances and other accounts, contingent liabilities and commitments

The general types of collateral are disclosed on page 137. Advances and other accounts, contingent liabilities and commitments are collateralised to the extent considered appropriate by the Group taking account of the risk assessment of individual exposures. The collateral coverage of advances to customers is analysed on pages 145 to 146. The components and nature of contingent liabilities and commitments are disclosed in Note 45. Regarding the commitments that are unconditionally cancellable without prior notice, the Group would assess the necessity to withdraw the credit line in case where the credit quality of a borrower deteriorates. For contingent liabilities and commitments, 11.6% (2012: 11.4%) is covered by collateral as at 31 December 2013.

(B) Gross advances and other accounts

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

	2013 HK$'m	2012 HK$'m
Advances to customers		
Personal		
– Mortgages	**208,502**	202,386
– Credit cards	**12,678**	11,534
– Others	**33,365**	24,782
Corporate		
– Commercial loans	**518,374**	472,425
– Trade finance	**85,413**	67,137
	858,332	778,264
Trade bills	**70,846**	45,180
Total	**929,178**	823,444

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

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

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

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

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

– Significant financial difficulty incurred by the borrower;

– A breach of contract, such as a default or delinquency in principal or interest payment;

– For economic or legal reasons related to the borrower's financial difficulty, the Group has granted to the borrower a concession that it would not otherwise consider;

– Probable that the borrower will become bankrupt or undergo other financial reorganisation; or

– Other observable data indicating that there is a measurable decrease in the estimated future cash flows from such advances.

NOTES TO THE FINANCIAL STATEMENTS

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(a) Advances neither overdue nor impaired

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

	2013			
	Pass HK$'m	**Special mention HK$'m**	**Substandard or below HK$'m**	**Total HK$'m**
Advances to customers				
Personal				
– Mortgages	**205,805**	**178**	**45**	**206,028**
– Credit cards	**12,213**	**–**	**–**	**12,213**
– Others	**32,774**	**125**	**11**	**32,910**
Corporate				
– Commercial loans	**510,777**	**4,908**	**119**	**515,804**
– Trade finance	**84,973**	**148**	**1**	**85,122**
	846,542	**5,359**	**176**	**852,077**
Trade bills	**70,846**	**–**	**–**	**70,846**
Total	**917,388**	**5,359**	**176**	**922,923**

	2012			
	Pass HK$'m	Special mention HK$'m	Substandard or below HK$'m	Total HK$'m
Advances to customers				
Personal				
– Mortgages	199,838	242	37	200,117
– Credit cards	11,103	–	–	11,103
– Others	24,193	121	9	24,323
Corporate				
– Commercial loans	465,123	4,693	65	469,881
– Trade finance	66,563	369	–	66,932
	766,820	5,425	111	772,356
Trade bills	45,172	–	–	45,172
Total	811,992	5,425	111	817,528

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(b) Advances overdue but not impaired

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

	2013				
	Overdue for three months or less HK$'m	**Overdue for six months or less but over three months HK$'m**	**Overdue for one year or less but over six months HK$'m**	**Overdue for over one year HK$'m**	**Total HK$'m**
Advances to customers					
Personal					
– Mortgages	**2,407**	**9**	**14**	**16**	**2,446**
– Credit cards	**436**	**1**	**–**	**–**	**437**
– Others	**408**	**–**	**5**	**4**	**417**
Corporate					
– Commercial loans	**740**	**20**	**2**	**32**	**794**
– Trade finance	**32**	**–**	**1**	**–**	**33**
Total	**4,023**	**30**	**22**	**52**	**4,127**

	2012				
	Overdue for three months or less HK$'m	Overdue for six months or less but over three months HK$'m	Overdue for one year or less but over six months HK$'m	Overdue for over one year HK$'m	Total HK$'m
Advances to customers					
Personal					
– Mortgages	2,209	13	7	22	2,251
– Credit cards	403	–	–	–	403
– Others	417	2	–	9	428
Corporate					
– Commercial loans	960	6	15	19	1,000
– Trade finance	19	–	–	–	19
	4,008	21	22	50	4,101
Trade bills	8	–	–	–	8
Total	4,016	21	22	50	4,109

NOTES TO THE FINANCIAL STATEMENTS

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(c) Impaired advances

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

	2013		2012	
	Gross advances HK$'m	**Market value of collateral HK$'m**	Gross advances HK$'m	Market value of collateral HK$'m
Advances to customers				
Personal				
– Mortgages	**28**	**31**	18	19
– Credit cards	**28**	**–**	28	–
– Others	**38**	**6**	31	6
Corporate				
– Commercial loans	**1,776**	**1,559**	1,544	1,315
– Trade finance	**258**	**183**	186	86
Total	**2,128**	**1,779**	1,807	1,426
Loan impairment allowances made in respect of such advances	**875**		768	

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

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

	2013 HK$'m	2012 HK$'m
Current market value of collateral held against the covered portion of such advances to customers	**1,779**	1,426
Covered portion of such advances to customers	**1,550**	1,177
Uncovered portion of such advances to customers	**578**	630

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(c) Impaired advances (continued)

Classified or impaired advances to customers are analysed as follows:

	2013 HK$'m	2012 HK$'m
Gross classified or impaired advances to customers	**2,433**	2,054
Gross classified or impaired advances to customers as a percentage of gross advances to customers	**0.28%**	0.26%
Individually assessed loan impairment allowances made in respect of such advances	**840**	736

Classified or impaired advances to customers represent advances which are either classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

(d) Advances overdue for more than three months

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

	2013		2012	
	Amount HK$'m	% of gross advances to customers	Amount HK$'m	% of gross advances to customers
Gross advances to customers which have been overdue for:				
– six months or less but over three months	**266**	**0.03%**	153	0.02%
– one year or less but over six months	**97**	**0.01%**	129	0.02%
– over one year	**314**	**0.04%**	323	0.04%
Advances overdue for over three months	**677**	**0.08%**	605	0.08%
Individually assessed loan impairment allowances made in respect of such advances	**406**		303	

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

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

	2013 HK$'m	2012 HK$'m
Current market value of collateral held against the covered portion of such advances to customers	**723**	1,115
Covered portion of such advances to customers	**245**	253
Uncovered portion of such advances to customers	**432**	352

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

As at 31 December 2013 and 2012, there were no trade bills overdue for more than three months.

(e) Rescheduled advances

	2013		2012	
	Amount HK$'m	**% of gross advances to customers**	Amount HK$'m	% of gross advances to customers
Rescheduled advances to customers net of amounts included in "Advances overdue for more than three months"	**1,012**	**0.12%**	1,119	0.14%

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

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers

(i) Sectoral analysis of gross advances to customers

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

	2013					
	Gross advances to customers HK$'m	% Covered by collateral or other security	Classified or impaired HK$'m	Overdue HK$'m	Individually assessed impairment allowances HK$'m	Collectively assessed impairment allowances HK$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development	40,596	37.02%	1	1	–	173
– Property investment	79,103	87.88%	54	275	4	416
– Financial concerns	7,748	11.42%	–	2	–	46
– Stockbrokers	4,215	50.25%	–	–	–	15
– Wholesale and retail trade	32,846	49.28%	95	237	34	173
– Manufacturing	19,031	36.22%	57	112	31	103
– Transport and transport equipment	34,327	31.95%	971	4	271	157
– Recreational activities	492	10.99%	–	1	–	2
– Information technology	10,852	1.55%	2	2	1	37
– Others	38,422	38.08%	42	164	24	172
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	9,773	99.97%	26	241	–	7
– Loans for purchase of other residential properties	190,031	99.98%	59	2,006	–	105
– Credit card advances	12,223	–	28	455	–	84
– Others	28,312	63.53%	36	354	10	50
Total loans for use in Hong Kong	507,971	69.73%	1,371	3,854	375	1,540
Trade finance	85,413	13.84%	266	285	122	375
Loans for use outside Hong Kong	264,948	28.35%	796	1,108	343	1,480
Gross advances to customers	858,332	51.39%	2,433	5,247	840	3,395

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

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

	2012					
	Gross advances to customers HK$'m	% Covered by collateral or other security	Classified or impaired HK$'m	Overdue HK$'m	Individually assessed impairment allowances HK$'m	Collectively assessed impairment allowances HK$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development	31,408	38.05%	1	2	–	115
– Property investment	76,975	83.98%	49	424	4	458
– Financial concerns	5,984	27.09%	–	3	–	52
– Stockbrokers	1,146	45.39%	–	–	–	11
– Wholesale and retail trade	30,031	57.89%	70	175	33	173
– Manufacturing	21,758	32.25%	53	158	24	125
– Transport and transport equipment	27,241	41.75%	1,104	4	313	166
– Recreational activities	614	21.77%	6	–	6	6
– Information technology	21,369	0.62%	2	2	1	74
– Others	36,351	34.12%	60	264	25	151
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	9,847	99.97%	34	304	–	8
– Loans for purchase of other residential properties	186,601	99.98%	68	1,835	–	110
– Credit card advances	11,534	–	28	431	–	79
– Others	19,894	62.98%	31	290	11	29
Total loans for use in Hong Kong	480,753	69.92%	1,506	3,892	417	1,557
Trade finance	67,137	14.94%	186	202	151	294
Loans for use outside Hong Kong	230,374	26.45%	362	720	168	1,118
Gross advances to customers	778,264	52.31%	2,054	4,814	736	2,969

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

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

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

	2013		2012	
	New impairment allowances HK$'m	**Classified or impaired loans written off HK$'m**	New impairment allowances HK$'m	Classified or impaired loans written off HK$'m
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development	**51**	**–**	3	–
– Property investment	**9**	**2**	34	1
– Financial concerns	**3**	**–**	11	–
– Stockbrokers	**4**	**–**	8	–
– Wholesale and retail trade	**19**	**11**	29	6
– Manufacturing	**8**	**19**	22	5
– Transport and transport equipment	**12**	**–**	365	–
– Recreational activities	**–**	**–**	9	–
– Information technology	**–**	**–**	16	–
– Others	**14**	**6**	31	6
Individuals				
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**–**	**–**	–	–
– Loans for purchase of other residential properties	**1**	**–**	11	–
– Credit card advances	**183**	**170**	149	141
– Others	**132**	**124**	79	72
Total loans for use in Hong Kong	**436**	**332**	767	231
Trade finance	**94**	**32**	94	3
Loans for use outside Hong Kong	**597**	**138**	311	4
Gross advances to customers	**1,127**	**502**	1,172	238

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers

The following geographical analysis of advances to customers is based on the location of the counterparties, after taking into account the transfer of risk. For an advance to customer guaranteed by a party situated in a country different from the customer, the risk will be transferred to the country of the guarantor.

Gross advances to customers

	2013 HK$'m	2012 HK$'m
Hong Kong	**666,602**	607,965
Mainland of China	**153,201**	138,345
Others	**38,529**	31,954
	858,332	778,264
Collectively assessed loan impairment allowances in respect of the gross advances to customers		
Hong Kong	**2,232**	2,074
Mainland of China	**946**	729
Others	**217**	166
	3,395	2,969

Overdue advances

	2013 HK$'m	2012 HK$'m
Hong Kong	**4,010**	3,937
Mainland of China	**1,084**	639
Others	**153**	238
	5,247	4,814
Individually assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**209**	198
Mainland of China	**323**	175
Others	**28**	33
	560	406
Collectively assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**80**	76
Mainland of China	**6**	6
Others	**2**	3
	88	85

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

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

Classified or impaired advances

	2013 HK$'m	2012 HK$'m
Hong Kong	**1,743**	1,631
Mainland of China	**586**	385
Others	**104**	38
	2,433	2,054
Individually assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**488**	526
Mainland of China	**324**	177
Others	**28**	33
	840	736
Collectively assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**35**	29
Mainland of China	**1**	3
Others	**2**	1
	38	33

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(C) Repossessed assets

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

	2013 HK$'m	2012 HK$'m
Industrial properties	**3**	5
Residential properties	**51**	12
	54	17

The estimated market value of repossessed assets held by the Group as at 31 December 2013 amounted to HK$118 million (2012: HK$27 million). They comprise properties in respect of which the Group has acquired access or control (e.g. through court proceedings or voluntary actions by the proprietors concerned) for release in full or in part of the obligations of the borrowers.

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

– adjusting the selling prices

– selling the loans together with the assets

– arranging loan restructuring

4. Financial risk management (continued)

4.1 Credit Risk (continued)

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

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

	2013			
	Aaa to A3 HK$'m	**Lower than A3 HK$'m**	**Unrated HK$'m**	**Total HK$'m**
Central banks	**139,022**	**–**	**–**	**139,022**
Banks and other financial institutions	**170,716**	**61,737**	**19,504**	**251,957**
	309,738	**61,737**	**19,504**	**390,979**

	2012			
	Aaa to A3 HK$'m	Lower than A3 HK$'m	Unrated HK$'m	Total HK$'m
Central banks	84,387	–	–	84,387
Banks and other financial institutions	125,082	31,918	16,698	173,698
	209,469	31,918	16,698	258,085

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities and certificates of deposit

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

	2013					
	Aaa HK$'m	**Aa1 to Aa3 HK$'m**	**A1 to A3 HK$'m**	**Lower than A3 HK$'m**	**Unrated HK$'m**	**Total HK$'m**
Available-for-sale securities	**73,321**	**150,393**	**133,961**	**28,205**	**25,169**	**411,049**
Held-to-maturity securities	**2,315**	**4,267**	**5,225**	**2,960**	**2,688**	**17,455**
Loans and receivables	**–**	**–**	**7,270**	**–**	**675**	**7,945**
Financial assets at fair value through profit or loss	**8,276**	**17,137**	**9,960**	**2,205**	**3,750**	**41,328**
Total	**83,912**	**171,797**	**156,416**	**33,370**	**32,282**	**477,777**

	2012					
	Aaa HK$'m	Aa1 to Aa3 HK$'m	A1 to A3 HK$'m	Lower than A3 HK$'m	Unrated HK$'m	Total HK$'m
Available-for-sale securities	97,987	142,536	168,142	22,606	19,826	451,097
Held-to-maturity securities	4,828	6,173	5,569	1,319	509	18,398
Loans and receivables	–	–	8,277	–	957	9,234
Financial assets at fair value through profit or loss	16,977	13,842	11,420	1,669	3,351	47,259
Total	119,792	162,551	193,408	25,594	24,643	525,988

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities and certificates of deposit (continued)

The following tables present an analysis of debt securities and certificates of deposit neither overdue nor impaired as at 31 December by issue rating. In the absence of such issue ratings, the ratings designated for the issuers are reported.

	2013					
	Aaa HK$'m	**Aa1 to Aa3 HK$'m**	**A1 to A3 HK$'m**	**Lower than A3 HK$'m**	**Unrated HK$'m**	**Total HK$'m**
Available-for-sale securities	**73,321**	**150,387**	**133,961**	**28,205**	**25,169**	**411,043**
Held-to-maturity securities	**2,271**	**4,267**	**5,224**	**2,960**	**2,688**	**17,410**
Loans and receivables	**–**	**–**	**7,270**	**–**	**675**	**7,945**
Financial assets at fair value through profit or loss	**8,276**	**17,137**	**9,960**	**2,205**	**3,750**	**41,328**
Total	**83,868**	**171,791**	**156,415**	**33,370**	**32,282**	**477,726**

	2012					
	Aaa HK$'m	Aa1 to Aa3 HK$'m	A1 to A3 HK$'m	Lower than A3 HK$'m	Unrated HK$'m	Total HK$'m
Available-for-sale securities	97,987	142,536	168,133	22,606	19,826	451,088
Held-to-maturity securities	4,758	6,142	5,568	1,319	509	18,296
Loans and receivables	–	–	8,277	–	957	9,234
Financial assets at fair value through profit or loss	16,977	13,842	11,420	1,669	3,351	47,259
Total	119,722	162,520	193,398	25,594	24,643	525,877

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities and certificates of deposit (continued)

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

	2013						
	Carrying values						Of which accumulated impairment allowances
	Aaa HK$'m	Aa1 to Aa3 HK$'m	A1 to A3 HK$'m	Lower than A3 HK$'m	Unrated HK$'m	Total HK$'m	HK$'m
Available-for-sale securities	–	6	–	–	–	6	–
Held-to-maturity securities	44	–	1	–	–	45	3
Total	44	6	1	–	–	51	3
Of which accumulated impairment allowances	3	–	–	–	–	3	

	2012						
	Carrying values						Of which accumulated impairment allowances
	Aaa HK$'m	Aa1 to Aa3 HK$'m	A1 to A3 HK$'m	Lower than A3 HK$'m	Unrated HK$'m	Total HK$'m	HK$'m
Available-for-sale securities	–	–	9	–	–	9	1
Held-to-maturity securities	70	31	1	–	–	102	9
Total	70	31	10	–	–	111	10
Of which accumulated impairment allowances	6	3	1	–	–	10	

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

4. Financial risk management (continued)

4.2 Market Risk

Market risk refers to the risk of loss arising from movements in the value of foreign exchange, commodity, interest rate and equity positions held by the Group due to the volatility of financial market price (interest rate, foreign exchange rate, equity price, commodity price). The Group adopts a moderate market risk appetite to achieve a balance between risk and return. The Group's objective in managing market risk is to secure healthy growth of the treasury business, by effective management of potential market risk in the Group's business, according to the Group's overall risk appetite and strategy of treasury business on the basis of a well established risk management regime and related management measures.

