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, 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 management to exercise its 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.

(a) Standards, amendments and interpretations already effective for accounting periods beginning on 1 January 2009

Standard/ Interpretation	Content	Applicable for financial years beginning on/after	Relevant to the Group
HKAS 1 (Revised)	Presentation of Financial Statements	1 January 2009	Yes
HKAS 23 (Revised)	Borrowing Costs	1 January 2009	No
HKAS 32 and HKAS 1 (Amendments)	Puttable Financial Instruments and Obligations Arising on Liquidation	1 January 2009	No
HKFRS 1 and HKAS 27 (Amendments)	Cost of an investment in a Subsidiary, Jointly Controlled Entity or Associate	1 January 2009	No
HKFRS 2 (Amendment)	Share based payments – Vesting Conditions and Cancellations	1 January 2009	No
HKFRS 7 (Amendment)	Improving Disclosures about Financial Instruments	1 January 2009	Yes
HKFRS 8	Operating Segments	1 January 2009	Yes
HK(IFRIC)-Int 13	Customer Loyalty Programmes	1 July 2008	Yes
HK(IFRIC)-Int 15	Agreements for the Construction of Real Estate	1 January 2009	No
HK(IFRIC)-Int 16	Hedges of a Net Investment in a Foreign Operation	1 October 2008	No

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretations already effective for accounting periods beginning on 1 January 2009 (continued)

- *HKAS 1 Presentation of Financial Statements (Revised)*

  The revised standard prohibits the presentation of items of income and expenses (that is 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All 'non-owner changes in equity' are required to be shown in a performance statement.

  The Group has elected to present its performance in two separate statements: an income statement and a statement of comprehensive income. The financial information has been prepared under the revised presentation requirements. The adoption of this revised standard affects the presentation of the Group's financial statements.

- *HKFRS 7 Financial Instruments: Disclosures (Amendment)*

  The amendment increases the disclosure requirements about fair value measurement and reinforces existing principles for disclosure about liquidity risk. The amendment introduces a three-level hierarchy for fair value measurement disclosures and requires some specific quantitative disclosures for financial instruments on the lowest level in the hierarchy. It is not required to provide comparative disclosures in the first year of application. The adoption of the amendment does not have an impact on the financial position or the comprehensive income of the Group.

- *HKFRS 8 Operating Segments*

  HKFRS 8 replaces HKAS 14 Segment Reporting. It requires a 'management approach' under which segment information, that reflects the operating result of segments reviewed regularly by the management for operation decisions making, resources allocation and performance assessment, is presented on the same basis and in the same manner as that used for internal reporting to the management. The adoption of HKFRS 8 makes no change in the number of reportable segments presented. However, there is a change in inter-segment funding, details of which are disclosed in Note 49. As the impact is not significant, no restatement of prior year figure has been made.

- *HK(IFRIC)-Int 13 Customer Loyalty Programmes*

  HK(IFRIC)-Int 13 clarifies that when an entity provides customers with incentives to buy goods or services under a customer loyalty programme (for example, customers accumulate loyalty points to redeem free or discounted products or service), the fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the award credits and the other components of the sale or service. As the interpretation does not have a significant impact on the Group's results of operations and financial position, no restatement of prior year figure has been made.

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet effective and have not been early adopted by the Group in 2009

The following standards, amendments and interpretations have been issued and are mandatory for accounting periods beginning on or after 1 July 2009:

Standard/ Interpretation	Content	Applicable for financial years beginning on/after	Relevant to the Group
HKAS 27 (Revised)	Consolidated and Separate Financial Statements	1 July 2009	Yes
HKAS 32 (Amendment)	Classification of Rights Issues	1 February 2010	No
HKAS 39 (Amendment)	Financial Instruments: Recognition and Measurement – Eligible Hedged Items	1 July 2009	No
HKFRS 1 (Revised)	First-time Adoption of HKFRS	1 July 2009	No
HKFRS 2 (Amendment)	Group Cash-settled Share-based Payment Transactions	1 January 2010	No
HKFRS 3 (Revised)	Business Combinations	1 July 2009	Yes
HKFRS 9	Financial Instruments Part 1: Classification and Measurement	1 January 2013	Yes
HK(IFRIC)-Int 9 (Revised)	Reassessment of embedded derivatives	30 June 2009	No
HK(IFRIC)-Int 17	Distributions of Non-cash Assets to Owners	1 July 2009	No
HK(IFRIC)-Int 18	Transfers of assets from customers	1 July 2009	No
HK(IFRIC)-Int 19	Extinguishing Financial Liabilities with Equity Instruments	1 July 2010	No

- *HKAS 27 Consolidated and Separate Financial Statements (Revised)*

  The revised standard requires changes in a parent's ownership interest in a subsidiary that do not result in the loss of control are accounted for within other comprehensive income. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in income statement. The Group will apply HKAS 27 (Revised) prospectively from 1 January 2010.

- *HKFRS 3 Business Combinations (Revised)*

  The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the consolidated income statement. All acquisition-related costs should be expensed. The Group will apply HKFRS 3 (Revised) prospectively to all business combinations (other than common control combination) acquired on or after 1 January 2010.

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet effective and have not been early adopted by the Group in 2009 (continued)

- *HKFRS 9 Financial Instruments Part 1: Classification and Measurement*

  HKFRS 9 was issued in November 2009 and replaces those parts of HKAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

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

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

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

  While adoption of HKFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted. The Group is considering the impact of the standard on the consolidated financial statements and the timing of its application.

(c) Improvements to HKFRS

'Improvements to HKFRS' contains numerous amendments to HKFRS which the HKICPA consider non-urgent but necessary. It comprises amendments that result in accounting changes for presentation, recognition or measurement purpose as well as terminology or editorial amendments related to a variety of individual HKFRS. Most of the amendments are effective for annual periods beginning on or after 1 January 2009 or 1 January 2010 respectively, with earlier application permitted. No material changes to accounting policies are expected as a result of these amendments.

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(d) Standard issued that is not yet effective but has been early adopted by the Group in 2009

The following revised standard has been early partially adopted by the Group retrospectively.

Standard/ Interpretation	Content	Applicable for financial years beginning on/after	Relevant to the Group
HKAS 24 (Revised)	Related Party Disclosures	1 January 2011	Yes

- *HKAS 24 Related Party Disclosures (Revised)*

  The revised standard was issued in November 2009. In 2009, the Group partially adopted the revised HKAS 24 – Related Party Disclosures as permitted in its transition provisions. The Group applied the partial exemption in HKAS 24 (Revised) regarding disclosure requirements for government-related entities. According to the previous version of HKAS 24, the Group was required to disclose transactions with the government and other government related-entities. The amendment introduces an exemption from certain disclosure requirements of HKAS 24 for transactions between government-related entities and the government, and all other government-related entities. The Group has early adopted the partial exemption and has applied this retrospectively. The early application does not have any effect on the Group's operating results, financial position or comprehensive income but has an impact on disclosure. The related party disclosures have been changed accordingly.

  The remainder of the revised standard amending the definition of related parties will be applied in the annual period beginning 1 January 2011 and will not have significant impact on the Group.

Except for the early partial adoption of HKAS 24 (Revised), the Group has not early adopted other new or amended accounting standards or interpretations in 2009.

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

For acquisition of 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 acquired company 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 acquired company 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 treated as a merger reserve in equity. The effects of all transactions between the Group and the acquired company, whether occurring before or after the combination, are eliminated in preparing the consolidated financial statements of the Group. The transaction costs for the combination will be expensed in the income statement.