In accordance with the Group's corporate governance principles in respect of risk management, the Board and RC, senior management and functional departments/units perform their duties and responsibilities to manage the Group's market risk. The Market Risk Management Division of the RMD is mainly responsible for managing market risk, assisting senior management to perform their day-to-day duties, independently monitoring the market risk profile and compliance of management policies and limits of the Group and BOCHK, and ensuring that the aggregate and individual market risks are within acceptable levels.

The Group's market risk management covers BOCHK and its subsidiaries. The Group establishes consistent market risk management policies to regulate BOCHK's and subsidiaries' market risk management; meanwhile, the Group sets up the Group VAR and stress test limits, which are allocated and monitored across the Group, according to the subsidiaries' business requirements and risk tolerance levels. In line with the requirements set in the Group policy, the management of subsidiaries may, subject to prior consent by BOCHK, formulate the detailed policies and procedures and are responsible for managing their daily market risk. The subsidiaries set up independent risk monitoring teams to monitor daily market risk and limit compliance, and submit management information and reports to BOCHK on a regular basis.

The Group sets up market risk indicators and limits to identify, measure, monitor and control market risk. Major risk indicators and limits include but are not limited to VAR, Stop Loss, Open Position, Stress Testing and Sensitivity Analysis (Basis Point Value, Greeks), etc. To meet management requirements, major risk indicators and limits are classified into four levels, and are approved by the RC, MC, CRO and the DCE in charge of the treasury business or the head of the respective business unit respectively. Treasury business units of BOCHK and subsidiaries (as for Group Limit) are required to conduct their business within approved market risk indicators and limits.

(A) VAR

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(A) VAR (continued)

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

	Year	At 31 December HK$'m	Minimum for the year HK$'m	Maximum for the year HK$'m	Average for the year HK$'m
VAR for all market risk	2013	19.2	13.9	40.8	23.1
	2012	14.6	14.6	35.1	25.4
VAR for foreign exchange risk	2013	16.1	10.3	37.8	17.4
	2012	9.2	9.2	25.7	16.7
VAR for interest rate risk	2013	24.0	8.8	39.6	20.0
	2012	9.9	8.9	29.5	17.7
VAR for equity risk	2013	0.1	0.0	3.2	1.1
	2012	0.0	0.0	2.3	0.4
VAR for commodity risk	2013	0.0	0.0	0.7	0.1
	2012	0.0	0.0	1.7	0.2

Note:

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

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

– the use of historical market data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;

– the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk especially at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;

– the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and

– VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Group recognises these limitations by formulating stress test indicators and limits to assess and manage the market risk uncovered by VAR. The stress testing programme of the market risk includes sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis on historical events including the 1987 Equity Market Crash, 1994 Bond Market Crash, 1997 Asian Financial Crisis, 2001 9-11 event and 2008 Financial Tsunami, etc.

(B) Currency risk

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

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

	2013							
	Renminbi HK$'m	US Dollars HK$'m	HK Dollars HK$'m	Euro HK$'m	Japanese Yen HK$'m	Pound Sterling HK$'m	Others HK$'m	Total HK$'m
Assets								
Cash and balances with banks and other financial institutions	296,496	38,476	14,273	1,264	230	259	2,743	353,741
Placements with banks and other financial institutions maturing between one and twelve months	35,264	10,442	476	107	–	–	405	46,694
Financial assets at fair value through profit or loss	7,261	11,508	24,563	–	–	–	161	43,493
Derivative financial instruments	722	4,598	20,006	2	–	–	20	25,348
Hong Kong SAR Government certificates of indebtedness	–	–	99,190	–	–	–	–	99,190
Advances and other accounts	105,008	259,236	549,916	3,792	459	205	6,327	924,943
Investment in securities								
– Available-for-sale securities	84,103	211,684	89,717	6,024	296	515	22,981	415,320
– Held-to-maturity securities	4,334	9,956	1,646	–	–	–	1,519	17,455
– Loans and receivables	833	4,039	3,073	–	–	–	–	7,945
Interests in associates and a joint venture	–	–	292	–	–	–	–	292
Investment properties	135	–	14,462	–	–	–	–	14,597
Properties, plant and equipment	865	3	51,490	–	–	–	–	52,358
Other assets (including deferred tax assets)	24,821	1,287	18,367	487	111	10	477	45,560
Total assets	559,842	551,229	887,471	11,676	1,096	989	34,633	2,046,936
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	99,190	–	–	–	–	99,190
Deposits and balances from banks and other financial institutions	167,166	58,511	50,607	381	89	106	1,413	278,273
Financial liabilities at fair value through profit or loss	1,590	16	10,842	–	–	7	1,125	13,580
Derivative financial instruments	894	2,433	15,323	187	1	–	74	18,912
Deposits from customers	311,506	272,761	674,425	9,965	3,563	11,270	40,658	1,324,148
Debt securities in issue at amortised cost	–	5,684	–	–	–	–	–	5,684
Other accounts and provisions (including current and deferred tax liabilities)	14,382	9,974	30,276	981	148	600	1,294	57,655
Insurance contract liabilities	28,428	6,867	31,342	–	–	–	–	66,637
Subordinated liabilities	–	19,849	–	–	–	–	–	19,849
Total liabilities	523,966	376,095	912,005	11,514	3,801	11,983	44,564	1,883,928
Net on-balance sheet position	35,876	175,134	(24,534)	162	(2,705)	(10,994)	(9,931)	163,008
Off-balance sheet net notional position*	(23,168)	(162,157)	167,162	(17)	2,573	10,966	9,465	4,824
Contingent liabilities and commitments	73,056	146,235	293,677	4,069	501	1,244	4,223	523,005

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

	2012							
	Renminbi HK$'m	US Dollars HK$'m	HK Dollars HK$'m	Euro HK$'m	Japanese Yen HK$'m	Pound Sterling HK$'m	Others HK$'m	Total HK$'m
Assets								
Cash and balances with banks and other financial institutions	156,693	24,087	12,051	1,796	376	889	2,856	198,748
Placements with banks and other financial institutions maturing between one and twelve months	28,365	31,872	4,525	419	–	201	643	66,025
Financial assets at fair value through profit or loss	5,178	11,273	32,801	–	–	–	80	49,332
Derivative financial instruments	367	5,074	25,871	–	–	–	27	31,339
Hong Kong SAR Government certificates of indebtedness	–	–	82,930	–	–	–	–	82,930
Advances and other accounts	97,641	191,418	517,998	6,125	758	148	5,651	819,739
Investment in securities								
– Available-for-sale securities	61,840	193,050	89,735	8,080	77,766	353	23,908	454,732
– Held-to-maturity securities	948	10,672	2,042	–	1,912	–	2,824	18,398
– Loans and receivables	1,157	5,846	–	–	–	2,231	–	9,234
Interests in associates and a joint venture	–	–	259	–	–	–	–	259
Investment properties	112	–	14,252	–	–	–	–	14,364
Properties, plant and equipment	855	4	47,884	–	–	–	–	48,743
Other assets (including deferred tax assets)	14,982	1,998	18,794	548	226	51	321	36,920
Total assets	368,138	475,294	849,142	16,968	81,038	3,873	36,310	1,830,763
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	82,930	–	–	–	–	82,930
Deposits and balances from banks and other financial institutions	82,762	48,667	45,710	102	50	26	1,889	179,206
Financial liabilities at fair value through profit or loss	776	48	18,525	7	–	6	810	20,172
Derivative financial instruments	382	3,682	16,621	337	–	–	192	21,214
Deposits from customers	234,719	246,065	683,270	11,156	3,393	12,127	35,560	1,226,290
Debt securities in issue at amortised cost	–	5,919	4	–	–	–	–	5,923
Other accounts and provisions (including current and deferred tax liabilities)	9,995	16,162	28,536	645	298	685	941	57,262
Insurance contract liabilities	17,550	6,400	29,987	–	–	–	–	53,937
Subordinated liabilities	–	22,006	–	6,749	–	–	–	28,755
Total liabilities	346,184	348,949	905,583	18,996	3,741	12,844	39,392	1,675,689
Net on-balance sheet position	21,954	126,345	(56,441)	(2,028)	77,297	(8,971)	(3,082)	155,074
Off-balance sheet net notional position*	(12,217)	(105,886)	190,779	1,917	(77,231)	8,714	3,305	9,381
Contingent liabilities and commitments	47,614	90,233	315,496	3,756	538	1,074	5,058	463,769

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk

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

– Repricing risk: mismatches in the maturity or repricing periods of assets and liabilities that may affect net interest income;

– Basis risk: different pricing basis for different transactions resulting that the yield on assets and cost of liabilities may change by different amounts within the same repricing period;

– Yield curve risk: non-parallel shifts in the yield curve that may have an adverse impact on net interest income or economic value; and

– Option risk: exercise of the options embedded in assets, liabilities or off-balance sheet items that can cause a change in the cash flows of assets and liabilities.

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

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

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

The Group uses scenario analyses and stress tests to assess the banking book interest rate risk that the Group would face under adverse circumstances. Scenario analyses and stress tests are also used to assess the impact on net interest income and economic value arising from the optionality of savings deposits, the prepayment of mortgage loans and the prepayment of debt securities with embedded options.

The Group is principally exposed to HK Dollar, US Dollar, onshore and offshore Renminbi in terms of interest rate risk. As at 31 December 2013, if HK Dollar, US Dollar and Renminbi market interest rates had a 100 basis point parallel upward shift of the yield curve in relevant currency with other variables held constant, the impacts on net interest income over a twelve-month period and on reserves would have been as follows:

	Impact on net interest income over the next twelve months at 31 December		Impact on reserves at 31 December	
	2013 HK$'m	2012 HK$'m	**2013 HK$'m**	2012 HK$'m
HK Dollar	**876**	744	**(505)**	(402)
US Dollar	**(486)**	(834)	**(6,425)**	(5,390)
Renminbi	**(691)**	(529)	**(1,288)**	(1,128)

The overall negative impact on net interest income of the above currencies has decreased when compared with 2012 and is mainly because of the narrowed short term negative gaps in relevant currencies. Reserves would have been reduced because of the expected reduction in valuation of available-for-sale securities due to a parallel shift up of 100 basis point in the yield curve. The reduction of reserves is increased compared with 2012 because the size of available-for-sale securities in capital market is increased.

The Group uses more severe assumptions when conducting stress test, including a change in the correlation between interest rates of relevant currencies, parallel movement of interest rates, and that in the absence of actions that would be taken to mitigate the impact of interest rates shock, all positions are assumed to run to maturity and reprice or mature simultaneously within a given time band. As the risk is complicated by having optionality embedded in certain products, behavioural assumptions are made to reflect more accurately the interest rate risk exposures.

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

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

	2013						
	Up to 1 month HK$'m	1 to 3 months HK$'m	3 to 12 months HK$'m	1 to 5 years HK$'m	Over 5 years HK$'m	Non-interest bearing HK$'m	Total HK$'m
Assets							
Cash and balances with banks and other financial institutions	336,303	–	–	–	–	17,438	353,741
Placements with banks and other financial institutions maturing between one and twelve months	–	33,801	12,893	–	–	–	46,694
Financial assets at fair value through profit or loss	2,691	6,211	10,244	15,198	6,984	2,165	43,493
Derivative financial instruments	–	–	–	–	–	25,348	25,348
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	99,190	99,190
Advances and other accounts	699,423	121,716	78,275	18,082	1,004	6,443	924,943
Investment in securities							
– Available-for-sale securities	47,934	58,235	78,309	146,099	80,472	4,271	415,320
– Held-to-maturity securities	1,325	460	4,009	5,250	6,411	–	17,455
– Loans and receivables	1,660	2,931	3,354	–	–	–	7,945
Interests in associates and a joint venture	–	–	–	–	–	292	292
Investment properties	–	–	–	–	–	14,597	14,597
Properties, plant and equipment	–	–	–	–	–	52,358	52,358
Other assets (including deferred tax assets)	608	–	–	–	–	44,952	45,560
Total assets	1,089,944	223,354	187,084	184,629	94,871	267,054	2,046,936
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	99,190	99,190
Deposits and balances from banks and other financial institutions	240,026	3,768	671	–	–	33,808	278,273
Financial liabilities at fair value through profit or loss	5,451	5,406	2,071	382	270	–	13,580
Derivative financial instruments	–	–	–	–	–	18,912	18,912
Deposits from customers	951,236	169,169	124,513	10,589	39	68,602	1,324,148
Debt securities in issue at amortised cost	–	–	–	5,684	–	–	5,684
Other accounts and provisions (including current and deferred tax liabilities)	12,198	2,588	4,106	397	–	38,366	57,655
Insurance contract liabilities	–	–	–	–	–	66,637	66,637
Subordinated liabilities	–	–	–	–	19,849	–	19,849
Total liabilities	1,208,911	180,931	131,361	17,052	20,158	325,515	1,883,928
Interest sensitivity gap	(118,967)	42,423	55,723	167,577	74,713	(58,461)	163,008

4. Financial risk management (continued)

4.2 *Market Risk (continued)*

(C) Interest rate risk (continued)

	2012						
	Up to 1 month HK$'m	1 to 3 months HK$'m	3 to 12 months HK$'m	1 to 5 years HK$'m	Over 5 years HK$'m	Non-interest bearing HK$'m	Total HK$'m
Assets							
Cash and balances with banks and other financial institutions	188,266	–	–	–	–	10,482	198,748
Placements with banks and other financial institutions maturing between one and twelve months	–	24,152	41,873	–	–	–	66,025
Financial assets at fair value through profit or loss	11,403	4,853	6,732	17,257	7,014	2,073	49,332
Derivative financial instruments	–	–	–	–	–	31,339	31,339
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	82,930	82,930
Advances and other accounts	620,505	118,455	64,651	9,495	22	6,611	819,739
Investment in securities							
– Available-for-sale securities	69,387	117,085	66,886	131,589	66,150	3,635	454,732
– Held-to-maturity securities	2,600	5,666	811	7,402	1,919	–	18,398
– Loans and receivables	–	1,558	7,676	–	–	–	9,234
Interests in associates and a joint venture	–	–	–	–	–	259	259
Investment properties	–	–	–	–	–	14,364	14,364
Properties, plant and equipment	–	–	–	–	–	48,743	48,743
Other assets (including deferred tax assets)	–	–	–	–	–	36,920	36,920
Total assets	892,161	271,769	188,629	165,743	75,105	237,356	1,830,763
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	82,930	82,930
Deposits and balances from banks and other financial institutions	159,083	1,483	208	–	–	18,432	179,206
Financial liabilities at fair value through profit or loss	10,017	6,286	3,475	255	139	–	20,172
Derivative financial instruments	–	–	–	–	–	21,214	21,214
Deposits from customers	919,431	129,374	110,938	5,969	38	60,540	1,226,290
Debt securities in issue at amortised cost	4	–	–	5,919	–	–	5,923
Other accounts and provisions (including current and deferred tax liabilities)	13,990	1,710	3,350	25	–	38,187	57,262
Insurance contract liabilities	–	–	–	–	–	53,937	53,937
Subordinated liabilities	–	–	6,749	–	22,006	–	28,755
Total liabilities	1,102,525	138,853	124,720	12,168	22,183	275,240	1,675,689
Interest sensitivity gap	(210,364)	132,916	63,909	153,575	52,922	(37,884)	155,074

4. Financial risk management (continued)

4.3 Liquidity Risk

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

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

The RC is the decision-making authority of liquidity risk management, and assumes the ultimate responsibility of liquidity risk management. As authorised by RC, ALCO exercises its oversight of liquidity risk and ensures the daily operations of the Group are in accordance with risk appetite and policies as set by RC. RMD (Interest Rate and Liquidity Risk Management) is responsible for overseeing the Group's liquidity risk. It cooperates with the Asset and Liability Management Division of Financial Management Department, Investment Management, etc. to assist the ALCO to perform liquidity management functions according to their specific responsibilities.

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

In accordance with the requirements of Supervisory Policy Manual LM-2 "Sound Systems and controls for Liquidity Risk Management" issued by the HKMA in 2011, the Group has embarked on refining the behaviour model and assumptions of existing cash flow analysis and stress test to enhance the Group's cash flow analysis under both normal and stressed conditions which are implemented in 2013. In cash flow analysis under normal circumstances, refinements have been made to assumptions relating to on-balance sheet items (such as customer deposits) and off-balance sheet items (such as loan commitments). According to various characteristics of the assets, liabilities and off-balance sheet items, the Group forecasts the future cash flow based on contractual maturity date and the assumptions of customer behaviour and balance sheet changes. The Group establishes MCO indicator which predicts the future 30 days maximum cumulative net cash outflow in normal situations based on the above assumptions, to assess if the Group has sufficient financing capacity to meet the cash flow gap in order to achieve the objective of continuing operation. As at 31 December 2013, before taking the cash inflow through the sale of outstanding marketable securities into consideration, BOCHK's 30 day cumulative cash flow was a net cash inflow, amounting to HK$27,090 million and was in compliant with the internal limit requirements.

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

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

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

The Group has established a set of uniform liquidity risk management policies which serve as standards and guidance to all the Group's members for liquidity risk management. On the basis of the Group's uniform policy, each of the subsidiaries develops its own liquidity management policies according to its own characteristics (subject to approval by BOCHK), and assumes its own liquidity risk management responsibility. Subsidiaries are required to report their respective liquidity positions on a regular basis to RMD (Interest Rate and Liquidity Risk Management) of BOCHK, which consolidates such information and evaluates group-wide liquidity risk.

(A) Liquidity ratio

	2013	2012
Average liquidity ratio	**37.93%**	41.20%

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

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

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis

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

	2013							
	On demand HK$'m	Up to 1 month HK$'m	1 to 3 months HK$'m	3 to 12 months HK$'m	1 to 5 years HK$'m	Over 5 years HK$'m	Indefinite HK$'m	Total HK$'m
Assets								
Cash and balances with banks and other financial institutions	246,366	94,800	–	–	–	–	12,575	353,741
Placements with banks and other financial institutions maturing between one and twelve months	–	–	33,801	12,893	–	–	–	46,694
Financial assets at fair value through profit or loss								
– held for trading								
– certificates of deposit	–	18	13	78	30	–	–	139
– debt securities	–	2,118	6,166	6,210	6,754	4,967	–	26,215
– designated at fair value through profit or loss								
– certificates of deposit	–	–	–	103	266	–	–	369
– debt securities	–	146	53	2,673	9,788	1,945	–	14,605
– fund and equity securities	–	–	–	–	–	–	2,165	2,165
Derivative financial instruments	13,672	2,127	1,287	2,789	1,833	3,640	–	25,348
Hong Kong SAR Government certificates of indebtedness	99,190	–	–	–	–	–	–	99,190
Advances and other accounts								
– advances to customers	82,371	29,710	55,130	143,186	317,087	224,648	1,965	854,097
– trade bills	6	16,254	19,003	35,583	–	–	–	70,846
Investment in securities								
– available-for-sale								
– certificates of deposit	–	10,419	13,950	36,657	16,836	215	–	78,077
– debt securities	–	16,424	24,027	50,782	160,000	81,733	6	332,972
– held-to-maturity								
– certificates of deposit	–	–	–	–	77	18	–	95
– debt securities	–	632	196	4,049	5,987	6,451	45	17,360
– loans and receivables								
– debt securities	–	1,660	2,931	3,354	–	–	–	7,945
– equity securities	–	–	–	–	–	–	4,271	4,271
Interests in associates and a joint venture	–	–	–	–	–	–	292	292
Investment properties	–	–	–	–	–	–	14,597	14,597
Properties, plant and equipment	–	–	–	–	–	–	52,358	52,358
Other assets (including deferred tax assets)	13,631	13,884	88	394	10,172	7,303	88	45,560
Total assets	455,236	188,192	156,645	298,751	528,830	330,920	88,362	2,046,936
Liabilities								
Hong Kong SAR currency notes in circulation	99,190	–	–	–	–	–	–	99,190
Deposits and balances from banks and other financial institutions	222,879	50,955	3,768	671	–	–	–	278,273
Financial liabilities at fair value through profit or loss	–	5,451	5,406	2,071	382	270	–	13,580
Derivative financial instruments	9,276	1,652	1,047	3,258	3,009	670	–	18,912
Deposits from customers	744,335	273,423	169,101	124,664	12,586	39	–	1,324,148
Debt securities in issue at amortised cost	–	–	–	32	5,652	–	–	5,684
Other accounts and provisions (including current and deferred tax liabilities)	25,358	14,003	4,038	6,426	7,819	11	–	57,655
Insurance contract liabilities	8,531	460	427	7,678	21,009	28,532	–	66,637
Subordinated liabilities	–	–	418	–	–	19,431	–	19,849
Total liabilities	1,109,569	345,944	184,205	144,800	50,457	48,953	–	1,883,928
Net liquidity gap	(654,333)	(157,752)	(27,560)	153,951	478,373	281,967	88,362	163,008

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	2012 (Restated)							
	On demand HK$'m	Up to 1 month HK$'m	1 to 3 months HK$'m	3 to 12 months HK$'m	1 to 5 years HK$'m	Over 5 years HK$'m	Indefinite HK$'m	Total HK$'m
Assets								
Cash and balances with banks and other financial institutions	145,534	42,938	–	–	–	–	10,276	198,748
Placements with banks and other financial institutions maturing between one and twelve months	–	–	24,152	41,873	–	–	–	66,025
Financial assets at fair value through profit or loss								
– held for trading								
– certificates of deposit	–	67	64	14	–	–	–	145
– debt securities	–	11,075	3,855	3,454	6,585	4,159	–	29,128
– designated at fair value through profit or loss								
– certificates of deposit	–	–	509	310	378	–	–	1,197
– debt securities	–	31	369	2,350	11,207	2,832	–	16,789
– fund and equity securities	–	–	–	–	–	–	2,073	2,073
Derivative financial instruments	17,690	2,535	2,032	3,421	1,600	4,061	–	31,339
Hong Kong SAR Government certificates of indebtedness	82,930	–	–	–	–	–	–	82,930
Advances and other accounts								
– advances to customers	60,076	19,055	53,963	138,157	288,680	213,106	1,522	774,559
– trade bills	76	10,150	15,765	19,189	–	–	–	45,180
Investment in securities								
– available-for-sale								
– certificates of deposit	–	3,001	15,580	45,533	8,708	19	–	72,841
– debt securities	–	49,064	76,254	40,775	143,730	68,424	9	378,256
– held-to-maturity								
– certificates of deposit	–	465	–	332	77	–	–	874
– debt securities	–	430	2,822	3,792	8,276	2,102	102	17,524
– loans and receivables								
– debt securities	–	–	1,558	7,676	–	–	–	9,234
– equity securities	–	–	–	–	–	–	3,635	3,635
Interests in associates and a joint venture	–	–	–	–	–	–	259	259
Investment properties	–	–	–	–	–	–	14,364	14,364
Properties, plant and equipment	–	–	–	–	–	–	48,743	48,743
Other assets (including deferred tax assets)	10,563	13,904	73	47	8,857	3,452	24	36,920
Total assets	316,869	152,715	196,996	306,923	478,098	298,155	81,007	1,830,763
Liabilities								
Hong Kong SAR currency notes in circulation	82,930	–	–	–	–	–	–	82,930
Deposits and balances from banks and other financial institutions	140,245	37,270	1,483	208	–	–	–	179,206
Financial liabilities at fair value through profit or loss	–	10,017	6,287	3,475	254	139	–	20,172
Derivative financial instruments	13,022	668	865	1,766	3,602	1,291	–	21,214
Deposits from customers	701,678	276,068	129,269	111,327	7,910	38	–	1,226,290
Debt securities in issue at amortised cost	–	4	–	32	5,887	–	–	5,923
Other accounts and provisions (including current and deferred tax liabilities)	28,005	14,148	2,999	4,545	7,559	6	–	57,262
Insurance contract liabilities	3,281	493	3,068	1,070	24,655	21,370	–	53,937
Subordinated liabilities	–	–	418	–	–	28,337	–	28,755
Total liabilities	969,161	338,668	144,389	122,423	49,867	51,181	–	1,675,689
Net liquidity gap	(652,292)	(185,953)	52,607	184,500	428,231	246,974	81,007	155,074

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

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

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

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

The above analysis in respect of insurance contract liabilities represents the estimated timing of net cash outflows resulting from recognised insurance contract liabilities on the balance sheet as at 31 December.

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) Analysis of undiscounted cash flows by contractual maturities

(a) Non-derivative cash flows

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

	2013					
	Up to 1 month HK$'m	**1 to 3 months HK$'m**	**3 to 12 months HK$'m**	**1 to 5 years HK$'m**	**Over 5 years HK$'m**	**Total HK$'m**
Financial liabilities						
Hong Kong SAR currency notes in circulation	**99,190**	**–**	**–**	**–**	**–**	**99,190**
Deposits and balances from banks and other financial institutions	**273,850**	**3,795**	**674**	**–**	**–**	**278,319**
Financial liabilities at fair value through profit or loss	**5,457**	**5,419**	**2,079**	**406**	**304**	**13,665**
Deposits from customers	**1,017,914**	**169,662**	**126,314**	**13,781**	**52**	**1,327,723**
Debt securities in issue at amortised cost	**–**	**–**	**218**	**6,252**	**–**	**6,470**
Subordinated liabilities	**–**	**538**	**538**	**4,303**	**20,999**	**26,378**
Other financial liabilities	**33,495**	**2,843**	**4,396**	**412**	**11**	**41,157**
Total financial liabilities	**1,429,906**	**182,257**	**134,219**	**25,154**	**21,366**	**1,792,902**

	2012					
	Up to 1 month HK$'m	1 to 3 months HK$'m	3 to 12 months HK$'m	1 to 5 years HK$'m	Over 5 years HK$'m	Total HK$'m
Financial liabilities						
Hong Kong SAR currency notes in circulation	82,930	–	–	–	–	82,930
Deposits and balances from banks and other financial institutions	177,516	1,489	221	–	–	179,226
Financial liabilities at fair value through profit or loss	10,018	6,293	3,480	261	137	20,189
Deposits from customers	977,873	129,624	112,716	8,945	53	1,229,211
Debt securities in issue at amortised cost	4	–	218	6,467	–	6,689
Subordinated liabilities	–	538	618	4,622	28,854	34,632
Other financial liabilities	28,700	2,021	3,439	38	6	34,204
Total financial liabilities	1,277,041	139,965	120,692	20,333	29,050	1,587,081

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(b) Derivative cash flows

(i) Derivatives settled on a net basis

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

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

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

	2013					
	Up to 1 month HK$'m	**1 to 3 months HK$'m**	**3 to 12 months HK$'m**	**1 to 5 years HK$'m**	**Over 5 years HK$'m**	**Total HK$'m**
Exchange rate contracts	**(9,106)**	**(47)**	**(91)**	**(1)**	**–**	**(9,245)**
Interest rate contracts	**(122)**	**(304)**	**(1,221)**	**(1,754)**	**(51)**	**(3,452)**
Commodity contracts	**(185)**	**–**	**–**	**–**	**–**	**(185)**
	(9,413)	**(351)**	**(1,312)**	**(1,755)**	**(51)**	**(12,882)**

	2012					
	Up to 1 month HK$'m	1 to 3 months HK$'m	3 to 12 months HK$'m	1 to 5 years HK$'m	Over 5 years HK$'m	Total HK$'m
Exchange rate contracts	(12,527)	(33)	(84)	–	–	(12,644)
Interest rate contracts	(134)	(343)	(1,299)	(3,153)	(55)	(4,984)
Commodity contracts	(487)	–	–	–	–	(487)
Equity contracts	(3)	–	–	–	–	(3)
	(13,151)	(376)	(1,383)	(3,153)	(55)	(18,118)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(b) Derivative cash flows (continued)

(ii) Derivatives settled on a gross basis

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

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

	2013					
	Up to 1 month HK$'m	**1 to 3 months HK$'m**	**3 to 12 months HK$'m**	**1 to 5 years HK$'m**	**Over 5 years HK$'m**	**Total HK$'m**
Exchange rate contracts:						
– Outflow	**(353,496)**	**(160,768)**	**(305,611)**	**(51,339)**	**(1,699)**	**(872,913)**
– Inflow	**353,991**	**160,969**	**305,307**	**51,183**	**1,698**	**873,148**
Total outflow	**(353,496)**	**(160,768)**	**(305,611)**	**(51,339)**	**(1,699)**	**(872,913)**
Total inflow	**353,991**	**160,969**	**305,307**	**51,183**	**1,698**	**873,148**

	2012					
	Up to 1 month HK$'m	1 to 3 months HK$'m	3 to 12 months HK$'m	1 to 5 years HK$'m	Over 5 years HK$'m	Total HK$'m
Exchange rate contracts:						
– Outflow	(284,426)	(180,744)	(292,998)	(37,187)	(1,200)	(796,555)
– Inflow	286,321	181,986	294,599	37,191	1,201	801,298
Commodity contracts:						
– Outflow	(4,024)	–	–	–	–	(4,024)
– Inflow	–	–	–	–	–	–
Equity contracts:						
– Outflow	–	–	–	–	–	–
– Inflow	2	–	–	–	–	2
Total outflow	(288,450)	(180,744)	(292,998)	(37,187)	(1,200)	(800,579)
Total inflow	286,323	181,986	294,599	37,191	1,201	801,300

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(c) Off-balance sheet items

Loan commitments

The contractual amounts of the Group's off-balance sheet financial instruments as at 31 December 2013 that the Group commits to extend credit to customers and other facilities amounted to HK$436,252 million (2012: HK$392,508 million). Those loan commitments can be drawn within one year.

Financial guarantees and other financial facilities

Financial guarantees and other financial facilities of the Group as at 31 December 2013 amounting to HK$86,753 million (2012: HK$71,261 million) are maturing no later than one year.

4.4 Insurance Risk

The Group is in the business of insuring against the risk of mortality, morbidity, disability, critical illness, accidents and related risks. The Group manages these risks through the application of its underwriting policies and reinsurance arrangements.

The underwriting strategy is intended to set premium pricing at an appropriate level that corresponds with the underlying exposure of the risks underwritten. Screening processes, such as the review of health condition and family medical history, are also included in the Group's underwriting procedures.

Within the insurance process, concentrations of risk may arise where a particular event or series of events could impact heavily on the Group's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts, and relate to circumstances where significant liabilities could arise.

For the in-force insurance contracts, most of the underlying insurance liabilities are related to endowment, whole life and unit-linked insurance products. For most of the insurance policies issued, the Group has a retention limit on any single life insured. The Group cedes the excess of the insured benefit over the limit to reinsurer under an excess of loss reinsurance arrangement. For some of the insurance liabilities denominated in Renminbi, the Group has entered into reinsurance arrangements that reinsure most of insurance risk.

Uncertainty in the estimation of future benefit payments and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality, morbidity and persistency. The Group conducted relevant experience studies. The results of the studies are considered in determining the assumptions which include appropriate level of prudential margins.

4. Financial risk management (continued)

4.5 Capital Management

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

The Banking (Capital) (Amendment) Rules 2012 and the Banking (Capital) (Amendment) Rules 2013 came into operation on 1 January 2013 and 30 June 2013 respectively. The rules mainly addressed the revision to both the minimum capital ratio requirement (in terms of expanding the existing capital adequacy ratio into three ratios, namely, a Common Equity Tier 1 capital ratio, a Tier 1 capital ratio and a Total capital ratio) and the definition of regulatory capital. In addition, the rules included the enhancements to the counterparty credit risk framework and amendments on the capital treatment for certain trade financing activities and securities financing transactions. The Group has complied with the rules to calculate Capital Adequacy Ratio.

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

The Group has adopted the foundation internal ratings-based ("FIRB") approach to calculate the credit risk capital charge for majority of non-securitisation exposures and internal ratings-based (securitisation) approach to calculate the credit risk capital charge for its securitisation exposures. A small residual credit exposures was remained under standardised (credit risk) ("STC") approach. The Group has adopted standardised credit valuation adjustment ("CVA") method to calculate the counterparty CVA capital charges for OTC derivative contracts and securities financing transactions under both banking book and trading book.

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

The Group continues to adopt standardised (operational risk) ("STO") approach to calculate the capital charge for operational risk.