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

(1) Subsidiaries (continued)

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group not under common control. The cost of such an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed as at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets (including intangible assets) acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values as at the acquisition date, irrespective of the extent of any non-controlling interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the Group's share of the identifiable net assets of the subsidiary acquired, the difference is recognised directly in the consolidated 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.

The gain or loss on the disposal of a subsidiary represents the difference between: (a) the proceeds of the sale and, (b) the Group's share of its net assets including goodwill on acquisition net of any accumulated impairment loss and any related accumulated foreign currency translation difference.

Non-controlling interest represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

(2) Associates

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. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates 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 is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the cost of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses unless the Group has incurred obligations or made payments on behalf of the associates.

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

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 business segment performance.

2. Summary of significant accounting policies (continued)

2.4 Foreign currency translation

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

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 rate of exchange at the balance sheet date are recognised directly in the income statement.

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 the available-for-sale reserve in equity.

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 balance sheet date;
- 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.

2.5 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 options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

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

Certain derivatives embedded in other financial instruments, such as the conversion option in a convertible bond, 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.

2. Summary of significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting (continued)

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.

(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.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity.

(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. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amount accumulated in equity is recycled in 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 cumulative gain or loss existing in the equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

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 set off 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 fees 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 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 are amortised as interest income or expense over the expected life of the financial instrument.

For all hedge transactions, interest income or interest expense from hedged instruments such as fixed rate debt securities 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.

Fees and commissions that are not an integral part of the effective yield are recognised on an accrual basis ratably over the period when the related service has been 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 categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments and available-for-sale financial assets. Management determines the classification of investments at initial recognition. The classification depends on the purpose for which the financial assets were 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 the criteria set out below, and is so designated by 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 consolidated 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 income 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 recognised in the consolidated income statement 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 rate method less allowances for impairment losses.

(3) Held-to-maturity

Financial assets classified as held-to-maturity are those traded in active markets, with fixed or determinable payments and fixed maturities that the Group's management has both the positive intention and the ability to hold to maturity. Were the Group to sell 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.

(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, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

(4) Available-for-sale (continued)

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 disposed of or impaired at which time the cumulative gain or loss previously recognised in equity should be transferred to the consolidated income statement. However, interest which includes the amortisation of premium and discount is calculated using the effective interest method and is recognised in the consolidated income statement. Dividends on equity instruments classified as available-for-sale are recognised in the consolidated income statement when the Group's right to receive payment is established.

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) 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 typically so designated if it meets 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 other than those classified as trading liabilities or designated at fair value through profit or loss, together with subordinated liabilities and other liabilities are carried at amortised cost or at 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. Summary of significant accounting policies (continued)

2.10 Recognition and de-recognition of financial instruments

Purchases and sales of financial assets at fair value through profit or loss, available-for-sale and held-to-maturity investments 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.

Trading liabilities, financial liabilities designated at fair value through profit or loss and debt securities in issue are recognised on the trade date. Deposits other than trading liabilities are recognised when money is received from customers, other liabilities are recognised when such obligations arise. Financial liabilities are de-recognised from the balance sheet when and only when the obligation specified in the contract is discharged, cancelled or expired. 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 income.

Securities and bills sold to a counter-party 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 counter-party with an obligation to re-sell to the counter-party 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 counter-party. The financial assets used to collateralise repurchase agreements are recorded as investment securities or financial assets at fair value through profit or loss. Reverse repos or securities borrowing are initially recorded in the balance sheet as cash and due from banks or placements with banks and other financial institutions, as appropriate, at the actual amount of cash paid to the counter-party. The financial assets received as collateral under reverse repurchase agreements are not recorded 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.

2.11 Determination of fair value of financial instruments

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

2.12 Precious metals

Precious metals comprise gold, silver and other precious metals. Precious metals are initially recognised at fair value and subsequently re-measured at their respective market prices as at the balance sheet date. Mark-to-market gains or losses on precious metals are included in net trading income.

2.13 Impairment of financial assets

The Group assesses as at each balance sheet date 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 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;

2. Summary of significant accounting policies (continued)

2.13 Impairment of financial assets (continued)

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

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

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

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

2. Summary of significant accounting policies (continued)

2.13 Impairment of financial assets (continued)

(1) Assets carried at amortised cost (continued)

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 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 cumulative 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 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.

2.14 Impairment of investment in subsidiaries and associates and non-financial assets

Assets that have an indefinite useful life or are not yet available for use are not subject to amortisation, but are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. 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.

2.15 Financial guarantee contracts

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

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

2. Summary of significant accounting policies (continued)

2.16 Premises, equipment, fixtures and fittings

Premises comprise primarily branches and offices. Premises are shown at fair value based on periodic, but at least annually, valuations by external independent valuers less subsequent depreciation. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. In the intervening periods, the directors review the carrying amount of premises, by reference to the open market value of similar properties, and adjustments are made when there has been a material change. All equipment, fixtures and fittings 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 in equity; 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:

- Premises — Over the remaining period of lease
- Equipment, fixtures and fittings — 3-15 years

The useful lives of assets are reviewed, and adjusted if appropriate, as at each balance sheet date.

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

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

2. Summary of significant accounting policies (continued)

2.17 Investment properties

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

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

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 reported directly in the income statement. Deferred income tax is provided on revaluation surpluses of investment properties in accordance with HK(SIC)-Int 21 "Income Taxes – Recovery of Revalued Non-Depreciable Assets" on HKAS 12 "Income Taxes".

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.

2.18 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) which include land use rights with payments that are separately identifiable at inception of the lease are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Where the Group is a lessor, the land and buildings subject to the operating lease are accounted for as investment properties. Rental income from operating leases is recognised on a straight-line basis over the lease term.

2. Summary of significant accounting policies (continued)

2.18 Leases (continued)

(2) Finance leases on properties

Where the land and buildings elements of leasehold properties held for own use can be split reliably at inception of the lease, leasehold land and land use rights are recognised as operating leases if they have indefinite economic lives. The up-front prepayments made or other costs incurred for acquiring the leasehold land and land use rights are expensed in the income statement on a straight-line basis over the period of the lease. Where there is impairment of the up-front prepayments, the impairment is expensed in the income statement immediately. Where the land and buildings cannot be split reliably at inception of the lease, the land and buildings elements will continue to be treated as finance leases and measured at fair value.

Separate measurements of the land and buildings elements are not required when the Group's interest in both land and buildings is classified as investment properties as if they are finance leases and are measured at fair value.

Pursuant to the Bank of China (Hong Kong) Limited (Merger) Ordinance ("Merger Ordinance") 2001, all assets and liabilities of the designated branches and subsidiaries, and the shares of certain entities of the legacy Bank of China Group in Hong Kong were effectively transferred to BOCHK, which was immediately owned by the then newly formed BOC Hong Kong (Holdings) Limited ("the Merger"). This was a significant event and the Group has therefore adopted the valuation at the date of the Merger as the deemed cost for its leasehold properties to reflect the circumstances at the time of the Merger.

On adoption of the deemed cost at the date of Merger, the Group made reference to the independent property valuation conducted as at 31 August 2001 for the purpose of the Merger, which did not split the values of the leasehold properties between the land and buildings elements. Any means of subsequent allocation of the valuation of the leasehold properties at the date of Merger between the land and buildings elements would be notional and therefore would not represent reliable information. It is determined that the values of the land and buildings elements of the Group's leasehold properties cannot be reliably split and the leasehold properties are treated as finance leases. The Group has also adopted the revaluation model under HKAS 16 "Property, Plant and Equipment" by which premises held for own use arising under these finance leases are measured at fair value less any accumulated depreciation and impairment losses.