The Group has continued to adopt an internal capital adequacy assessment process ("ICAAP") to comply with the HKMA's requirements in the Supervisory Policy Manual "Supervisory Review Process" in 2013. Based on the HKMA's guidelines on Pillar II, ICAAP has been initiated to assess the extra capital needed to cover the material risks not captured or not adequately captured under Pillar I, and therefore minimum Common Equity Tier 1 capital ratio, minimum Tier 1 capital ratio and the minimum Total capital ratio are determined. The Group considers this ICAAP process as an on-going process for capital management and periodically reviews and adjusts its capital structure where appropriate in relation to the overall risk profile.

4. Financial risk management (continued)

4.5 Capital Management (continued)

In addition, the capital plan of the Group is drawn up annually and then submitted to the Board for approval after endorsement of the ALCO. The plan is built up by assessing the implications of various factors upon capital adequacy such as the business strategies, return on equity, risk appetite, credit rating, as well as regulatory requirements. Hence, the future capital requirement is determined and capital sources are identified also. The plan is to ensure the Group maintains adequate capital and appropriate capital structure which align with its business development needs, thereby achieving an optimal balance among risk, return and capital adequacy.

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

(A) Basis of regulatory consolidation

The consolidation basis for regulatory purposes comprises the positions of BOCHK and certain subsidiaries specified by the HKMA in accordance with the Banking (Capital) Rules. For accounting purposes, subsidiaries are consolidated in accordance with the accounting standards issued by the HKICPA pursuant to section 18A of the Professional Accountants Ordinance.

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

	2013	
Name of company	**Total assets HK$'m**	**Total equity HK$'m**
BOC Group Life Assurance Company Limited	**79,579**	**4,404**
BOCHK Asset Management (Cayman) Limited	**50**	**50**
Bank of China (Hong Kong) Nominees Limited	**–**	**–**
Bank of China (Hong Kong) Trustees Limited	**9**	**9**
BNPP Flexi III China Fund	**1,862**	**1,862**
BOC Group Trustee Company Limited	**200**	**200**
BOC Travel Services Limited	**2**	**2**
BOCHK Asset Management Limited	**49**	**37**
BOCHK Information Technology (Shenzhen) Co., Ltd.	**193**	**172**
BOCHK Information Technology Services (Shenzhen) Ltd.	**281**	**241**
BOCI-Prudential Trustee Limited	**442**	**414**
Che Hsing (Nominees) Limited	**1**	**1**
Chiyu Banking Corporation (Nominees) Limited	**96**	**96**
Grace Charter Limited	**–**	**(11)**
G.Z.Y. Microfilm Technology (Shenzhen) Co., Ltd.	**68**	**68**
Kwong Li Nam Investment Agency Limited	**4**	**4**
Nanyang Commercial Bank (Nominees) Limited	**1**	**1**
Nanyang Commercial Bank Trustee Limited	**17**	**17**
Po Sang Financial Investment Services Company Limited	**121**	**105**
Po Sang Futures Limited	**219**	**171**
Seng Sun Development Company, Limited	**40**	**37**
Sin Chiao Enterprises Corporation, Limited	**135**	**135**
Sin Hua Trustee Limited	**4**	**4**
Sino Information Services Company Limited	**21**	**20**

4. Financial risk management (continued)

4.5 Capital Management (continued)

(A) Basis of regulatory consolidation (continued)

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

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

The principal activities of the above subsidiaries are set out in "Appendix – Subsidiaries of the Company" on pages 274 to 276.

(B) Capital ratio

	2013
CET1 capital ratio	**10.57%**
Tier 1 capital ratio	**10.67%**
Total capital ratio	**15.80%**

	2012
Core capital ratio	12.31%
Capital adequacy ratio	16.80%

4. Financial risk management (continued)

4.5 Capital Management (continued)

(C) Components of capital base after deductions

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

	2013 HK$'m
CET1 capital: instruments and reserves	
Directly issued qualifying CET1 capital instruments plus any related share premium	43,043
Retained earnings	59,291
Disclosed reserves	43,025
Minority interests arising from CET1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in CET1 capital of the consolidation group)	504
CET1 capital before regulatory deductions	145,863
CET1 capital: regulatory deductions	
Valuation adjustments	(21)
Deferred tax assets net of deferred tax liabilities	(164)
Gains and losses due to changes in own credit risk on fair valued liabilities	(81)
Cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties)	(44,491)
Regulatory reserve for general banking risks	(8,994)
Total regulatory deductions to CET1 capital	(53,751)
CET1 capital	92,112
AT1 capital: instruments	
AT1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in AT1 capital of the consolidation group)	894
AT1 capital	894
Tier 1 capital	93,006
Tier 2 capital: instruments and provisions	
Capital instruments subject to phase out arrangements from Tier 2 capital	19,294
Tier 2 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in Tier 2 capital of the consolidation group)	321
Collective impairment allowances and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital	5,047
Tier 2 capital before regulatory deductions	24,662
Tier 2 capital: regulatory deductions	
Add back of cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) eligible for inclusion in Tier 2 capital	20,021
Total regulatory deductions to Tier 2 capital	20,021
Tier 2 capital	44,683
Total capital	**137,689**

4. Financial risk management (continued)

4.5 Capital Management (continued)

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

	2012 HK$'m
Core capital:	
Paid-up ordinary share capital	43,043
Reserves	38,987
Profit and loss account	5,820
Non-controlling interests	1,658
Deductible item	(25)
	89,483
Deductions from core capital	(387)
Core capital	89,096
Supplementary capital:	
Fair value gains arising from holdings of available-for-sale securities	2,067
Fair value gains arising from holdings of securities designated at fair value through profit or loss	35
Collective loan impairment allowances	192
Regulatory reserve	539
Surplus provisions	3,963
Term subordinated debt	26,043
	32,839
Deductions from supplementary capital	(387)
Supplementary capital	32,452
Total capital base after deductions	121,548

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

– A detailed breakdown of the capital base and regulatory deductions, using the standard template as specified by the HKMA.

– A reconciliation of capital components to the balance sheet, using the standard template as specified by the HKMA.

– A description of the main features and the full terms and conditions of the issued capital instruments.

5. Fair values of assets and liabilities

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

– Level 1: based on quoted prices (unadjusted) in active markets for identical assets or liabilities. This category includes listed equity securities on exchange, debt instruments issued by certain governments, certain exchange-traded derivative contracts and precious metals. As properties are unique in nature and not identical with another, they are not categorised in this level.

– Level 2: based on valuation techniques for which the lowest level input that is significant to the fair value measurement is observable, either directly or indirectly. This category includes majority of the OTC derivative contracts, debt securities and certificates of deposit with quote from pricing services providers and issued structured deposits. It also includes residential properties and shops with insignificant adjustments made to observable market inputs.

– Level 3: based on valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable. This category includes equity investment and debt instruments with significant unobservable components. It also includes offices and shops with significant adjustments made to observable market inputs.

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

5.1 Financial instruments measured at fair value

The Group has an established governance structure and controls framework to ensure that fair values are either determined or validated by control units independent of the front offices. Control units have overall responsibility for independent verification of valuation results from front line businesses and all other significant fair value measurements. Specific controls include verification of observable pricing inputs; review and approval for new models and changes to models; calibration and back-testing of models against observed market transactions; analysis and investigation of significant daily valuation movements; review of significant unobservable inputs and valuation adjustments. Significant valuation issues are reported to senior management, Risk Committee and Audit Committee.

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

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

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

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

Debt securities and certificates of deposit

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

Asset backed securities

For this class of instruments, external prices are obtained from independent third parties. The valuation of these securities, depending on the nature of transaction, is estimated from market standard cash flow models with input parameter which include spreads to discount rates, default and recovery rates and prepayment rates that may be observable or compiled through matrix pricing for similar issues.

Derivatives

Over-the-counter derivative contracts include forward, swap and option contracts on foreign exchange, interest rate, equity or commodity. The fair values of these contracts are mainly measured using valuation techniques such as discounted cash flow models and option pricing models. The inputs can be observable or unobservable market data. Observable inputs include interest rate, foreign exchange rates, equity and stock prices, commodity prices and volatilities. Unobservable inputs such as volatility surface may be used for less commonly traded option products which are embedded in structured deposits. For certain complex derivatives contracts, the fair values are determined based on broker/dealer price quotations.

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

Financial liabilities designated at fair value through profit or loss

This class of instruments includes certain deposits received from customers that are embedded with derivatives. The plain vanilla contracts are valued in the similar way described in previous debt securities section. The fair value of structured deposits is derived from the fair value of the underlying deposit by using discounted cash flow analysis taking the Group's own credit risk into account, and the fair value of the embedded derivatives determined as described in the paragraph above on derivatives.

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(A) Fair value hierarchy

	2013			
	Level 1 HK$'m	Level 2 HK$'m	Level 3 HK$'m	Total HK$'m
Financial assets				
Financial assets at fair value through profit or loss (Note 23)				
– Trading securities				
– Debt securities	–	26,215	–	26,215
– Certificates of deposit	–	139	–	139
– Equity securities	3	355	–	358
– Financial assets designated at fair value through profit or loss				
– Debt securities	343	13,877	385	14,605
– Certificates of deposit	–	369	–	369
– Fund	661	–	–	661
– Equity securities	1,146	–	–	1,146
Derivative financial instruments (Note 24)	13,685	11,663	–	25,348
Available-for-sale securities (Note 27)				
– Debt securities	8,422	323,771	779	332,972
– Certificates of deposit	–	72,609	5,468	78,077
– Equity securities	2,801	1,220	250	4,271
Financial liabilities				
Financial liabilities at fair value through profit or loss (Note 34)				
– Trading liabilities	–	9,748	–	9,748
– Financial liabilities designated at fair value through profit or loss	–	3,832	–	3,832
Derivative financial instruments (Note 24)	9,358	9,554	–	18,912

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(A) Fair value hierarchy (continued)

	2012			
	Level 1 HK$'m	Level 2 HK$'m	Level 3 HK$'m	Total HK$'m
Financial assets				
Financial assets at fair value through profit or loss (Note 23)				
– Trading securities				
– Debt securities	–	29,128	–	29,128
– Certificates of deposit	–	145	–	145
– Equity securities	13	212	–	225
– Financial assets designated at fair value through profit or loss				
– Debt securities	414	16,042	333	16,789
– Certificates of deposit	–	1,197	–	1,197
– Fund	636	–	–	636
– Equity securities	1,212	–	–	1,212
Derivative financial instruments (Note 24)	17,677	13,662	–	31,339
Available-for-sale securities (Note 27)				
– Debt securities	98,350	278,457	1,449	378,256
– Certificates of deposit	–	71,653	1,188	72,841
– Equity securities	2,592	838	205	3,635
Financial liabilities				
Financial liabilities at fair value through profit or loss (Note 34)				
– Trading liabilities	–	17,331	–	17,331
– Financial liabilities designated at fair value through profit or loss	–	2,070	771	2,841
Derivative financial instruments (Note 24)	13,004	8,210	–	21,214

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

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items

	2013				
	Financial assets				Financial liabilities
	Financial assets designated at fair value through profit or loss	Available-for-sale securities			Financial liabilities designated at fair value through profit or loss
	Debt securities HK$'m	Debt securities HK$'m	Certificates of deposit HK$'m	Equity securities HK$'m	HK$'m
At 1 January 2013	333	1,449	1,188	205	(771)
Gains/(losses)					
– Income statement					
– Net gain on financial instruments designated at fair value through profit or loss	25	–	–	–	–
– Other comprehensive income					
– Change in fair value of available-for-sale securities	–	(43)	(1)	24	–
Purchases	192	–	4,947	21	–
Sales	–	–	(506)	–	–
Settlements	–	–	–	–	771
Transfers into level 3	–	–	160	–	–
Transfers out of level 3	(165)	(171)	(320)	–	–
Reclassification	–	(456)	–	–	–
At 31 December 2013	385	779	5,468	250	–
Total unrealised gain for the year included in income statement for financial assets and liabilities held as at 31 December 2013					
– Net gain on financial instruments designated at fair value through profit or loss	22	–	–	–	–

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items (continued)

	2012				
	Financial assets				Financial liabilities
	Financial assets designated at fair value through profit or loss	Available-for-sale securities			Financial liabilities designated at fair value through profit or loss
	Debt securities HK$'m	Debt securities HK$'m	Certificates of deposit HK$'m	Equity securities HK$'m	HK$'m
At 1 January 2012	134	625	2,197	184	(203)
Gains/(losses)					
– Income statement					
– Net gain on financial instruments designated at fair value through profit or loss	33	–	–	–	–
– Other comprehensive income					
– Change in fair value of available-for-sale securities	–	(9)	(1)	21	–
Purchases	–	993	867	–	–
Issues	–	–	–	–	(771)
Sales	(5)	–	(179)	–	–
Settlements	–	–	–	–	203
Transfers into level 3	171	456	–	–	–
Transfers out of level 3	–	(616)	(1,696)	–	–
At 31 December 2012	333	1,449	1,188	205	(771)
Total unrealised gain for the year included in income statement for financial assets and liabilities held as at 31 December 2012					
– Net gain on financial instruments designated at fair value through profit or loss	33	–	–	–	–

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

Debt securities and certificates of deposit were transferred into and out of level 3 in the year of 2013 due to change of valuation observability. For certain illiquid debt securities, the Group obtains valuation quotations from counterparties which may be based on unobservable inputs with significant impact on the valuation. Therefore, these instruments have been classified by the Group as level 3. The Group has established internal control procedures to control the Group's exposure to such financial instruments.

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items (continued)

The fair values of unlisted available-for-sale equity shares are determined with reference to multiples of comparable listed companies, such as average of the price/earning ratios of comparables or net asset value, if appropriate comparables are not available. The fair value is positively correlated to the price/earning ratios of appropriate comparables or net asset values. Had the net asset value of the underlying equity investments increased/decreased by 5%, the Group's other comprehensive income would have increased/decreased by HK$13 million.

Financial liabilities designated at fair value through profit or loss categorised in level 3 are deposits received from customers that are embedded with options bought by the Group. All deposits categorised as level 3 as at 31 December 2012 were matured in the year of 2013 and there were no deposits categorised as level 3 as at 31 December 2013.

5.2 Financial instruments not measured at fair value

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

Balances with banks and other financial institutions and trade bills

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

Advances to customers

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

Held-to-maturity securities

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

Loans and receivables

A discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

Deposits from customers

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

Debt securities in issue at amortised cost

Fair value for senior notes and other debt securities in issue is based on market prices or broker/dealer price quotations.

Subordinated liabilities

Fair value for subordinated notes is based on market prices or broker/dealer price quotations.

5. Fair values of assets and liabilities (continued)

5.2 Financial instruments not measured at fair value (continued)

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

	2013	
	Carrying value HK$'m	**Fair value HK$'m**
Financial assets		
Held-to-maturity securities (Note 27)		
– Debt securities	**17,360**	**17,460**
– Certificates of deposit	**95**	**95**
Loans and receivables (Note 27)	**7,945**	**7,942**
Financial liabilities		
Debt securities in issue at amortised cost (Note 36)		
– Senior notes	**5,684**	**6,193**
Subordinated liabilities (Note 41)		
– Subordinated notes	**19,849**	**21,224**

	2012	
	Carrying value HK$'m	Fair value HK$'m
Financial assets		
Held-to-maturity securities (Note 27)		
– Debt securities	17,524	18,010
– Certificates of deposit	874	874
Loans and receivables (Note 27)	9,234	9,255
Financial liabilities		
Debt securities in issue at amortised cost (Note 36)		
– Senior notes	5,919	6,317
– Other debt securities in issue	4	4
Subordinated liabilities (Note 41)		
– Subordinated loans	6,749	6,749
– Subordinated notes	22,006	22,261

5. Fair values of assets and liabilities (continued)

5.2 Financial instruments not measured at fair value (continued)

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

	2013			
	Level 1 HK$'m	Level 2 HK$'m	Level 3 HK$'m	Total HK$'m
Financial assets				
Held-to-maturity securities				
– Debt securities	–	17,308	152	17,460
– Certificates of deposit	–	18	77	95
Loans and receivables	–	7,942	–	7,942
Financial liabilities				
Debt securities in issue at amortised cost				
– Senior notes	–	6,193	–	6,193
Subordinated liabilities				
– Subordinated notes	–	21,224	–	21,224

5.3 Non-financial instruments measured at fair value

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

Investment properties and premises

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

Valuation methods and inputs used in Level 2 fair value measurements

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

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

5. Fair values of assets and liabilities (continued)

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

Investment properties and premises (continued)

Information about Level 3 fair value measurements

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

The fair value of the bank vault is determined using the depreciated replacement cost approach as no direct comparable is available given the specialised nature of the property. The major inputs are the market value of the existing land, the current cost of replacing the property and the depreciation rate. Appropriate adjustments are made to reflect the specialised nature of the property.