2.19 Insurance contracts

(1) Insurance contracts classification, recognition and measurement

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

The Group's insurance subsidiary issues insurance 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's insurance subsidiary issues long term business insurance contracts, which insure events associated with human life (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 an investment fund set up by the Group with the consideration received from the contract holders, the liability is adjusted for all changes in the fair value of 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 human life under retirement schemes. 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 balance sheet date is reported as the unearned premium liability.

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).

(2) Liability adequacy test

At each balance sheet date, 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.

2.22 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. Summary of significant accounting policies (continued)

2.22 Employee benefits (continued)

(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 balance sheet date.

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 unexpired annual leaves, they do not entitle employees to a cash payment for unused entitlement on leaving the Group. Such compensated absences are recognised when the absences occur.

(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 are expected to be settled within twelve months and are measured at the amounts expected to be paid when they are settled.

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 within the corresponding item.

Income tax payable on profits, based on the applicable tax law enacted or substantially enacted at the balance sheet date in each jurisdiction where the Company and the subsidiaries and associates 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 balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from asset impairment provisions, depreciation of property and equipment, revaluation of certain assets including available-for-sale securities and properties, 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 investments 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.

2. Summary of significant accounting policies (continued)

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 be confirmed only 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.

2.27 Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if the Group has the ability, directly and indirectly through one or more intermediaries, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control. 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 reported 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. 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 to reduce any differences between loss estimates and actual loss experience.

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

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.

For asset/mortgage backed securities ("ABS/MBS"), the Group adopts a comprehensive methodology in determining whether a particular security is impaired. Under the methodology, the Group will not only take into consideration the mark-to-market (MTM) price of the issue and its external credit rating, but also other factors including the FICO score, vintage, location, adjustable rate mortgage ("ARM") status, delinquencies, level of collateral protection, loan to value ratio and prepayment speed of the underlying assets. Having considered these factors, the ABS/MBS issue has to further pass the required credit enhancement coverage ratio set by the Group. This ratio is determined by applying assumptions regarding the default rates based on the available delinquency, foreclosure and real estate owned ("REO") data of the ABS/MBS issue.

The methodology and assumptions used for the assessments are reviewed regularly. In evaluating impairment of ABS/MBS during the year, the Group continued to consider a significant decline in market prices of ABS/MBS to be one of the key indicators of impairment. In addition, due to reduced market liquidity and wider dispersion in indicative prices of certain ABS/MBS held by the Group, the Group also ensured that there was additional objective evidence of credit impairment by considering whether there has been a significant adverse change in the credit enhancement coverage ratio, taking into account the reported delinquencies and credit losses incurred in the underlying mortgage portfolio for each security held by the Group.

Many of the ABS/MBS held by the Group are complex, and involve cashflows over many years. These future cashflows depend on economic factors such as US residential real estate prices and the performance of the US economy. The recoverable amounts of the securities therefore cannot be predicted with certainty at the current balance sheet date, and additional impairment charges – or releases of impairment charges – may be required in future accounting periods.

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

3.3 Fair values of derivatives financial instruments

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

3.4 Fair value of structured investment vehicle

One of the Group's non-banking subsidiaries has invested in a structured investment vehicle managed by a third party portfolio manager, which is included in the Group's investment portfolio classified as financial assets at fair value through profit or loss. As there is no active market for this investment, management has assessed the fair value with reference to valuation received from the third party portfolio manager. As at 31 December 2009, the net carrying amount of this investment in the structured investment vehicle was approximately HK$4 million (2008: approximately HK$57 million).

3.5 Held-to-maturity investments

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. This classification requires significant judgement. In making this judgement, the Group evaluates its 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 close to maturity, it will be required to reclassify the entire portfolio of assets as available-for-sale. The investments would then be measured at fair value and not amortised cost.

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

In determining the Group's long term business fund liabilities under insurance contracts, 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 standard industry and 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 management's estimate, the long term business fund liability would increase by approximately HK$43 million (2008: HK$106 million), which accounts for 0.14% (2008: 0.39%) of the liability. In this case, it is assumed there is no relief arising from reinsurance contracts held.

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.

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

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

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 management's estimates, the long term business fund liability would increase by approximately HK$637 million (2008: approximately HK$998 million). In this case, 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. In the calculation of expense reserve, the Group has assumed it will carry on selling new business rather than ceases in 12 months period.

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 advice of a 35 basis points (2008: 15 basis points) change in market yield of the underlying assets and valuation interest rates. The amount of resilience reserve to be set up depends on the degree of change in interest rate assumed.

3.7 Provisions

The Group uses judgement to assess whether the Group has a present legal or constructive obligation as a result of past events at each balance sheet date, and judgement is used to determine if it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and to determine a reliable estimate of the amount of the obligation.

On 22 July 2009, the Group agreed with the Securities and Futures Commission, the HKMA and thirteen other distributing banks to make an offer to eligible customers to repurchase their holdings in all outstanding Lehman Brothers minibonds ("Minibonds") subscribed through the Group ("the Repurchase Scheme").

In determining the Group's charge to the income statement in respect of the Minibonds, the Group took into account the estimated aggregate amount paid and payable under the Repurchase Scheme and the voluntary offer, the provision made prior to the date of the Repurchase Scheme and the amount recoverable from the Minibonds.

The amount recoverable from the Minibonds is uncertain and dependent on a number of factors including resolution of certain legal matters, which may result in a wide range of recovery outcomes. The Group has made an assessment of the amount recoverable under such uncertainties. The final amount recovered by the Group could be different from the assessment and may result in a considerable credit being recognised in the income statement in the period when it is realised.

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, policies and processes for managing and the methods used to measure these risks.

Financial risk management framework

The Group's management governance structure is designed to cover all business processes and ensure 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 modified 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 the Risk Committee ("RC"), has the primary responsibility for the formulation of risk management strategies and for ensuring that the Group has an effective risk management system to implement these strategies.

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

The Chief Executive ("CE") is responsible for managing the Group's various types of risks, approving detailed risk management policies, and approving 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. He may 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, Nanyang, NCB (China), and Chiyu, are subject to 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 Group has put in place appropriate internal control systems, including establishment of an organisation structure that sets adequately 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.

4. Financial risk management (continued)

Product development

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

In accordance with the strategic objectives set by the Management, the respective product management units are responsible for formulating business and product development plans, and 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, the respective business units shall work closely with relevant risk evaluating departments to identify and assess all the related risks. Based on the consideration of segregation of duties, risk evaluating departments shall conduct independent review on risk management procedures and assessment results. Products can only be launched after the risk management procedures are fulfilled and endorsed by all risk evaluating departments.

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

4.1 Credit Risk

Credit risk is the risk that a customer or counterparty will be unable to or unwilling to meet its obligations under a contract. It arises principally from 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 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 ("CCO") reports directly to the CRO and is responsible for the management of credit risk and for the formulation of all credit policies and procedures. The Chief Analytics Officer who reports directly to the CRO is responsible for the development and maintenance of internal rating models and rating criteria. Various units of the Group have their respective credit risk management responsibilities. Business units act as the first line of defense while risk management units, which are independent from the business units, are responsible for the day-to-day management of credit risks. The Risk Management Department ("RMD") has the primary responsibility for drafting, reviewing and updating credit risk management policies and procedures. In accordance with Group's operating principle, the Group's principal banking subsidiaries, Nanyang, 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 lending strategies and conducting rigorous reviews on the concerned portfolios.