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

	Valuation method	Significant unobservable inputs	Weighted average	Relationship of unobservable inputs to fair value
Bank vault	Depreciated replacement cost approach	Depreciation rate	2% per year	The higher the depreciation rate, the lower the fair value.
		Premium on specialised nature of the property	+20% to building cost	The higher the premium, the higher the fair value.
Other properties	Market comparison approach or income capitalisation approach	Premium/(discount) on features of the property compared to comparable properties	-19%	The higher the premium, the higher the fair value. The higher the discount, the lower the fair value.

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

Precious metals

The fair values of precious metals are determined by obtaining quoted market prices in active market.

5. Fair values of assets and liabilities (continued)

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

(A) Fair value hierarchy

	2013			
	Level 1 HK$'m	Level 2 HK$'m	Level 3 HK$'m	Total HK$'m
Non-financial assets				
Investment properties (Note 30)	–	1,586	13,011	14,597
Properties, plant and equipment (Note 31)				
– Premises	–	7,972	41,819	49,791
Other assets (Note 32)				
– Precious metals	5,146	–	–	5,146

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

(B) Reconciliation of level 3 items

	2013	
	Non-financial assets	
		Properties, plant and equipment
	Investment properties HK$'m	Premises HK$'m
At 1 January 2013	12,888	38,904
Gains		
– Income statement		
– Net gain from disposal of/fair value adjustments on investment properties	152	–
– Net gain from disposal/revaluation of properties, plant and equipment	–	10
– Other comprehensive income		
– Revaluation of premises	–	3,316
Depreciation	–	(803)
Additions	2	347
Reclassification	(32)	32
Exchange difference	1	13
At 31 December 2013	13,011	41,819
Total unrealised gain for the year included in income statement for non-financial assets held as at 31 December 2013		
– Net gain from disposal of/fair value adjustments on investment properties	152	–
– Net gain from disposal/revaluation of properties, plant and equipment	–	10
	152	10

6. Net interest income

	2013 **HK$'m**	2012 HK$'m
Interest income		
Due from banks and other financial institutions	**8,586**	8,168
Advances to customers	**19,878**	17,222
Listed investments	**4,845**	4,542
Unlisted investments	**5,858**	5,231
Others	**212**	250
	39,379	35,413
Interest expense		
Due to banks and other financial institutions	**(1,039)**	(971)
Deposits from customers	**(9,840)**	(9,013)
Debt securities in issue	**(143)**	(161)
Subordinated liabilities	**(118)**	(313)
Others	**(323)**	(247)
	(11,463)	(10,705)
Net interest income	**27,916**	24,708

Included within interest income is HK$6 million (2012: HK$10 million) of interest with respect to income accrued on advances classified as impaired for the year ended 31 December 2013. Interest income accrued on impaired investment in securities amounted to HK$5 million (2012: HK$9 million).

Included within interest income and interest expense are HK$39,595 million (2012: HK$35,254 million) and HK$12,081 million (2012: HK$11,278 million), before hedging effect, for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

NOTES TO THE FINANCIAL STATEMENTS

7. Net fee and commission income

	2013 HK$'m	(Restated) 2012 HK$'m
Fee and commission income		
Credit card business	**3,516**	3,161
Securities brokerage	**2,432**	2,114
Loan commissions	**1,900**	1,774
Insurance	**1,285**	965
Funds distribution	**821**	540
Bills commissions	**819**	736
Payment services	**665**	667
Trust and custody services	**387**	360
Safe deposit box	**244**	228
Currency exchange	**197**	156
Others	**450**	409
	12,716	11,110
Fee and commission expense		
Credit card business	**(2,677)**	(2,392)
Securities brokerage	**(295)**	(299)
Payment services	**(93)**	(92)
Others	**(686)**	(564)
	(3,751)	(3,347)
Net fee and commission income	**8,965**	7,763
Of which arise from		
– financial assets or financial liabilities not at fair value through profit or loss		
– Fee and commission income	**1,993**	1,770
– Fee and commission expense	**(10)**	(7)
	1,983	1,763
– trust and other fiduciary activities		
– Fee and commission income	**568**	550
– Fee and commission expense	**(34)**	(14)
	534	536

Certain comparative amounts of fee and commission income, fee and commission expense and operating expenses have been reclassified to conform with the current year's presentation.

8. Net trading gain

	2013 HK$'m	2012 HK$'m
Net gain from:		
– foreign exchange and foreign exchange products	**1,952**	1,988
– interest rate instruments and items under fair value hedge	**573**	900
– commodities	**91**	121
– equity instruments	**341**	120
	2,957	3,129

9. Net gain on other financial assets

	2013 HK$'m	2012 HK$'m
Net gain on available-for-sale securities	**116**	644
Net gain on held-to-maturity securities	**–**	108
Others	**(33)**	(2)
	83	750

10. Other operating income

	2013 HK$'m	2012 HK$'m
Dividend income from investment in securities		
– listed investments	**91**	88
– unlisted investments	**36**	29
Gross rental income from investment properties	**487**	436
Less: Outgoings in respect of investment properties	**(63)**	(56)
Others	**103**	92
	654	589

Included in the "Outgoings in respect of investment properties" is HK$6 million (2012: HK$3 million) of direct operating expenses related to investment properties that were not let during the year.

11. Net insurance benefits and claims

	2013 HK$'m	2012 HK$'m
Gross insurance benefits and claims		
Claims, benefits and surrenders paid	**(6,243)**	(7,515)
Movement in liabilities	**(12,034)**	(6,632)
	(18,277)	(14,147)
Reinsurers' share of benefits and claims		
Claims, benefits and surrenders recovered	**249**	83
Movement in assets	**8,755**	5,544
	9,004	5,627
Net insurance benefits and claims	**(9,273)**	(8,520)

12. Net charge of impairment allowances

	2013 HK$'m	2012 HK$'m
Advances to customers		
Individually assessed		
– new allowances	**(418)**	(566)
– releases	**105**	54
– recoveries	**254**	234
Net charge of individually assessed loan impairment allowances (Note 26)	**(59)**	(278)
Collectively assessed		
– new allowances	**(709)**	(606)
– releases	**4**	–
– recoveries	**34**	30
Net charge of collectively assessed loan impairment allowances (Note 26)	**(671)**	(576)
Net charge of loan impairment allowances	**(730)**	(854)
Available-for-sale securities		
Net reversal of impairment allowances on available-for-sale securities		
– Individually assessed	**–**	2
Held-to-maturity securities		
Net reversal of impairment allowances on held-to-maturity securities		
– Individually assessed (Note 27)	**5**	3
Others	**(12)**	(10)
Net charge of impairment allowances	**(737)**	(859)

13. Operating expenses

	2013 HK$'m	(Restated) 2012 HK$'m
Staff costs (including directors' emoluments)		
– salaries and other costs	**6,313**	5,932
– pension cost	**506**	474
	6,819	6,406
Premises and equipment expenses (excluding depreciation)		
– rental of premises	**792**	695
– information technology	**403**	398
– others	**381**	363
	1,576	1,456
Depreciation (Note 31)	**1,663**	1,493
Auditor's remuneration		
– audit services	**26**	33
– non-audit services	**8**	4
Other operating expenses	**1,991**	1,867
	12,083	11,259

Contingent rent included in the "Rental of premises" amounted to HK$10 million during the year (2012: Nil).

Certain comparative amounts of operating expenses have been reclassified to fee and commission expense to conform with the current year's presentation.

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

	2013 HK$'m	2012 HK$'m
Net gain from disposal of investment properties	**–**	4
Net gain from fair value adjustments on investment properties (Note 30)	**264**	1,885
	264	1,889

15. Net gain from disposal/revaluation of properties, plant and equipment

	2013 HK$'m	2012 HK$'m
Net gain from disposal of premises	**–**	118
Net loss from disposal of other fixed assets	**(13)**	(8)
Net gain/(loss) from revaluation of premises (Note 31)	**14**	(4)
	1	106

16. Taxation

Taxation in the income statement represents:

	2013 HK$'m	2012 HK$'m
Current tax		
Hong Kong profits tax		
– current year taxation	**4,174**	3,762
– over-provision in prior years	**(13)**	(55)
	4,161	3,707
Overseas taxation		
– current year taxation	**711**	436
– over-provision in prior years	**(16)**	–
	4,856	4,143
Deferred tax		
Origination and reversal of temporary differences (Note 39)	**(138)**	(169)
	4,718	3,974

Hong Kong profits tax has been provided at the rate of 16.5% (2012: 16.5%) on the estimated assessable profits arising in Hong Kong during the year. Taxation on overseas profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the countries in which the Group operates.

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

	2013 HK$'m	2012 HK$'m
Profit before taxation	**27,793**	25,521
Calculated at a taxation rate of 16.5% (2012: 16.5%)	**4,586**	4,211
Effect of different taxation rates in other countries	**26**	45
Income not subject to taxation	**(188)**	(501)
Expenses not deductible for taxation purposes	**74**	105
Utilisation of previously unrecognised tax losses	**(121)**	(91)
Over-provision in prior years	**(29)**	(55)
Foreign withholding tax	**370**	260
Taxation charge	**4,718**	3,974
Effective tax rate	**17.0%**	15.6%

17. Profit attributable to the equity holders of the Company

The consolidated profit attributable to the equity holders of the Company for the year ended 31 December 2013 includes a profit of HK$13,519 million (2012: HK$12,820 million) which has been dealt with in the financial statements of the Company.

18. Dividends

	2013		2012	
	Per share HK$	Total HK$'m	Per share HK$	Total HK$'m
Interim dividend paid	**0.545**	**5,762**	0.545	5,762
Proposed final dividend	**0.465**	**4,917**	0.693	7,327
	1.010	**10,679**	1.238	13,089

At a meeting held on 29 August 2013, the Board declared an interim dividend of HK$0.545 per ordinary share for the first half of 2013 amounting to approximately HK$5,762 million.

At a meeting held on 26 March 2014, the Board proposed to recommend to the Annual General Meeting on 11 June 2014 a final dividend of HK$0.465 per ordinary share for the year ended 31 December 2013 amounting to approximately HK$4,917 million. This proposed final dividend is not reflected as a dividend payable in these financial statements, but will be reflected as an appropriation of retained earnings for the year ending 31 December 2014.

19. Earnings per share for profit attributable to the equity holders of the Company

The calculation of basic earnings per share is based on the consolidated profit attributable to the equity holders of the Company for the year ended 31 December 2013 of approximately HK$22,252 million (2012: HK$20,930 million) and on the ordinary shares in issue of 10,572,780,266 shares (2012: 10,572,780,266 ordinary shares).

There was no dilution of earnings per share as no potential ordinary shares were in issue for the year ended 31 December 2013 (2012: Nil).

20. Retirement benefit costs

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

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

The Group's total contributions made to the ORSO schemes for the year ended 31 December 2013 amounted to approximately HK$352 million (2012: approximately HK$343 million), after a deduction of forfeited contributions of approximately HK$5 million (2012: approximately HK$3 million). For the MPF Scheme, the Group contributed approximately HK$64 million (2012: approximately HK$59 million) for the year ended 31 December 2013.

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

(a) Directors' and senior management's emoluments

(i) Directors' emoluments

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

	2013			
	Directors' fee HK$'000	Basic salaries, allowances and benefits in kind HK$'000	Bonus HK$'000	Total HK$'000
Executive Directors				
HE Guangbei (Chief Executive)	100	8,326	4,286	12,712
GAO Yingxin	100	5,741	2,570	8,411
	200	14,067	6,856	21,123
Non-executive Directors				
TIAN Guoli	–	–	–	–
XIAO Gang	–	–	–	–
LI Lihui	–	–	–	–
CHEN Siqing	–	–	–	–
LI Zaohang	–	–	–	–
ZHOU Zaiqun#	4,136	–	–	4,136
FUNG Victor Kwok King*	300	–	–	300
KOH Beng Seng*	380	–	–	380
NING Gaoning*	250	–	–	250
SHAN Weijian*	350	–	–	350
TUNG Savio Wai-Hok*	430	–	–	430
TUNG Chee Chen*	142	–	–	142
	5,988	–	–	5,988
	6,188	14,067	6,856	27,111

Mr XIAO Gang resigned as Chairman and Non-executive Director of the Company with effect from 17 March 2013. Mr TUNG Chee Chen retired as an Independent Non-executive Director of the Company after the conclusion of the annual general meeting held on 28 May 2013. Mr TIAN Guoli was appointed as Chairman and Non-executive Director of the Company with effect from 4 June 2013. Mr LI Lihui resigned as Vice Chairman and Non-executive Director of the Company, Mr ZHOU Zaiqun retired as Non-executive Director of the Company and Mr CHEN Siqing was appointed as Vice Chairman of the Company with effect from 25 March 2014.

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

(a) Directors' and senior management's emoluments (continued)

(i) Directors' emoluments (continued)

	2012			
	Directors' fee HK$'000	Basic salaries, allowances and benefits in kind HK$'000	Bonus HK$'000	Total HK$'000
Executive Directors				
HE Guangbei (Chief Executive)	100	7,812	4,024	11,936
GAO Yingxin	100	5,438	2,441	7,979
	200	13,250	6,465	19,915
Non-executive Directors				
XIAO Gang	–	–	–	–
LI Lihui	–	–	–	–
CHEN Siqing	–	–	–	–
LI Zaohang	–	–	–	–
ZHOU Zaiqun#	3,987	–	–	3,987
FUNG Victor Kwok King*	301	–	–	301
KOH Beng Seng*	350	–	–	350
NING Gaoning*	89	–	–	89
SHAN Weijian*	350	–	–	350
TUNG Savio Wai-Hok*	399	–	–	399
TUNG Chee Chen*	349	–	–	349
	5,825	–	–	5,825
	6,025	13,250	6,465	25,740

Notes:

Included fee as Chairman and Non-executive Director of Nanyang Commercial Bank, Limited

* Independent Non-executive Directors

For the year ended 31 December 2013, certain directors waived emoluments of HK$2 million (2012: HK$2 million), which include directors' fee from subsidiaries.

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

(a) Directors' and senior management's emoluments (continued)

(ii) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include two (2012: two) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining three (2012: three) individuals during the year are as follows:

	2013 HK$'m	2012 HK$'m
Basic salaries and allowances	**12**	15
Bonus	**6**	7
Directors' fee from subsidiaries	**–**	1
	18	23

Emoluments paid to or receivable by individuals during the year with reference to their tenure are within the following bands:

	Number of individuals	
	2013	2012
HK$5,000,001 to HK$5,500,000	**–**	–
HK$5,500,001 to HK$6,000,000	**1**	2
HK$6,000,001 to HK$6,500,000	**2**	–
HK$11,500,001 to HK$12,000,000	**–**	1

(iii) Senior management's emoluments

Emoluments paid to or receivable by individuals during the year with reference to their tenure as senior management are within the following bands:

	Number of individuals	
	2013	2012
HK$2,000,001 to HK$2,500,000	**1**	–
HK$4,500,001 to HK$5,000,000	**–**	1
HK$5,000,001 to HK$5,500,000	**2**	2
HK$5,500,001 to HK$6,000,000	**3**	2
HK$6,000,001 to HK$6,500,000	**1**	–
HK$7,500,001 to HK$8,000,000	**–**	1
HK$8,000,001 to HK$8,500,000	**1**	–
HK$11,500,001 to HK$12,000,000	**–**	2
HK$12,500,001 to HK$13,000,000	**1**	–

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

(b) Remuneration for Senior Management and Key Personnel under CG-5

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

(i) Remuneration awarded during the year

	2013					
	Senior Management			**Key Personnel**		
	Non-deferred HK$'m	**Deferred HK$'m**	**Total HK$'m**	**Non-deferred HK$'m**	**Deferred HK$'m**	**Total HK$'m**
Fixed remuneration						
Cash	**46**	**–**	**46**	**52**	**–**	**52**
Variable remuneration						
Cash	**14**	**5**	**19**	**24**	**7**	**31**
Total	**60**	**5**	**65**	**76**	**7**	**83**

	2012					
	Senior Management			Key Personnel		
	Non-deferred HK$'m	Deferred HK$'m	Total HK$'m	Non-deferred HK$'m	Deferred HK$'m	Total HK$'m
Fixed remuneration						
Cash	46	–	46	51	–	51
Variable remuneration						
Cash	13	6	19	23	6	29
Total	59	6	65	74	6	80

The remuneration above includes 11 (2012: 10) members of Senior Management and 19 (2012: 22) members of Key Personnel.