Loans and advances

Different credit approval and control procedures are adopted according to the level of risk associated with the customer, counterparty or transaction. Corporate and financial institution credit applications are independently reviewed, objectively assessed and monitored by risk management units and credit rating models/scorecards are used in the process of credit approval whenever they are applicable. A credit scoring system is used to process retail credit transactions, including residential mortgage loans, personal loans and credit cards. The Credit Risk Assessment Committee comprising experts from the Group's credit and other functions is responsible for making an independent assessment of all credit facilities which require the approval of Deputy Chief Executives or above.

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

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

The Group's internal loan grading system divides credit assets into 5 categories with reference to HKMA's guidelines.

"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 external credit rating and assessment on credit quality of the underlying assets are used for managing the credit risk involved. Credit limits are established on a customer and security issuer basis. For derivatives, the Group sets customer limits to manage the credit risk involved and follows the same approval and control processes as loans and advances. On-going monitoring procedures are established.

The Group adopts a comprehensive methodology in determining whether a particular asset/mortgage backed security ("ABS/MBS") is impaired. Under the methodology, the Group will take into consideration not only the mark-to-market (MTM) price of the issue and its external credit rating, but also additional factors such as the FICO score, vintage, location, adjustable rate mortgage ("ARM") status, delinquencies, level of collateral protection, loan to value ratio and prepayment speed of the underlying assets. Furthermore, having considered these factors, the ABS/MBS issue has to further pass the required credit enhancement coverage ratio set by the Group. This ratio is determined by applying assumptions regarding the default rates based on the available delinquency, foreclosure and real estate owned ("REO") data of the ABS/MBS issue.

Settlement risk arises mainly from foreign exchange transactions with counterparties and also from derivatives in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty or customer to cover all settlement 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 policy covering 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 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 properties, cash deposits, securities and investment funds. In the commercial and industrial sector, the main types of collateral are real properties, securities, receivables, cash deposits and machinery.

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

As at 31 December 2009 and 2008, the Group did not hold any collateral that it was permitted to sell or re-pledge in the absence of default by the borrower.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(A) Credit exposures

Maximum exposures to credit risk before collateral held or other credit enhancements are summarised as follows:

	2009 **HK$'m**	2008 HK$'m
Credit risk exposures relating to on-balance sheet assets are as follows:		
Balances with banks and other financial institutions	**157,379**	153,269
Placements with banks and other financial institutions maturing between 1 and 12 months	**60,282**	89,718
Financial assets at fair value through profit or loss – debt securities	**40,328**	41,438
Derivative financial instruments	**17,584**	19,628
Hong Kong SAR Government certificates of indebtedness	**38,310**	34,200
Advances and other accounts	**527,135**	469,493
Investment in securities		
– debt securities – available-for-sale	**225,356**	170,935
– debt securities – held-to-maturity	**72,439**	106,465
– debt securities – loans and receivables	**12,703**	12,595
Other assets	**11,895**	13,332
Credit risk exposures relating to off-balance sheet items are as follows:		
Letters of guarantee issued	**10,990**	11,838
Loan commitment and other credit related liabilities	**265,434**	241,551
	1,439,835	1,364,462

The above tables represent a worst case scenario of credit risk exposure to the Group at 31 December 2009 and 2008, without taking account of any collateral held, master netting agreements or other credit enhancements attached. For on-balance sheet assets, the exposures set out above are based on net carrying amounts. 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 that are irrevocable over the life of the respective facilities or revocable in the event of a significant adverse change, the maximum exposure to credit risk is disclosed as the full amount of the committed facilities.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances

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

	2009 HK$'m	2008 HK$'m
Advances to customers		
Personal		
– Mortgages	**140,940**	130,980
– Credit cards	**7,229**	6,445
– Others	**13,270**	14,359
Corporate		
– Commercial loans	**324,212**	284,108
– Trade finance	**29,321**	24,555
	514,972	460,447
Trade bills	**9,100**	7,609
Advances to banks and other financial institutions	**5,332**	3,738
Total	**529,404**	471,794

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.

A financial asset 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 and that loss event(s) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If there is objective evidence that an impairment loss on loans 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 financial asset. Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the holder of the asset about the loss events.

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

– Significant financial difficulty incurred by the borrower;

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

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

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

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (continued)

(a) Advances neither overdue nor impaired

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

	2009			
	Pass HK$'m	**Special mention HK$'m**	**Substandard or below HK$'m**	**Total HK$'m**
Advances to customers				
Personal				
– Mortgages	**138,876**	**128**	**85**	**139,089**
– Credit cards	**7,050**	**–**	**–**	**7,050**
– Others	**12,876**	**78**	**19**	**12,973**
Corporate				
– Commercial loans	**321,318**	**1,073**	**226**	**322,617**
– Trade finance	**28,669**	**392**	**4**	**29,065**
	508,789	**1,671**	**334**	**510,794**
Trade bills	**9,080**	**20**	**–**	**9,100**
Advances to banks and other financial institutions	**4,719**	**613**	**–**	**5,332**
Total	**522,588**	**2,304**	**334**	**525,226**

	2008			
	Pass HK$'m	Special mention HK$'m	Substandard or below HK$'m	Total HK$'m
Advances to customers				
Personal				
– Mortgages	128,545	155	88	128,788
– Credit cards	6,179	–	–	6,179
– Others	13,839	75	10	13,924
Corporate				
– Commercial loans	275,844	6,349	274	282,467
– Trade finance	23,381	538	5	23,924
	447,788	7,117	377	455,282
Trade bills	7,084	523	2	7,609
Advances to banks and other financial institutions	3,738	–	–	3,738
Total	458,610	7,640	379	466,629

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (continued)

(b) Advances overdue but not impaired

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

	2009					
	Overdue for 3 months or less HK$'m	Overdue for 6 months or less but over 3 months HK$'m	Overdue for 1 year or less but over 6 months HK$'m	Overdue for over 1 year HK$'m	Total HK$'m	Market value of collateral HK$'m
Advances to customers						
Personal						
– Mortgages	1,765	34	12	26	1,837	4,567
– Credit cards	152	–	–	–	152	–
– Others	218	2	10	13	243	513
Corporate						
– Commercial loans	664	5	10	196	875	1,831
– Trade finance	38	–	1	9	48	153
Total	2,837	41	33	244	3,155	7,064

	2008					
	Overdue for 3 months or less HK$'m	Overdue for 6 months or less but over 3 months HK$'m	Overdue for 1 year or less but over 6 months HK$'m	Overdue for over 1 year HK$'m	Total HK$'m	Market value of collateral HK$'m
Advances to customers						
Personal						
– Mortgages	2,065	34	12	30	2,141	4,870
– Credit cards	237	–	–	–	237	–
– Others	318	3	3	32	356	731
Corporate						
– Commercial loans	832	8	9	156	1,005	2,437
– Trade finance	81	4	–	15	100	178
Total	3,533	49	24	233	3,839	8,216

	2009 HK$'m	2008 HK$'m
Current market value of collateral held against the covered portion of advances to customers	7,064	8,216
Covered portion of advances to customers	2,856	3,341
Uncovered portion of advances to customers	299	498

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (continued)

(c) Impaired advances

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

	2009		2008	
	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	**14**	**15**	51	50
– Credit cards	**27**	**–**	29	–
– Others	**54**	**21**	79	21
Corporate				
– Commercial loans	**720**	**163**	636	434
– Trade finance	**208**	**28**	531	205
Total	**1,023**	**227**	1,326	710
Loan impairment allowances made in respect of such advances	**696**		829	