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

(b) Remuneration for Senior Management and Key Personnel under CG-5 (continued)

(ii) Deferred remuneration

	2013		2012	
	Senior Management HK$'m	**Key Personnel HK$'m**	Senior Management HK$'m	Key Personnel HK$'m
Deferred remuneration				
Vested	**6**	**4**	3	3
Unvested	**11**	**14**	12	11
	17	**18**	15	14
At 1 January	**12**	**11**	9	8
Awarded	**5**	**7**	6	6
Paid out	**(6)**	**(4)**	(3)	(3)
Reduced through performance adjustments	**–**	**–**	–	–
At 31 December	**11**	**14**	12	11

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

Senior Management: The senior executives designated by the Board who are responsible for oversight of the firm-wide strategy or material business lines, including Chief Executive, Deputy Chief Executives, Chief Financial Officer, Chief Risk Officer, Chief Operating Officer, Board Secretary and Head of Group Audit.

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

22. Cash and balances with banks and other financial institutions

	2013 HK$'m	2012 HK$'m
Cash	**9,456**	6,688
Balances with central banks	**139,022**	84,387
Balances with banks and other financial institutions	**110,463**	64,735
Placements with banks and other financial institutions maturing within one month	**94,800**	42,938
	353,741	198,748

23. Financial assets at fair value through profit or loss

	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	2013 HK$'m	2012 HK$'m	**2013 HK$'m**	2012 HK$'m	**2013 HK$'m**	2012 HK$'m
At fair value						
Debt securities						
– Listed in Hong Kong	**7,811**	5,378	**759**	959	**8,570**	6,337
– Listed outside Hong Kong	**5,007**	4,982	**7,009**	7,119	**12,016**	12,101
	12,818	10,360	**7,768**	8,078	**20,586**	18,438
– Unlisted	**13,397**	18,768	**6,837**	8,711	**20,234**	27,479
	26,215	29,128	**14,605**	16,789	**40,820**	45,917
Certificates of deposit						
– Unlisted	**139**	145	**369**	1,197	**508**	1,342
Fund						
– Unlisted	**–**	–	**661**	636	**661**	636
Equity securities						
– Listed in Hong Kong	**3**	13	**880**	1,126	**883**	1,139
– Listed outside Hong Kong	**–**	–	**266**	86	**266**	86
	3	13	**1,146**	1,212	**1,149**	1,225
– Unlisted	**355**	212	**–**	–	**355**	212
	358	225	**1,146**	1,212	**1,504**	1,437
Total	**26,712**	29,498	**16,781**	19,834	**43,493**	49,332

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

	2013 HK$'m	2012 HK$'m
Sovereigns	**17,966**	22,729
Public sector entities*	**172**	267
Banks and other financial institutions	**13,065**	15,006
Corporate entities	**12,290**	11,330
	43,493	49,332

* Included financial assets at fair value through profit or loss of HK$156 million (2012: HK$168 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

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

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

	2013 HK$'m	2012 HK$'m
Treasury bills	**9,895**	17,210
Certificates of deposit	**508**	1,342
Other financial assets at fair value through profit or loss	**33,090**	30,780
	43,493	49,332

24. Derivative financial instruments and hedge accounting

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

Currency forwards represent commitments to purchase and sell foreign currency on a future date. Interest rate futures are contractual obligations to receive or pay a net amount based on changes in interest rates or buy or sell interest rate financial instruments on a future date at an agreed price in the financial market under the administration of the stock exchange. Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contract rate of interest and the current market rate, based on a notional principal amount.

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

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

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

24. Derivative financial instruments and hedge accounting (continued)

(a) *Derivative financial instruments*

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

Derivatives are also used to manage the interest rate risk of the banking book. A derivative instrument must be included in the approved product list before any transactions for that instrument can be made. There are limits to control the notional amount of exposure arising from derivative transactions, and the maximum tenor of the deal is set. Every derivative transaction must be input into the relevant system for settlement, mark-to-market revaluation, reporting and control.

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

	2013			
	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting HK$'m	Total HK$'m
Exchange rate contracts				
Spot, forwards and futures	302,252	–	641	302,893
Swaps	683,295	2,532	10,691	696,518
Foreign currency options				
– Options purchased	20,982	–	–	20,982
– Options written	23,457	–	–	23,457
	1,029,986	2,532	11,332	1,043,850
Interest rate contracts				
Futures	2,790	–	–	2,790
Swaps	267,140	86,803	4,177	358,120
	269,930	86,803	4,177	360,910
Commodity contracts	5,367	–	–	5,367
Equity contracts	2,099	–	–	2,099
Other contracts	59	–	–	59
Total	1,307,441	89,335	15,509	1,412,285

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

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

	2012			
	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting HK$'m	Total HK$'m
Exchange rate contracts				
Spot, forwards and futures	270,913	–	–	270,913
Swaps	680,377	3,174	7,451	691,002
Foreign currency options				
– Options purchased	4,821	–	–	4,821
– Options written	9,096	–	–	9,096
	965,207	3,174	7,451	975,832
Interest rate contracts				
Futures	235	–	–	235
Swaps	284,906	46,872	8,646	340,424
	285,141	46,872	8,646	340,659
Commodity contracts	20,481	–	–	20,481
Equity contracts	1,507	–	–	1,507
Other contracts	69	–	–	69
Total	1,272,405	50,046	16,097	1,338,548

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

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

	2013							
	Fair value assets				Fair value liabilities			
	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting HK$'m	Total HK$'m	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting HK$'m	Total HK$'m
Exchange rate contracts								
Spot, forwards and futures	14,208	–	–	14,208	(10,000)	–	(7)	(10,007)
Swaps	5,275	34	145	5,454	(4,953)	(43)	(167)	(5,163)
Foreign currency options								
– Options purchased	58	–	–	58	–	–	–	–
– Options written	–	–	–	–	(150)	–	–	(150)
	19,541	34	145	19,720	(15,103)	(43)	(174)	(15,320)
Interest rate contracts								
Futures	1	–	–	1	(1)	–	–	(1)
Swaps	1,767	3,359	5	5,131	(2,191)	(1,127)	(64)	(3,382)
	1,768	3,359	5	5,132	(2,192)	(1,127)	(64)	(3,383)
Commodity contracts	472	–	–	472	(185)	–	–	(185)
Equity contracts	24	–	–	24	(24)	–	–	(24)
Total	21,805	3,393	150	25,348	(17,504)	(1,170)	(238)	(18,912)

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

	2012							
	Fair value assets				Fair value liabilities			
	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting HK$'m	Total HK$'m	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting HK$'m	Total HK$'m
Exchange rate contracts								
Spot, forwards and futures	17,257	–	–	17,257	(13,001)	–	–	(13,001)
Swaps	7,476	42	119	7,637	(2,557)	(55)	(136)	(2,748)
Foreign currency options								
– Options purchased	23	–	–	23	–	–	–	–
– Options written	–	–	–	–	(28)	–	–	(28)
	24,756	42	119	24,917	(15,586)	(55)	(136)	(15,777)
Interest rate contracts								
Futures	1	–	–	1	–	–	–	–
Swaps	2,231	3,338	24	5,593	(3,157)	(1,693)	(89)	(4,939)
	2,232	3,338	24	5,594	(3,157)	(1,693)	(89)	(4,939)
Commodity contracts	818	–	–	818	(488)	–	–	(488)
Equity contracts	10	–	–	10	(10)	–	–	(10)
Total	27,816	3,380	143	31,339	(19,241)	(1,748)	(225)	(21,214)

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

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

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

	2013		
	Contract/ notional amount HK$'m	**Credit risk-weighted amount HK$'m**	**Fair value HK$'m**
Exchange rate contracts			
Spot, forwards and futures	**122,717**	**1,152**	**1,006**
Swaps	**631,019**	**4,129**	**5,291**
Foreign currency options			
– Options purchased	**20,592**	**144**	**60**
	774,328	**5,425**	**6,357**
Interest rate contracts			
Futures	**2,790**	**1**	**1**
Swaps	**358,570**	**1,541**	**4,795**
	361,360	**1,542**	**4,796**
Commodity contracts	**167**	**4**	**1**
Equity contracts	**2,099**	**144**	**27**
Total	**1,137,954**	**7,115**	**11,181**

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

	2012		
	Contract/ notional amount HK$'m	Credit risk-weighted amount HK$'m	Fair value HK$'m
Exchange rate contracts			
Spot, forwards and futures	79,292	462	416
Swaps	640,320	3,746	7,376
Foreign currency options			
– Options purchased	2,601	10	13
	722,213	4,218	7,805
Interest rate contracts			
Swaps	340,424	913	5,112
Commodity contracts	221	6	1
Equity contracts	720	38	2
Total	1,063,578	5,175	12,920

The fair values which were calculated after taking into account the effect of valid bilateral netting agreements for the Group amounted to HK$173 million (2012: Nil).

(b) Hedge accounting

The fair values of derivative financial instruments designated as hedging instruments as at 31 December are as follows:

	2013		2012	
	Assets HK$'m	**Liabilities HK$'m**	Assets HK$'m	Liabilities HK$'m
Fair value hedges	**3,359**	**(1,127)**	3,338	(1,693)
Cash flow hedges	**34**	**(43)**	42	(55)
	3,393	**(1,170)**	3,380	(1,748)

24. Derivative financial instruments and hedge accounting (continued)

(b) Hedge accounting (continued)

(i) Fair value hedges

The Group uses interest rate swaps to hedge against change in fair value of financial assets and liabilities arising from movements in market interest rates.

Gains or losses on fair value hedges reflected in net trading gain for the year are as follows:

	2013		2012	
	Hedged assets HK$'m	**Hedged liabilities HK$'m**	Hedged assets HK$'m	Hedged liabilities HK$'m
Net gain/(loss)				
– hedging instruments	**2,284**	**(1,467)**	(110)	590
– hedged items	**(2,284)**	**2,031**	86	(426)
	–	**564**	(24)	164

(ii) Cash flow hedges

The Group hedges a portion of foreign exchange risks that it expects to assume as a result of cash flows from certain fixed income securities using cross-currency interest rate swaps.

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

(iii) Hedges of net investments in foreign operations

As at 31 December 2013, a proportion of the Group's RMB-denominated deposits from customers of HK$1,888 million (2012: HK$1,834 million) were designated as a hedging instrument to hedge against the net investments in foreign operations.

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

25. Advances and other accounts

	2013 HK$'m	2012 HK$'m
Personal loans and advances	**254,545**	238,702
Corporate loans and advances	**603,787**	539,562
Advances to customers*	**858,332**	778,264
Loan impairment allowances		
– Individually assessed	**(840)**	(736)
– Collectively assessed	**(3,395)**	(2,969)
	854,097	774,559
Trade bills	**70,846**	45,180
Total	**924,943**	819,739

As at 31 December 2013, advances to customers included accrued interest of HK$1,344 million (2012: HK$1,434 million).

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

* Included advances to customers denominated in HK dollars of HK$552,769 million (2012: HK$520,638 million) and US dollars equivalent to HK$217,702 million (2012: HK$177,027 million).

26. Loan impairment allowances

	2013		
	Individual assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2013	26	710	736
(Credited)/charged to income statement (Note 12)	(4)	63	59
Loans written off during the year as uncollectible	(3)	(206)	(209)
Recoveries	11	243	254
Unwind of discount on impairment allowances	–	(6)	(6)
Exchange difference	–	6	6
At 31 December 2013	30	810	840

	2013		
	Collective assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2013	269	2,700	2,969
Charged to income statement (Note 12)	303	368	671
Loans written off during the year as uncollectible	(291)	(2)	(293)
Recoveries	34	–	34
Exchange difference	–	14	14
At 31 December 2013	315	3,080	3,395

26. Loan impairment allowances (continued)

	2012		
	Individual assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2012	28	231	259
(Credited)/charged to income statement (Note 12)	(16)	294	278
Loans written off during the year as uncollectible	(3)	(23)	(26)
Recoveries	17	217	234
Unwind of discount on impairment allowances	–	(10)	(10)
Exchange difference	–	1	1
At 31 December 2012	26	710	736

	2012		
	Collective assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2012	237	2,334	2,571
Charged to income statement (Note 12)	213	363	576
Loans written off during the year as uncollectible	(211)	(1)	(212)
Recoveries	30	–	30
Exchange difference	–	4	4
At 31 December 2012	269	2,700	2,969

27. Investment in securities

	2013 HK$'m	2012 HK$'m
The Group		
(a) Available-for-sale securities		
Debt securities, at fair value		
– Listed in Hong Kong	**27,134**	20,252
– Listed outside Hong Kong	**123,369**	110,594
	150,503	130,846
– Unlisted	**182,469**	247,410
	332,972	378,256
Certificates of deposit, at fair value		
– Listed in Hong Kong	**502**	–
– Listed outside Hong Kong	**686**	1,375
	1,188	1,375
– Unlisted	**76,889**	71,466
	78,077	72,841
Equity securities, at fair value		
– Listed in Hong Kong	**2,801**	2,592
– Unlisted	**1,470**	1,043
	4,271	3,635
	415,320	454,732
(b) Held-to-maturity securities		
Debt securities, at amortised cost		
– Listed in Hong Kong	**710**	948
– Listed outside Hong Kong	**12,353**	7,807
	13,063	8,755
– Unlisted	**4,300**	8,778
	17,363	17,533
Certificates of deposit, at amortised cost		
– Unlisted	**95**	874
	17,458	18,407
Impairment allowances	**(3)**	(9)
	17,455	18,398
(c) Loans and receivables		
Unlisted, at amortised cost	**7,945**	9,234
Total	**440,720**	482,364
Market value of listed held-to-maturity securities	**13,132**	8,983
The Company		
Available-for-sale securities		
Equity securities, at fair value		
– Listed in Hong Kong	**2,801**	2,528

27. Investment in securities (continued)

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

	2013			
	Available-for-sale securities HK$'m	**Held-to-maturity securities HK$'m**	**Loans and receivables HK$'m**	**Total HK$'m**
The Group				
Sovereigns	**53,060**	**2,318**	**–**	**55,378**
Public sector entities*	**46,292**	**137**	**–**	**46,429**
Banks and other financial institutions	**243,746**	**7,227**	**7,112**	**258,085**
Corporate entities	**72,222**	**7,773**	**833**	**80,828**
	415,320	**17,455**	**7,945**	**440,720**

	2012			
	Available-for-sale securities HK$'m	Held-to-maturity securities HK$'m	Loans and receivables HK$'m	Total HK$'m
The Group				
Sovereigns	152,583	3,208	–	155,791
Public sector entities*	39,913	1,278	–	41,191
Banks and other financial institutions	211,561	12,115	8,077	231,753
Corporate entities	50,675	1,797	1,157	53,629
	454,732	18,398	9,234	482,364

* Included available-for-sale securities of HK$24,530 million (2012: HK$20,974 million) and held-to-maturity securities of HK$58 million (2012: HK$248 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

As at 31 December 2013 and 2012, all of the available-for-sale securities held by the Company were issued by banks and other financial institutions.

27. Investment in securities (continued)

The movements in investment in securities are summarised as follows:

	2013		
	Available-for-sale securities HK$'m	**Held-to-maturity securities HK$'m**	**Loans and receivables HK$'m**
The Group			
At 1 January 2013	**454,732**	**18,398**	**9,234**
Additions	**547,165**	**1,102**	**12,927**
Disposals, redemptions and maturity	**(553,997)**	**(8,590)**	**(14,321)**
Amortisation	**(157)**	**46**	**100**
Change in fair value	**(8,854)**	**–**	**–**
Net reversal of impairment allowances	**–**	**5**	**–**
Reclassification	**(6,797)**	**6,797**	**–**
Exchange difference	**(16,772)**	**(303)**	**5**
At 31 December 2013	**415,320**	**17,455**	**7,945**

	2012		
	Available-for-sale securities HK$'m	Held-to-maturity securities HK$'m	Loans and receivables HK$'m
The Group			
At 1 January 2012	316,398	53,927	6,673
Additions	865,481	12,687	16,446
Disposals, redemptions and maturity	(728,314)	(47,895)	(14,146)
Amortisation	380	(215)	90
Change in fair value	5,484	–	–
Net reversal of impairment allowances	–	3	–
Exchange difference	(4,697)	(109)	171
At 31 December 2012	454,732	18,398	9,234

27. Investment in securities (continued)

	Available-for-sale securities	
	2013 HK$'m	2012 HK$'m
The Company		
At 1 January	**2,528**	2,506
Change in fair value	**273**	22
At 31 December	**2,801**	2,528

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

	Available-for-sale securities		Held-to-maturity securities	
	2013 HK$'m	2012 HK$'m	**2013 HK$'m**	2012 HK$'m
The Group				
Treasury bills	**33,975**	115,637	**585**	885
Certificates of deposit	**78,077**	72,841	**95**	874
Others	**303,268**	266,254	**16,775**	16,639
	415,320	454,732	**17,455**	18,398

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

	2013 HK$'m	2012 HK$'m
The Group		
At 1 January	**9**	25
Credited to income statement (Note 12)	**(5)**	(3)
Disposals	**(1)**	(13)
At 31 December	**3**	9

During the year 2013, the Group reclassified certain debt securities with fair value of HK$6,797 million out of available-for-sale category into held-to-maturity category. The Group had the intention and ability to hold these reclassified debt securities until maturity at the date of reclassification.