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

	2009 HK$'m	2008 HK$'m
Current market value of collateral held against the covered portion of advances to customers	**227**	710
Covered portion of advances to customers	**192**	628
Uncovered portion of advances to customers	**831**	698

Classified or impaired advances to customers are analysed as follows:

	2009 HK$'m	2008 HK$'m
Gross classified or impaired advances to customers	**1,769**	2,138
Gross classified or impaired advances to customers as a percentage of gross advances to customers	**0.34%**	0.46%
Individually assessed loan impairment allowances made in respect of such advances	**671**	800

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (continued)

(c) Impaired advances (continued)

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

(d) Advances overdue for more than 3 months

The gross amount of advances overdue for more than 3 months is analysed as follows:

	2009		2008	
	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	**103**	**0.02%**	339	0.07%
– one year or less but over six months	**154**	**0.03%**	66	0.02%
– over one year	**569**	**0.11%**	571	0.12%
Advances overdue for over three months	**826**	**0.16%**	976	0.21%
Individually assessed loan impairment allowances made in respect of such advances	**393**		439	

	2009 HK$'m	2008 HK$'m
Current market value of collateral held against the covered portion of advances to customers	**977**	1,436
Covered portion of advances to customers	**459**	604
Uncovered portion of advances to customers	**367**	372

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 2009 and 2008, there were no advances to banks and other financial institutions overdue for more than three months.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (continued)

(e) Rescheduled advances

	2009		2008	
	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 3 months	**573**	**0.11%**	127	0.03%

As at 31 December 2009, the total rescheduled advances to customers that were rescheduled during the year amounted to HK$515 million (2008: HK$54 million).

As at 31 December 2009 and 2008, 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 and for which the revised repayment terms, either of interest or of repayment period, are non-commercial. Rescheduled advances, which have been overdue for more than three months under the revised repayment terms, are included in overdue advances.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (continued)

(f) Concentration of advances to customers

(i) Sectoral analysis of gross advances to customers

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

	2009					
	Gross advances 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	23,002	38.08%	3	5	1	68
– Property investment	72,686	86.03%	206	475	10	359
– Financial concerns	11,596	8.02%	–	5	–	53
– Stockbrokers	301	32.90%	–	–	–	2
– Wholesale and retail trade	19,231	53.38%	154	225	61	96
– Manufacturing	21,388	46.46%	117	178	47	108
– Transport and transport equipment	26,951	16.39%	91	14	3	80
– Recreational activities	309	14.41%	–	–	–	1
– Information technology	15,581	0.79%	–	1	–	45
– Others	33,216	22.10%	62	203	15	106
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	11,932	99.94%	77	457	1	10
– Loans for purchase of other residential properties	127,208	99.99%	125	1,368	1	68
– Credit card advances	7,348	–	27	183	–	76
– Others	10,645	73.48%	68	174	36	18
Total loans for use in Hong Kong	381,394	65.91%	930	3,288	175	1,090
Trade finance	29,321	23.03%	237	224	175	128
Loans for use outside Hong Kong	104,257	25.54%	602	240	321	380
Gross advances to customers	514,972	55.30%	1,769	3,752	671	1,598

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (continued)

(f) Concentration of advances to customers (continued)

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

	2008					
	Gross advances 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	19,856	40.49%	2	14	1	66
– Property investment	71,374	88.00%	294	585	30	312
– Financial concerns	11,547	8.63%	–	–	1	56
– Stockbrokers	124	10.33%	–	–	–	–
– Wholesale and retail trade	18,156	52.85%	218	300	71	98
– Manufacturing	16,410	53.67%	234	298	138	80
– Transport and transport equipment	21,590	13.82%	2	9	1	81
– Recreational activities	139	46.87%	–	–	–	–
– Information technology	6,049	2.21%	–	3	–	19
– Others	23,529	26.91%	68	213	13	83
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	13,477	99.91%	98	510	4	12
– Loans for purchase of other residential properties	116,303	99.97%	153	1,650	7	74
– Credit card advances	6,553	–	30	273	–	71
– Others	11,490	77.92%	107	333	57	20
Total loans for use in Hong Kong	336,597	70.84%	1,206	4,188	323	972
Trade finance	24,555	30.36%	560	494	355	108
Loans for use outside Hong Kong	99,295	22.38%	372	235	122	421
Gross advances to customers	460,447	58.23%	2,138	4,917	800	1,501

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (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:

	2009		2008	
	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	**6**	**–**	28	–
– Property investment	**32**	**37**	139	5
– Financial concerns	**4**	**–**	24	–
– Stockbrokers	**2**	**–**	–	–
– Wholesale and retail trade	**44**	**28**	120	103
– Manufacturing	**34**	**101**	249	125
– Transport and transport equipment	**10**	**1**	34	–
– Recreational activities	**1**	**–**	–	–
– Information technology	**7**	**–**	9	–
– Others	**19**	**12**	34	8
Individuals				
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**1**	**1**	1	1
– Loans for purchase of other residential properties	**1**	**–**	8	–
– Credit card advances	**194**	**189**	157	141
– Others	**66**	**66**	61	47
Total loans for use in Hong Kong	**421**	**435**	864	430
Trade finance	**82**	**158**	374	26
Loans for use outside Hong Kong	**246**	**6**	266	19
Gross advances to customers	**749**	**599**	1,504	475

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (continued)

(f) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers and overdue advances

The following geographical analysis of gross advances to customers and overdue advances is based on the location of the counterparties, after taking into account the transfer of risk in respect of such advances where appropriate.

Gross advances to customers

	2009 HK$'m	2008 HK$'m
Hong Kong	**409,564**	374,506
Mainland China	**72,556**	55,318
Others	**32,852**	30,623
	514,972	460,447
Collectively assessed loan impairment allowances in respect of the gross advances to customers		
Hong Kong	**1,205**	1,172
Mainland China	**290**	221
Others	**103**	108
	1,598	1,501

Overdue advances

	2009 HK$'m	2008 HK$'m
Hong Kong	**3,470**	4,622
Mainland China	**253**	266
Others	**29**	29
	3,752	4,917
Individually assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**297**	554
Mainland China	**154**	99
Others	**6**	21
	457	674
Collectively assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**57**	50
Mainland China	**9**	6
	66	56

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross loans and advances (continued)

(f) Concentration of advances to customers (continued)

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

Classified or impaired advances

	2009 HK$'m	2008 HK$'m
Hong Kong	**1,153**	1,792
Mainland China	**260**	323
Others	**356**	23
	1,769	2,138
Individually assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**316**	677
Mainland China	**191**	100
Others	**164**	23
	671	800
Collectively assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**23**	26
Mainland China	**6**	7
	29	33

(C) Repossessed assets

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

	2009 HK$'m	2008 HK$'m
Commercial properties	**18**	18
Industrial properties	**6**	–
Residential properties	**71**	85
	95	103

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(C) Repossessed assets (continued)

The estimated market value of repossessed assets held by the Group as at 31 December 2009 amounted to HK$137 million (2008: HK$173 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 borrowers 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

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

The following table presents 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, based on Moody's ratings or their equivalent.