28. Investment in subsidiaries

	2013 HK$'m	2012 HK$'m
The Company		
Unlisted shares, at cost	**54,834**	54,834

The particulars of all direct and indirect subsidiaries of the Company are set out in the Appendix of this Annual Report, "Subsidiaries of the Company". The following is a list of principal subsidiaries as at 31 December 2013:

Name	Place of incorporation and operation	Particulars of issued share capital/ registered capital	Interest held	Principal activities
Bank of China (Hong Kong) Limited	Hong Kong	43,042,840,858 ordinary shares of HK$1 each	*100%	Banking business
BOC Group Life Assurance Company Limited	Hong Kong	303,800,000 ordinary shares of HK$10 each	*51%	Life insurance business
Nanyang Commercial Bank, Limited	Hong Kong	7,000,000 ordinary shares of HK$100 each	100%	Banking business
Chiyu Banking Corporation Limited	Hong Kong	3,000,000 ordinary shares of HK$100 each	70.49%	Banking business
BOC Credit Card (International) Limited	Hong Kong	4,800,000 ordinary shares of HK$100 each	100%	Credit card services
Po Sang Futures Limited	Hong Kong	950,000 ordinary shares of HK$100 each	100%	Securities and futures brokerage
Nanyang Commercial Bank (China), Limited	PRC	Registered capital RMB6,500,000,000	100%	Banking business

* Shares held directly by the Company

28. Investment in subsidiaries (continued)

The particulars of subsidiary with significant non-controlling interests are as follows:

BOC Group Life Assurance Company Limited

	2013	2012
Proportion of ownership interests and voting rights held by non-controlling interests	**49%**	49%

	2013 HK$'m	2012 HK$'m
Profit attributable to non-controlling interests	**526**	300
Accumulated non-controlling interests	**2,158**	2,080
Summarised financial information:		
– total assets	**79,580**	66,150
– total liabilities	**75,176**	61,904
– profit for the year	**1,072**	614
– total comprehensive income for the year	**159**	1,228

29. Interests in associates and a joint venture

	2013 HK$'m	2012 HK$'m
At 1 January	**259**	234
Share of results	**42**	35
Share of tax	**(7)**	(8)
Dividend received	**(2)**	(2)
At 31 December	**292**	259

29. Interests in associates and a joint venture (continued)

The particulars of the Group's associates and joint venture, all of which are unlisted, are as follows:

Name	Place of incorporation and operation	Particulars of issued share capital/ registered capital	Interest held	Principal activities
Associates:				
BOC Services Company Limited	PRC	Registered capital RMB50,000,000	45.00%	Credit card back-end service support
BOC Expresspay Company Limited	PRC	Registered capital RMB450,000,000	25.33%	Prepay debit card services
Joint Venture:				
Joint Electronic Teller Services Limited	Hong Kong	100,238 ordinary shares of HK$100 each	19.96%	Operation of a private inter-bank message switching network in respect of ATM services

	Associates		Joint venture	
	2013 HK$'m	2012 HK$'m	**2013 HK$'m**	2012 HK$'m
Interests in associates/joint venture	**232**	199	**60**	60
Share of profit/total comprehensive income for the year of associates/joint venture	**33**	25	**2**	2

30. Investment properties

	2013 HK$'m	2012 HK$'m
At 1 January	**14,364**	12,441
Additions	**2**	2
Disposals	**–**	(62)
Fair value gains (Note 14)	**264**	1,885
Reclassification (to)/from properties, plant and equipment (Note 31)	**(34)**	98
Exchange difference	**1**	–
At 31 December	**14,597**	14,364

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

	2013 HK$'m	2012 HK$'m
Held in Hong Kong		
On long-term lease (over 50 years)	**2,893**	2,754
On medium-term lease (10 to 50 years)	**11,436**	11,361
Held outside Hong Kong		
On medium-term lease (10 to 50 years)	**248**	249
On short-term lease (less than 10 years)	**20**	–
	14,597	14,364

As at 31 December 2013, investment properties are included in the balance sheet at valuation carried out at 31 December 2013 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited. The fair value represents the price that would be received to sell each investment property in an orderly transaction with market participants at the measurement date.

31. Properties, plant and equipment

	Premises HK$'m	Equipment, fixtures and fittings HK$'m	Total HK$'m
Net book value at 1 January 2013	**46,178**	**2,565**	**48,743**
Additions	**376**	**720**	**1,096**
Disposals	**(1)**	**(16)**	**(17)**
Revaluation	**4,143**	**–**	**4,143**
Depreciation for the year (Note 13)	**(953)**	**(710)**	**(1,663)**
Reclassification from investment properties (Note 30)	**34**	**–**	**34**
Exchange difference	**14**	**8**	**22**
Net book value at 31 December 2013	**49,791**	**2,567**	**52,358**
At 31 December 2013			
Cost or valuation	**49,791**	**8,275**	**58,066**
Accumulated depreciation and impairment	**–**	**(5,708)**	**(5,708)**
Net book value at 31 December 2013	**49,791**	**2,567**	**52,358**
The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2013			
At cost	**–**	**8,275**	**8,275**
At valuation	**49,791**	**–**	**49,791**
	49,791	**8,275**	**58,066**
Net book value at 1 January 2012	37,049	2,601	39,650
Additions	358	687	1,045
Disposals	(147)	(9)	(156)
Revaluation	9,792	–	9,792
Depreciation for the year (Note 13)	(778)	(715)	(1,493)
Reclassification to investment properties (Note 30)	(98)	–	(98)
Exchange difference	2	1	3
Net book value at 31 December 2012	46,178	2,565	48,743
At 31 December 2012			
Cost or valuation	46,178	7,793	53,971
Accumulated depreciation and impairment	–	(5,228)	(5,228)
Net book value at 31 December 2012	46,178	2,565	48,743
The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2012			
At cost	–	7,793	7,793
At valuation	46,178	–	46,178
	46,178	7,793	53,971

31. Properties, plant and equipment (continued)

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

	2013 HK$'m	2012 HK$'m
Held in Hong Kong		
On long-term lease (over 50 years)	**18,774**	16,913
On medium-term lease (10 to 50 years)	**30,250**	28,547
Held outside Hong Kong		
On long-term lease (over 50 years)	**74**	65
On medium-term lease (10 to 50 years)	**675**	632
On short-term lease (less than 10 years)	**18**	21
	49,791	46,178

As at 31 December 2013, premises are included in the balance sheet at valuation carried out at 31 December 2013 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited. The fair value represents the price that would be received to sell each premises in an orderly transaction with market participants at the measurement date.

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

	2013 HK$'m	2012 HK$'m
Increase in valuation credited to premises revaluation reserve	**4,078**	9,718
Increase/(decrease) in valuation credited/(charged) to income statement (Note 15)	**14**	(4)
Increase in valuation credited to non-controlling interests	**51**	78
	4,143	9,792

As at 31 December 2013, the net book value of premises that would have been included in the Group's balance sheet had the premises been carried at cost less accumulated depreciation and impairment losses was HK$7,221 million (2012: HK$6,904 million).

32. Other assets

	2013 HK$'m	2012 HK$'m
Repossessed assets	**64**	18
Precious metals	**5,146**	6,610
Reinsurance assets	**23,937**	14,671
Accounts receivable and prepayments	**16,109**	15,532
	45,256	36,831

33. Hong Kong SAR currency notes in circulation

The Hong Kong SAR currency notes in circulation are secured by deposit of funds in respect of which the Hong Kong SAR Government certificates of indebtedness are held.

34. Financial liabilities at fair value through profit or loss

	2013 HK$'m	2012 HK$'m
Trading liabilities		
– Short positions in Exchange Fund Bills and Notes	**9,748**	17,331
Financial liabilities designated at fair value through profit or loss		
– Structured deposits (Note 35)	**3,832**	2,841
	13,580	20,172

The carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2013 was less than the amount that the Group would be contractually required to pay at maturity to the holders by HK$6 million (the carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2012 was more than the amount that the Group would be contractually required to pay at maturity to the holders by HK$1 million). The amount of change in the fair values of financial liabilities at fair value through profit or loss, during the year and cumulatively, attributable to changes in own credit risk was insignificant.

35. Deposits from customers

	2013 HK$'m	2012 HK$'m
Current, savings and other deposit accounts (per balance sheet)	**1,324,148**	1,226,290
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 34)	**3,832**	2,841
	1,327,980	1,229,131
Analysed by:		
Demand deposits and current accounts		
– corporate	**81,162**	76,742
– personal	**23,622**	20,553
	104,784	97,295
Savings deposits		
– corporate	**224,970**	202,846
– personal	**411,167**	400,719
	636,137	603,565
Time, call and notice deposits		
– corporate	**350,381**	298,902
– personal	**236,678**	229,369
	587,059	528,271
	1,327,980	1,229,131

36. Debt securities in issue at amortised cost

	2013 HK$'m	2012 HK$'m
Senior notes under the Medium Term Note Programme	**5,684**	5,919
Other debt securities	**–**	4
	5,684	5,923

37. Other accounts and provisions

	2013 HK$'m	2012 HK$'m
Other accounts payable	**47,803**	47,639
Provisions	**346**	344
	48,149	47,983

38. Assets pledged as security

As at 31 December 2013, liabilities of the Group amounting to HK$11,529 million (2012: HK$18,029 million) were secured by assets deposited with central depositories to facilitate settlement operations. In addition, the liabilities of the Group amounting to HK$3,394 million (2012: HK$438 million) were secured by debt securities and bills related to sale and repurchase arrangements. The amount of assets pledged by the Group to secure these liabilities was HK$15,031 million (2012: HK$18,596 million) mainly included in "Trading securities", "Available-for-sale securities" and "Trade bills".

39. Deferred taxation

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

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

	2013					
	Accelerated tax depreciation HK$'m	Property revaluation HK$'m	Losses HK$'m	Impairment allowance HK$'m	Other temporary differences HK$'m	Total HK$'m
At 1 January 2013	564	6,772	(144)	(492)	617	7,317
Charged/(credited) to income statement (Note 16)	17	(91)	52	(100)	(16)	(138)
Charged/(credited) to other comprehensive income	–	666	–	–	(1,203)	(537)
Exchange difference	–	1	–	(2)	(1)	(2)
At 31 December 2013	581	7,348	(92)	(594)	(603)	6,640

	2012					
	Accelerated tax depreciation HK$'m	Property revaluation HK$'m	Losses HK$'m	Impairment allowance HK$'m	Other temporary differences HK$'m	Total HK$'m
At 1 January 2012	547	5,299	(131)	(451)	(109)	5,155
Charged/(credited) to income statement (Note 16)	17	(128)	(13)	(41)	(4)	(169)
Charged to other comprehensive income	–	1,601	–	–	730	2,331
At 31 December 2012	564	6,772	(144)	(492)	617	7,317

39. Deferred taxation (continued)

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

	2013 HK$'m	2012 HK$'m
Deferred tax assets	**(304)**	(89)
Deferred tax liabilities	**6,944**	7,406
	6,640	7,317

	2013 HK$'m	2012 HK$'m
Deferred tax assets to be recovered after more than twelve months	**(85)**	(154)
Deferred tax liabilities to be settled after more than twelve months	**7,391**	6,847
	7,306	6,693

As at 31 December 2013, the Group has not recognised deferred tax assets in respect of tax losses amounting to HK$7 million (2012: HK$718 million). These tax losses do not expire under the current tax legislation.

40. Insurance contract liabilities

	2013 HK$'m	2012 HK$'m
At 1 January	**53,937**	47,220
Benefits paid	**(5,798)**	(7,169)
Claims incurred and movement in liabilities	**18,498**	13,886
At 31 December	**66,637**	53,937

The insurance contract liabilities that are covered by reinsurance arrangements amounted to HK$23,902 million (2012: HK$14,644 million) and the associated reinsurance assets of HK$23,937 million (2012: HK$14,671 million) are included in "Other assets" (Note 32).

41. Subordinated liabilities

	2013 HK$'m	2012 HK$'m
Subordinated loans, at amortised cost		
EUR660m*	–	6,749
Subordinated notes, at amortised cost with fair value hedge adjustment		
USD2,500m**	**19,849**	22,006
Total	**19,849**	28,755

In 2008, BOCHK obtained floating-rate subordinated loans from BOC, the intermediate holding company of the Group. The subordinated loans are repayable prior to maturity after the first 5-year tenure at the option of the borrower. During the year, HKMA has approved BOCHK to early repay the subordinated loans.

In 2010, BOCHK issued listed subordinated notes with an aggregate amount of USD2,500 million.

Amounts qualified as Tier 2 capital instruments/supplementary capital for regulatory purposes are shown in Note 4.5(C).

* Interest rate at 6-month EURIBOR plus 0.85% for the first 5 years, 6-month EURIBOR plus 1.35% for the remaining tenure payable semi-annually, due June 2018. It has been fully repaid during the year.

** Interest rate at 5.55% per annum payable semi-annually, due February 2020.

42. Share capital

	2013 HK$'m	2012 HK$'m
Authorised:		
20,000,000,000 ordinary shares of HK$5 each	**100,000**	100,000
Issued and fully paid:		
10,572,780,266 ordinary shares of HK$5 each	**52,864**	52,864

43. Reserves

The Group's and the Company's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity and statement of changes in equity respectively on pages 103 to 104 of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

44. Notes to consolidated cash flow statement

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

	2013 HK$'m	2012 HK$'m
Operating profit	**27,493**	23,499
Depreciation	**1,663**	1,493
Net charge of impairment allowances	**737**	859
Unwind of discount on impairment allowances	**(6)**	(10)
Advances written off net of recoveries	**(214)**	26
Change in subordinated liabilities	**(1,744)**	703
Change in balances with banks and other financial institutions with original maturity over three months	**(3,896)**	(7,794)
Change in placements with banks and other financial institutions with original maturity over three months	**33,223**	34,466
Change in financial assets at fair value through profit or loss	**2,082**	568
Change in derivative financial instruments	**3,689**	(5,619)
Change in advances and other accounts	**(105,734)**	(65,385)
Change in investment in securities	**(6,023)**	(104,150)
Change in other assets	**(8,437)**	(11,077)
Change in deposits and balances from banks and other financial institutions	**99,067**	(57,488)
Change in financial liabilities at fair value through profit or loss	**(6,592)**	16,935
Change in deposits from customers	**97,858**	80,339
Change in debt securities in issue at amortised cost	**(239)**	(62)
Change in other accounts and provisions	**166**	6,172
Change in insurance contract liabilities	**12,700**	6,717
Effect of changes in exchange rates	**(570)**	3,862
Operating cash inflow/(outflow) before taxation	**145,223**	(75,946)
Cash flows from operating activities included:		
– Interest received	**38,611**	35,297
– Interest paid	**11,129**	9,704
– Dividend received	**127**	117

44. Notes to consolidated cash flow statement (continued)

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

	2013 HK$'m	2012 HK$'m
Cash and balances with banks and other financial institutions with original maturity within three months	**330,408**	179,311
Placements with banks and other financial institutions with original maturity within three months	**22,044**	8,152
Treasury bills with original maturity within three months	**10,024**	53,912
Certificates of deposit with original maturity within three months	**725**	1,580
	363,201	242,955

45. Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment and the aggregate credit risk-weighted amount and is prepared with reference to the Completion Instructions for the HKMA return of capital adequacy ratio.

	2013 HK$'m	2012 HK$'m
Direct credit substitutes	**17,555**	14,168
Transaction-related contingencies	**12,929**	11,681
Trade-related contingencies	**56,269**	45,412
Commitments that are unconditionally cancellable without prior notice	**361,772**	320,777
Other commitments with an original maturity of		
– up to one year	**6,601**	18,988
– over one year	**67,879**	52,743
	523,005	463,769
Credit risk-weighted amount	**55,353**	59,008

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

46. Capital commitments

The Group has the following outstanding capital commitments not provided for in the financial statements:

	2013 HK$'m	2012 HK$'m
Authorised and contracted for but not provided for	**350**	325
Authorised but not contracted for	**11**	1
	361	326

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

47. Operating lease commitments

(a) The Group as lessee

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

	2013 HK$'m	2012 HK$'m
Land and buildings		
– not later than one year	**714**	697
– later than one year but not later than five years	**1,188**	1,209
– later than five years	**323**	446
	2,225	2,352

Certain non-cancellable operating leases included in the table above were subject to renegotiation and rent adjustment with reference to market rates prevailing at specified agreed dates or according to the special conditions as stipulated in the leases.

(b) The Group as lessor

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

	2013 HK$'m	2012 HK$'m
Land and buildings		
– not later than one year	**402**	410
– later than one year but not later than five years	**416**	272
	818	682

The Group leases its investment properties (Note 30) under operating lease arrangements, with leases typically for a period from one to three years. The terms of the leases generally require the tenants to pay security deposits and provide for rent adjustments according to the prevailing market conditions at the expiration of the lease.

48. Litigation

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

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

49. Segmental reporting

The Group manages the business mainly from a business segment perspective and over 90% of the Group's revenues, profits before tax and assets are derived from Hong Kong. Currently, four operating segments are identified which are Personal Banking, Corporate Banking, Treasury and Insurance. The classification of the Group's operating segments is based on customer segment and product type, which is aligned with the RPC (relationship, product and channel) management model of the Group.

Both Personal Banking and Corporate Banking provide general banking services including various deposit products, overdrafts, loans, credit cards, trade related products and other credit facilities, investment and insurance products, and foreign currency and derivative products, etc. Personal Banking mainly serves retail customers while Corporate Banking mainly deals with corporate customers. Treasury manages the funding and liquidity, and the interest rate and foreign exchange positions of the Group in addition to proprietary trades. The Insurance segment represents business mainly relating to life insurance products, including traditional and unit-linked individual life insurance and group life insurance products. "Others" mainly represents Group's holdings of premises, investment properties, equity investments and interests in associates and a joint venture.

Measurement of segment assets, liabilities, income, expenses, results and capital expenditure is based on the Group's accounting policies. The segment information includes items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Inter-segment funding is charged according to the internal funds transfer pricing mechanism of the Group, which is primarily based on market rates with the consideration of specific features of the product.

As the Group derives a majority of revenue from interest and the senior management relies primarily on net interest income in managing the business, interest income and expense for all reportable segments are presented on a net basis. Under the same consideration, insurance premium income and insurance benefits and claims are also presented on a net basis.

49. Segmental reporting (continued)

	2013							
	Personal Banking HK$'m	Corporate Banking HK$'m	Treasury HK$'m	Insurance HK$'m	Others HK$'m	Subtotal HK$'m	Eliminations HK$'m	Consolidated HK$'m
Net interest income/(expense)								
– external	1,836	9,630	14,547	1,900	3	27,916	–	27,916
– inter-segment	5,757	2,274	(7,550)	14	(495)	–	–	–
	7,593	11,904	6,997	1,914	(492)	27,916	–	27,916
Net fee and commission income/(expense)	5,324	3,576	144	(65)	385	9,364	(399)	8,965
Net insurance premium income	–	–	–	9,185	–	9,185	(15)	9,170
Net trading gain/(loss)	734	337	2,201	(169)	(161)	2,942	15	2,957
Net loss on financial instruments designated at fair value through profit or loss	–	–	(27)	(132)	–	(159)	–	(159)
Net gain/(loss) on other financial assets	–	21	179	(63)	(54)	83	–	83
Other operating income	48	4	3	7	1,646	1,708	(1,054)	654
Total operating income	13,699	15,842	9,497	10,677	1,324	51,039	(1,453)	49,586
Net insurance benefits and claims	–	–	–	(9,273)	–	(9,273)	–	(9,273)
Net operating income before impairment allowances	13,699	15,842	9,497	1,404	1,324	41,766	(1,453)	40,313
Net (charge)/reversal of impairment allowances	(289)	(453)	5	–	–	(737)	–	(737)
Net operating income	13,410	15,389	9,502	1,404	1,324	41,029	(1,453)	39,576
Operating expenses	(6,477)	(3,544)	(1,155)	(259)	(2,101)	(13,536)	1,453	(12,083)
Operating profit/(loss)	6,933	11,845	8,347	1,145	(777)	27,493	–	27,493
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	264	264	–	264
Net (loss)/gain from disposal/revaluation of properties, plant and equipment	(7)	(1)	–	(1)	10	1	–	1
Share of profits less losses after tax of associates and a joint venture	–	–	–	–	35	35	–	35
Profit/(loss) before taxation	6,926	11,844	8,347	1,144	(468)	27,793	–	27,793
Assets								
Segment assets	286,067	662,806	962,077	79,580	70,050	2,060,580	(13,936)	2,046,644
Interests in associates and a joint venture	–	–	–	–	292	292	–	292
	286,067	662,806	962,077	79,580	70,342	2,060,872	(13,936)	2,046,936
Liabilities								
Segment liabilities	738,429	625,842	445,973	75,176	12,444	1,897,864	(13,936)	1,883,928
Other information								
Capital expenditure	28	4	–	6	1,060	1,098	–	1,098
Depreciation	341	188	77	10	1,047	1,663	–	1,663
Amortisation of securities	–	–	(156)	145	–	(11)	–	(11)

49. Segmental reporting (continued)

	2012 (Restated)							
	Personal Banking HK$'m	Corporate Banking HK$'m	Treasury HK$'m	Insurance HK$'m	Others HK$'m	Subtotal HK$'m	Eliminations HK$'m	Consolidated HK$'m
Net interest income/(expense)								
– external	932	8,784	13,229	1,757	6	24,708	–	24,708
– inter-segment	5,725	1,085	(6,288)	–	(522)	–	–	–
	6,657	9,869	6,941	1,757	(516)	24,708	–	24,708
Net fee and commission income/(expense)	4,316	3,338	138	(67)	247	7,972	(209)	7,763
Net insurance premium income	–	–	–	6,466	–	6,466	(15)	6,451
Net trading gain/(loss)	559	364	1,873	359	(34)	3,121	8	3,129
Net gain on financial instruments designated at fair value through profit or loss	–	–	42	705	–	747	–	747
Net (loss)/gain on other financial assets	–	(2)	623	129	–	750	–	750
Other operating income	50	3	8	14	1,429	1,504	(915)	589
Total operating income	11,582	13,572	9,625	9,363	1,126	45,268	(1,131)	44,137
Net insurance benefits and claims	–	–	–	(8,520)	–	(8,520)	–	(8,520)
Net operating income before impairment allowances	11,582	13,572	9,625	843	1,126	36,748	(1,131)	35,617
Net (charge)/reversal of impairment allowances	(214)	(650)	16	(11)	–	(859)	–	(859)
Net operating income	11,368	12,922	9,641	832	1,126	35,889	(1,131)	34,758
Operating expenses	(5,852)	(3,196)	(1,259)	(223)	(1,860)	(12,390)	1,131	(11,259)
Operating profit/(loss)	5,516	9,726	8,382	609	(734)	23,499	–	23,499
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	1,889	1,889	–	1,889
Net (loss)/gain from disposal/revaluation of properties, plant and equipment	(3)	(1)	–	–	110	106	–	106
Share of profits less losses after tax of associates and a joint venture	–	–	–	–	27	27	–	27
Profit before taxation	5,513	9,725	8,382	609	1,292	25,521	–	25,521
Assets								
Segment assets	266,839	573,803	870,488	66,150	65,760	1,843,040	(12,536)	1,830,504
Interests in associates and a joint venture	–	–	–	–	259	259	–	259
	266,839	573,803	870,488	66,150	66,019	1,843,299	(12,536)	1,830,763
Liabilities								
Segment liabilities	716,696	551,508	346,561	61,904	11,556	1,688,225	(12,536)	1,675,689
Other information								
Capital expenditure	27	8	–	15	997	1,047	–	1,047
Depreciation	324	169	90	6	904	1,493	–	1,493
Amortisation of securities	–	–	190	65	–	255	–	255

Certain comparative amounts of operating expenses have been reclassified to net fee and commission income to conform with the current year's presentation.

50. Offsetting financial instruments

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

	2013					
				Related amounts not set off in the balance sheet		
	Gross amounts of recognised financial assets HK$'m	Gross amounts of recognised financial liabilities set off in the balance sheet HK$'m	Net amounts of financial assets presented in the balance sheet HK$'m	Financial instruments HK$'m	Cash collateral received HK$'m	Net amount HK$'m
Assets						
Derivative financial instruments	11,450	–	11,450	(6,732)	(1,826)	2,892
Other assets	13,286	(8,532)	4,754	–	–	4,754
Total	24,736	(8,532)	16,204	(6,732)	(1,826)	7,646

	2013					
				Related amounts not set off in the balance sheet		
	Gross amounts of recognised financial liabilities HK$'m	Gross amounts of recognised financial assets set off in the balance sheet HK$'m	Net amounts of financial liabilities presented in the balance sheet HK$'m	Financial instruments HK$'m	Cash collateral pledged HK$'m	Net amount HK$'m
Liabilities						
Derivative financial instruments	9,263	–	9,263	(6,732)	–	2,531
Repurchase agreements	2,100	–	2,100	(2,100)	–	–
Other liabilities	8,784	(8,532)	252	–	–	252
Total	20,147	(8,532)	11,615	(8,832)	–	2,783

50. Offsetting financial instruments (continued)

	2012					
	Gross amounts of recognised financial assets HK$'m	Gross amounts of recognised financial liabilities set off in the balance sheet HK$'m	Net amounts of financial assets presented in the balance sheet HK$'m	Related amounts not set off in the balance sheet: Financial instruments HK$'m	Related amounts not set off in the balance sheet: Cash collateral received HK$'m	Net amount HK$'m
Assets						
Derivative financial instruments	13,542	–	13,542	(6,292)	(3,245)	4,005
Other assets	15,452	(9,939)	5,513	–	–	5,513
Total	28,994	(9,939)	19,055	(6,292)	(3,245)	9,518

	2012					
	Gross amounts of recognised financial liabilities HK$'m	Gross amounts of recognised financial assets set off in the balance sheet HK$'m	Net amounts of financial liabilities presented in the balance sheet HK$'m	Related amounts not set off in the balance sheet: Financial instruments HK$'m	Related amounts not set off in the balance sheet: Cash collateral pledged HK$'m	Net amount HK$'m
Liabilities						
Derivative financial instruments	8,182	–	8,182	(6,292)	–	1,890
Other liabilities	10,456	(9,939)	517	–	–	517
Total	18,638	(9,939)	8,699	(6,292)	–	2,407

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

51. Transfers of financial assets

The transferred financial assets below that do not qualify for derecognition are debt securities held by counterparties as collateral under sale and repurchase agreements.

	2013	
	Carrying amount of transferred assets HK$'m	**Carrying amount of associated liabilities HK$'m**
Repurchase agreements	**2,100**	**2,100**

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

52. Loans to directors and officers

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

	2013 HK$'m	2012 HK$'m
Aggregate amount of relevant transactions outstanding at year end	**3,790**	5,865
Maximum aggregate amount of relevant transactions outstanding during the year	**7,661**	7,316

53. Significant related party transactions

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

The significant related party transactions are defined according to HKAS 24 while the connected transactions are defined by Chapter 14A of the Listing Rules. The details of connected transactions are set out in "Connected transactions" on page 271.

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

General information of the parent companies:

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

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

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

The majority of transactions with BOC arise from money market activities. As at 31 December 2013, the related aggregate amounts due from and to BOC of the Group were HK$130,693 million (2012: HK$59,739 million) and HK$41,263 million (2012: HK$46,429 million) respectively. The aggregate amounts of income and expenses of the Group arising from these transactions with BOC for the year ended 31 December 2013 were HK$2,278 million (2012: HK$2,252 million) and HK$146 million (2012: HK$148 million) respectively. Transactions with other companies controlled by BOC are not considered material.

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

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

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

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

53. Significant related party transactions (continued)

(c) *Summary of transactions entered into during the ordinary course of business with associates, a joint venture and other related parties*

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

	2013		2012	
	Associates and joint venture HK$'m	**Other related parties HK$'m**	Associates and joint venture HK$'m	Other related parties HK$'m
Income statement items:				
Administrative services fees received/receivable	**–**	**9**	–	8
Other operating expenses	**49**	**–**	–	–
Balance sheet items:				
Deposits from customers	**22**	**–**	34	–
Other accounts and provisions	**–**	**–**	5	–

(d) *Key management personnel*

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

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

	2013 HK$'m	2012 HK$'m
Salaries and other short-term employee benefits	**66**	66
Post-employment benefits	**1**	1
	67	67

54. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions and is prepared with reference to the Completion Instructions for the prudential return "Foreign Currency Position of an Authorised Institution" issued by the HKMA. The net options position is calculated based on the basis of delta-weighted positions of all foreign exchange options contracts.

	2013							
	Equivalent in million of HK$							
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi	Other foreign currencies	Total foreign currencies
Spot assets	537,034	1,093	11,963	22,583	1,447	589,995	16,566	1,180,681
Spot liabilities	(387,497)	(3,797)	(11,663)	(31,203)	(12,441)	(540,509)	(17,849)	(1,004,959)
Forward purchases	438,862	42,992	49,900	34,026	25,008	197,747	36,646	825,181
Forward sales	(581,245)	(40,424)	(50,197)	(25,635)	(14,046)	(239,842)	(35,547)	(986,936)
Net options position	2,416	–	(1)	(5)	4	(2,991)	(5)	(582)
Net long/(short) position	9,570	(136)	2	(234)	(28)	4,400	(189)	13,385
Net structural position	333	–	–	–	–	9,075	–	9,408

	2012							
	Equivalent in million of HK$							
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi	Other foreign currencies	Total foreign currencies
Spot assets	480,099	81,033	17,279	24,874	4,336	374,118	17,313	999,052
Spot liabilities	(357,163)	(3,736)	(19,074)	(25,594)	(13,308)	(359,234)	(19,321)	(797,430)
Forward purchases	438,027	39,150	36,876	27,824	32,925	169,229	30,962	774,993
Forward sales	(543,759)	(116,379)	(35,207)	(27,018)	(24,226)	(184,128)	(28,746)	(959,463)
Net options position	(53)	(3)	5	(4)	8	(17)	(21)	(85)
Net long/(short) position	17,151	65	(121)	82	(265)	(32)	187	17,067
Net structural position	321	–	–	–	–	8,583	–	8,904

55. Cross-border claims

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

	2013			
	Banks HK$'m	**Public sector entities* HK$'m**	**Others HK$'m**	**Total HK$'m**
Asia, other than Hong Kong				
– Mainland of China	**399,428**	**128,223**	**150,889**	**678,540**
– Japan	**11,554**	**6,277**	**143**	**17,974**
– Others	**38,480**	**3,164**	**31,839**	**73,483**
	449,462	**137,664**	**182,871**	**769,997**
North America				
– United States	**1,221**	**33,461**	**38,559**	**73,241**
– Others	**7,101**	**2,126**	**282**	**9,509**
	8,322	**35,587**	**38,841**	**82,750**
Total	**457,784**	**173,251**	**221,712**	**852,747**

	2012			
	Banks HK$'m	Public sector entities* HK$'m	Others HK$'m	Total HK$'m
Asia, other than Hong Kong				
– Mainland of China	272,511	81,892	128,295	482,698
– Japan	7,283	81,320	158	88,761
– Others	49,874	4,410	24,687	78,971
	329,668	167,622	153,140	650,430
North America				
– United States	2,439	46,397	34,290	83,126
– Others	12,990	1,392	276	14,658
	15,429	47,789	34,566	97,784
Total	345,097	215,411	187,706	748,214

* Included United States of HK$10,523 million (2012: HK$10,442 million) and other countries in North America of HK$2,126 million (2012: HK$1,355 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

56. Non-bank Mainland exposures

The analysis of non-bank Mainland exposures is based on the categories of non-bank counterparties and the type of direct exposures with reference to the Completion Instructions for the HKMA return of non-bank Mainland exposures. The Group's Mainland exposures arising from non-bank counterparties are summarised as follows:

	2013			
	On-balance sheet exposure HK$'m	**Off-balance sheet exposure HK$'m**	**Total exposure HK$'m**	**Individually assessed impairment allowances HK$'m**
Mainland entities	**373,439**	**82,774**	**456,213**	**234**
Companies and individuals outside Mainland where the credit is granted for use in Mainland	**52,238**	**15,745**	**67,983**	**135**
Other non-bank Mainland exposures	**25,375**	**1,651**	**27,026**	**15**
	451,052	**100,170**	**551,222**	**384**

	2012			
	On-balance sheet exposure HK$'m	Off-balance sheet exposure HK$'m	Total exposure HK$'m	Individually assessed impairment allowances HK$'m
Mainland entities	317,910	70,998	388,908	142
Companies and individuals outside Mainland where the credit is granted for use in Mainland	44,283	16,191	60,474	16
Other non-bank Mainland exposures	23,213	2,600	25,813	67
	385,406	89,789	475,195	225

57. Ultimate holding company

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

58. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 26 March 2014.