	2009			
	Aaa to A3 HK$'m	**Lower than A3 HK$'m**	**Unrated HK$'m**	**Total HK$'m**
Central banks	**81,790**	**–**	**–**	**81,790**
Banks and other financial institutions	**126,468**	**445**	**8,958**	**135,871**
	208,258	**445**	**8,958**	**217,661**

	2008			
	Aaa to A3 HK$'m	Lower than A3 HK$'m	Unrated HK$'m	Total HK$'m
Central banks	66,158	–	–	66,158
Banks and other financial institutions	168,456	586	3,555	172,597
	234,614	586	3,555	238,755

As at 31 December 2009 and 2008, 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

The table below represents an analysis of the carrying value of debt securities by credit rating and credit risk characteristic, based on Moody's ratings or their equivalent to the respective issues of the debt securities.

	2009							
					Unrated			
	Aaa HK$'m	Aa1 to Aa3 HK$'m	A1 to A3 HK$'m	Lower than A3 HK$'m	Hong Kong government and government bodies HK$'m	Other governments and government agencies HK$'m	Other HK$'m	Total HK$'m
Investment in securities								
US non-agency residential mortgage-backed								
– Subprime	504	31	12	–	–	–	–	547
– Alt-A	138	191	44	11	–	–	–	384
– Prime	635	242	632	1,344	–	–	–	2,853
Fannie Mae								
– issued debt securities	1,348	–	–	–	–	–	–	1,348
– mortgage-backed securities	–	–	–	–	–	51	–	51
Freddie Mac								
– issued debt securities	79	160	–	–	–	–	–	239
– mortgage-backed securities	–	–	–	–	–	1,164	–	1,164
Other MBS/ABS	3,481	416	25	–	–	2,695	–	6,617
Other debt securities	84,843	71,964	39,499	6,824	9,609	39,437	45,119	297,295
Subtotal	91,028	73,004	40,212	8,179	9,609	43,347	45,119	310,498
Financial assets at fair value through profit or loss								
Fannie Mae								
– issued debt securities	260	–	–	–	–	–	–	260
Other MBS/ABS	25	–	–	–	–	–	–	25
Other debt securities	1,039	7,941	14,630	1,639	13,902	290	602	40,043
Subtotal	1,324	7,941	14,630	1,639	13,902	290	602	40,328
Total	92,352	80,945	54,842	9,818	23,511	43,637	45,721	350,826

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

	2008							
					Unrated			
	Aaa HK$'m	Aa1 to Aa3 HK$'m	A1 to A3 HK$'m	Lower than A3 HK$'m	Hong Kong government and government bodies HK$'m	Other governments and government agencies HK$'m	Other HK$'m	Total HK$'m
Investment in securities								
US non-agency residential mortgage-backed								
– Subprime	913	–	30	104	–	–	–	1,047
– Alt-A	1,245	383	274	432	–	–	–	2,334
– Prime	9,549	1,558	2,878	1,950	–	–	–	15,935
Fannie Mae								
– issued debt securities	1,504	–	–	–	–	–	–	1,504
– mortgage-backed securities	–	–	–	–	–	88	–	88
Freddie Mac								
– issued debt securities	864	162	–	–	–	–	–	1,026
– mortgage-backed securities	–	–	–	–	–	1,633	–	1,633
Other MBS/ABS	6,874	24	63	–	–	3,807	–	10,768
Other debt securities	40,537	83,827	27,509	4,371	12,175	51,368	35,873	255,660
Subtotal	61,486	85,954	30,754	6,857	12,175	56,896	35,873	289,995
Financial assets at fair value through profit or loss								
Fannie Mae								
– issued debt securities	287	–	–	–	–	–	–	287
Other MBS/ABS	27	–	–	–	–	–	–	27
Other debt securities	2,304	15,417	10,233	1,457	11,358	–	355	41,124
Subtotal	2,618	15,417	10,233	1,457	11,358	–	355	41,438
Total	64,104	101,371	40,987	8,314	23,533	56,896	36,228	331,433

The total amount of unrated issues amounted to HK$112,869 million (2008: HK$116,657 million) as at 31 December 2009, of which only HK$3,868 million (2008: HK$8,975 million) were without issuer ratings. For details, please refer to page 156.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

For the above debt securities with no issue rating, their issuer ratings are analysed as follows:

	2009					
	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	**30,333**	**28,233**	**6,683**	**3,089**	**2,468**	**70,806**
Held-to-maturity securities	**697**	**9,687**	**3,039**	**155**	**988**	**14,566**
Loans and receivables	**–**	**9,768**	**2,935**	**–**	**–**	**12,703**
Financial assets at fair value through profit or loss	**156**	**13,903**	**323**	**–**	**412**	**14,794**
Total	**31,186**	**61,591**	**12,980**	**3,244**	**3,868**	**112,869**

	2008					
	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	18,180	49,408	3,293	35	5,481	76,397
Held-to-maturity securities	624	10,140	2,037	–	3,151	15,952
Loans and receivables	3,386	8,768	397	–	44	12,595
Financial assets at fair value through profit or loss	1	11,413	–	–	299	11,713
Total	22,191	79,729	5,727	35	8,975	116,657

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

The following table presents an analysis of debt securities neither overdue nor impaired as at 31 December by rating agency designation, based on Moody's ratings or their equivalent to the respective issues of the debt securities.

	2009					
	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	**79,180**	**44,254**	**24,626**	**5,135**	**70,806**	**224,001**
Held-to-maturity securities	**11,331**	**28,396**	**15,267**	**2,194**	**14,566**	**71,754**
Loans and receivables	**–**	**–**	**–**	**–**	**12,703**	**12,703**
Financial assets at fair value through profit or loss	**1,324**	**7,941**	**14,630**	**1,639**	**14,794**	**40,328**
Total	**91,835**	**80,591**	**54,523**	**8,968**	**112,869**	**348,786**

	2008					
	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	32,231	41,722	12,752	1,839	76,362	164,906
Held-to-maturity securities	22,667	42,554	16,201	2,067	15,952	99,441
Loans and receivables	–	–	–	–	12,595	12,595
Financial assets at fair value through profit or loss	2,618	15,417	10,233	1,457	11,709	41,434
Total	57,516	99,693	39,186	5,363	116,618	318,376

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

The impaired debt securities by credit rating are analysed as follows:

	2009						
	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	**106**	**279**	**275**	**695**	**–**	**1,355**	**676**
Held-to-maturity securities	**411**	**75**	**44**	**155**	**–**	**685**	**112**
Total	**517**	**354**	**319**	**850**	**–**	**2,040**	**788**
Of which accumulated impairment allowances	**74**	**117**	**130**	**186**	**281**	**788**	

	2008						
	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	3,451	814	542	1,187	35	6,029	4,561
Held-to-maturity securities	3,137	864	1,259	1,764	–	7,024	4,440
Total	6,588	1,678	1,801	2,951	35	13,053	9,001
Of which accumulated impairment allowances	4,195	1,400	976	2,078	352	9,001	

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

Debt securities overdue but not impaired are analysed as follows:

	Overdue for 6 months or less but over 3 months	
	2009 HK$'m	2008 HK$'m
Financial assets at fair value through profit or loss	**–**	4

Note: Impairment is not measured for financial assets at fair value through profit or loss as assets are managed according to movements in fair value, and the fair value movement is taken directly to the income statement. Consequently, such overdue debt securities are reported under "overdue but not impaired".

Debt securities overdue for more than 3 months are analysed as follows:

	Overdue for 6 months or less but over 3 months	
	2009 HK$'m	2008 HK$'m
Available-for-sale securities	**–**	35
Financial assets at fair value through profit or loss	**–**	4
	–	39

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

MBS/ABS

The table below represents an analysis of the Group's exposure to MBS/ABS by geographical location.

	2009		
	Carrying values		Of which accumulated impairment allowances HK$'m
	Total HK$'m	Impaired securities HK$'m	
US MBS/ABS			
Non-agency residential mortgage-backed			
– Subprime	**547**	**479**	**55**
– Alt-A	**384**	**146**	**66**
– Prime	**2,853**	**1,308**	**348**
Ginnie Mae	**2,695**	**–**	**–**
Fannie Mae	**51**	**–**	**–**
Freddie Mac	**1,164**	**–**	**–**
Others	**1,534**	**–**	**–**
	9,228	**1,933**	**469**
Other countries MBS/ABS			
Residential mortgage-backed	**2,253**	**75**	**38**
Commercial mortgage-backed	**160**	**–**	**–**
	2,413	**75**	**38**
Total MBS/ABS	**11,641**	**2,008**	**507**

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

MBS/ABS (continued)

	2008		
	Carrying values		Of which accumulated impairment allowances HK$'m
	Total HK$'m	Impaired securities HK$'m	
US MBS/ABS			
Non-agency residential mortgage-backed			
– Subprime	1,047	829	339
– Alt-A	2,334	1,750	1,302
– Prime	15,935	9,594	6,479
Ginnie Mae	3,807	–	–
Fannie Mae	88	–	–
Freddie Mac	1,633	–	–
Commercial mortgage-backed	929	–	–
Others	2,806	–	–
	28,579	12,173	8,120
Other countries MBS/ABS			
Residential mortgage-backed	2,649	69	27
Commercial mortgage-backed	454	–	–
Others	150	–	–
	3,253	69	27
Total MBS/ABS	31,832	12,242	8,147

	2009 HK$'m	2008 HK$'m
Increase/(decrease) in fair value taken to available-for-sale securities reserve on MBS/ABS for the year (net of impairment charges taken to income statement excluding deferred tax impact)	**1,617**	(1,340)
Closing balance of available-for-sale securities reserve relating to MBS/ABS (excluding deferred tax impact)	**(90)**	(1,707)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

MBS/ABS (continued)

The impaired MBS/ABS by credit rating are analysed as follows:

	2009						
	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
US MBS/ABS							
Non-agency residential mortgage-backed							
– Subprime	467	–	12	–	–	479	55
– Alt-A	–	91	44	11	–	146	66
– Prime	50	188	231	839	–	1,308	348
	517	279	287	850	–	1,933	469
Other countries MBS/ABS							
Residential mortgage-backed	–	75	–	–	–	75	38
Total MBS/ABS	517	354	287	850	–	2,008	507
Of which accumulated impairment allowances	74	117	130	186	–	507	

	2008						
	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
US MBS/ABS							
Non-agency residential mortgage-backed							
– Subprime	695	–	30	104	–	829	339
– Alt-A	662	383	274	431	–	1,750	1,302
– Prime	5,162	1,295	1,312	1,825	–	9,594	6,479
	6,519	1,678	1,616	2,360	–	12,173	8,120
Other countries MBS/ABS							
Residential mortgage-backed	69	–	–	–	–	69	27
Total MBS/ABS	6,588	1,678	1,616	2,360	–	12,242	8,147
Of which accumulated impairment allowances	4,195	1,400	938	1,614	–	8,147	

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

MBS/ABS (continued)

The table below represents an analysis of impairment charges/(releases) for the year for MBS/ABS held as at 31 December.

	2009					
	Aaa HK$'m	Aa1 to Aa3 HK$'m	A1 to A3 HK$'m	Lower than A3 HK$'m	Unrated HK$'m	Total HK$'m
US MBS/ABS						
Non-agency residential mortgage-backed						
– Subprime	(15)	–	(3)	–	–	(18)
– Alt-A	–	10	20	(3)	–	27
– Prime	22	15	(2)	139	–	174
	7	25	15	136	–	183
Other countries MBS/ABS						
Residential mortgage-backed	–	8	–	–	–	8
Total MBS/ABS	7	33	15	136	–	191

	2008					
	Aaa HK$'m	Aa1 to Aa3 HK$'m	A1 to A3 HK$'m	Lower than A3 HK$'m	Unrated HK$'m	Total HK$'m
US MBS/ABS						
Non-agency residential mortgage-backed						
– Subprime	(90)	–	27	27	–	(36)
– Alt-A	394	299	157	359	–	1,209
– Prime	3,725	1,055	658	1,094	–	6,532
	4,029	1,354	842	1,480	–	7,705
Other countries MBS/ABS						
Residential mortgage-backed	27	–	–	–	–	27
Total MBS/ABS	4,056	1,354	842	1,480	–	7,732

Note: The impairment charges/(releases) for MBS/ABS disposed during the year are excluded.

4. Financial risk management (continued)

4.2 Market Risk

Market risk is the risk of loss that results from movements in market rates and prices. The Group's market risk in trading book arises from trading positions taken from customer-related business and proprietary trading. These positions are subject to daily mark-to-market valuation. The risk includes potential losses arising from changes in foreign exchange and interest rates as well as equities and commodities prices. On the other hand, banking book positions are subject to interest rate risk and liquidity risk. In particular, the Group's bond investment portfolio is exposed to the potential losses arising from changes in market price of the debt securities as these positions are subject to monthly mark-to-market valuation. The Group manages market risk in its trading book separately from its banking book.

Market risk management framework

The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. Market risk management framework of the Group comprises three levels. The Board of Directors is the ultimate decision making authority. Formulation of the risk management procedures and implementation mechanism, and monitoring of the compliance are mainly responsible by senior management (including CE and CRO). RMD is responsible for the oversight of the Group's market risk to ensure that overall and individual market risks are within the Group's risk tolerance. Risk exposures are monitored on a day-to-day basis to ensure that they are within established risk limits and are regularly reported to the senior management. Nanyang, NCB (China), Chiyu and BOC Life have their own independent risk monitoring units to monitor limit compliance on a daily basis.

The Group's control of market risk is based on restricting individual operations to trading within various market risk limits approved by the RC, and a list of permissible instruments authorised by senior management, as well as enforcing rigorous new product approval procedures to ensure all risks arising are thoroughly identified, properly measured and adequately controlled.

Market risk arising from the trading book is managed within various major risk limits approved by the RC, including risk positions and/or risk factor sensitivities. Since April 2007 BOCHK has also formally applied Value-at-Risk (VAR) limit as a daily risk management tool. These overall risk limits are divided into sub-limits by reference to different risk products, including interest rate, foreign exchange rate, commodity price and equity products. Transactions are classified into different risk product categories according to the prominent type of risk inherent in the transactions.

The Group also uses the VAR technique to measure potential losses and market risks of its trading book for reporting to the RC and senior management on a periodic basis. VAR is a statistical technique which estimates the potential losses that could occur on risk positions taken over a specified time horizon within a given level of confidence. BOCHK, being the banking entity within the Group with the major trading positions, which are mainly foreign currency positions in major currencies, uses VAR technique to monitor and control market risk on a daily basis.

4. Financial risk management (continued)

4.2 Market Risk (continued)

Market risk management framework (continued)

The Group uses historical simulation approaches to calculate portfolio and individual VAR by historical movements in market rates and prices, given a 99% confidence level and a 1-day holding period. Movements in market prices are calculated by reference to market data from the last two years.

(a) VAR

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

HK$'m		At 31 December	Minimum for the year	Maximum for the year	Average for the year
VAR for all market risk	– 2009	9.8	9.0	16.3	12.6
	– 2008	12.6	3.0	13.5	6.5
VAR for foreign exchange	– 2009	7.7	7.4	15.8	11.3
risk products	– 2008	13.1	2.5	14.2	6.0
VAR for interest rate risk products	– 2009	6.4	2.1	12.8	5.7
	– 2008	4.2	1.0	5.9	2.9
VAR for equity risk products	– 2009	0.1	0.1	2.5	0.3
	– 2008	0.2	0.1	2.8	0.5
VAR for commodity risk products	– 2009	0.0	0.0	0.1	0.0
	– 2008	0.0	0.0	0.5	0.0

In 2009, the average daily revenue[2] of BOCHK earned from market risk-related trading activities was HK$3.88 million (2008: HK$5.35 million).

1 Structural FX positions have been excluded.

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

Predictive power of the VAR measure is monitored by backtesting, which compares the calculated VAR figure of those trading positions of each business day with the actual revenues arising on those positions on the next business day. These actual revenues exclude non-trading income including fees and commissions. If backtesting revenues are negative and exceed the VAR, a "backtesting exception" is noted. Backtesting results are reported to the Group's senior management, including CE and CRO.

4. Financial risk management (continued)

4.2 Market Risk (continued)

(a) VAR (continued)

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

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

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

– the use of a 99 per cent 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 augmenting its VAR limits with other position and sensitivity limit structures.

Additionally, the Group applies a certain range of stress testing, both on individual portfolios and on the Group's consolidated positions. Stress testing programme of the trading book 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, the 1997 Asian Crisis and the 11 September Event in 2001. The Group also reassessed the stress testing programme to ensure its rigour and robustness in view of the financial crisis in 2008. The Group's stress-testing regime provides senior management with an assessment of the financial impact of identified extreme events on the market risk exposures of the Group.

For BOCHK, banking book market risk is managed within various risk limits such as sensitivity limits like PVBP (Price Value per Basis Point) limits and Greek limits, and the AFS Economic Value at Risk limit, which is aimed at controlling the price risk impact of the available-for-sale debt securities portfolio on the Bank's capital base. In addition, Profit-and-loss Management Alert Limit (P/L MAL) is set up to control the earnings impact arising from the banking book's financial instruments. These limits are approved by ALCO and the results are reported to ALCO on a monthly basis.

4. Financial risk management (continued)

4.2 *Market Risk (continued)*

(b) Currency risk

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$ equivalent, categorised by the original currency.

	2009							
	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	59,001	45,058	51,024	2,066	317	623	2,699	160,788
Placements with banks and other financial institutions maturing between one and twelve months	1,782	34,514	19,365	3,083	43	125	1,370	60,282
Financial assets at fair value through profit or loss	700	10,884	32,948	–	–	–	62	44,594
Derivative financial instruments	5	1,201	16,238	48	–	–	92	17,584
Hong Kong SAR Government certificates of indebtedness	–	–	38,310	–	–	–	–	38,310
Advances and other accounts	15,810	112,386	386,259	3,352	1,170	46	8,112	527,135
Investment in securities								
– Available-for-sale securities	2,414	115,645	36,176	24,365	13,261	1,882	34,870	228,613
– Held-to-maturity securities	1,761	26,623	25,291	6,749	2,725	362	8,928	72,439
– Loans and receivables	–	5,873	6,661	–	–	–	169	12,703
Interests in associates	–	–	217	–	–	–	–	217
Investment properties	59	–	9,305	–	–	–	–	9,364
Properties, plant and equipment	350	–	25,936	–	–	–	–	26,286
Other assets (including deferred tax assets)	125	614	13,497	11	110	54	65	14,476
Total assets	82,007	352,798	661,227	39,674	17,626	3,092	56,367	1,212,791
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	38,310	–	–	–	–	38,310
Deposits and balances of banks and other financial institutions	38,104	24,930	35,539	18	28	13	1,015	99,647
Financial liabilities at fair value through profit or loss	–	599	15,229	–	–	–	460	16,288
Derivative financial instruments	7	2,056	10,921	869	3	–	111	13,967
Deposits from customers	38,714	158,094	564,319	15,517	2,199	14,645	48,833	842,321
Other accounts and provisions (including current and deferred tax liabilities)	1,194	8,304	24,229	617	56	528	1,511	36,439
Insurance contract liabilities	1	6,202	27,205	–	–	–	–	33,408
Subordinated liabilities	–	19,399	–	7,377	–	–	–	26,776
Total liabilities	78,020	219,584	715,752	24,398	2,286	15,186	51,930	1,107,156
Net on-balance sheet position	3,987	133,214	(54,525)	15,276	15,340	(12,094)	4,437	105,635
Off-balance sheet net notional position*	462	(120,753)	149,934	(15,284)	(15,284)	11,849	(4,728)	6,196
Contingent liabilities and commitments	5,940	61,833	197,945	4,341	569	835	4,961	276,424

4. Financial risk management (continued)

4.2 Market Risk (continued)

(b) Currency risk (continued)

	2008							
	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	53,381	36,592	53,720	2,662	1,425	3,163	2,326	153,269
Placements with banks and other financial institutions maturing between one and twelve months	504	31,441	38,728	5,924	–	6,487	6,634	89,718
Financial assets at fair value through profit or loss	1,274	7,670	34,817	–	–	–	51	43,812
Derivative financial instruments	–	485	19,032	99	1	–	11	19,628
Hong Kong SAR Government certificates of indebtedness	–	–	34,200	–	–	–	–	34,200
Advances and other accounts	15,056	97,002	347,249	2,915	1,622	1,002	4,647	469,493
Investment in securities								
– Available-for-sale securities	828	71,883	25,396	21,160	40,652	1,651	11,051	172,621
– Held-to-maturity securities	2,165	52,352	33,652	6,132	1,823	791	9,550	106,465
– Loans and receivables	–	2,243	9,039	108	–	110	1,095	12,595
Interests in associates	–	–	88	–	–	–	–	88
Investment properties	63	–	7,664	–	–	–	–	7,727
Properties, plant and equipment	98	–	22,697	–	–	–	–	22,795
Other assets (including deferred tax assets)	121	244	13,545	596	220	19	88	14,833
Total assets	73,490	299,912	639,827	39,596	45,743	13,223	35,453	1,147,244
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	34,200	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions	38,131	24,191	18,558	2,251	693	2,494	2,461	88,779
Financial liabilities at fair value through profit or loss	–	1,852	19,890	–	–	–	196	21,938
Derivative financial instruments	–	513	19,622	297	1	–	17	20,450
Deposits from customers	30,518	193,952	502,199	15,584	2,135	13,445	44,744	802,577
Debt securities in issue at amortised cost	–	148	845	–	–	–	49	1,042
Other accounts and provisions (including current and deferred tax liabilities)	1,331	9,682	17,874	325	7,907	348	646	38,113
Insurance contract liabilities	–	4,447	23,827	–	–	–	–	28,274
Subordinated liabilities	–	19,394	735	7,210	–	–	–	27,339
Total liabilities	69,980	254,179	637,750	25,667	10,736	16,287	48,113	1,062,712
Net on-balance sheet position	3,510	45,733	2,077	13,929	35,007	(3,064)	(12,660)	84,532
Off-balance sheet net notional position*	(4)	(33,929)	68,465	(13,826)	(34,817)	3,043	12,542	1,474
Contingent liabilities and commitments	9,132	62,401	176,092	3,032	551	303	1,878	253,389

* 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

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

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

– Yield curve risk – non-parallel shifts in the yield curve, e.g. steepening or flattening of the yield curve that may have an adverse impact on net interest income or economic value

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

BOCHK has formulated "Interest Rate Risk Management Policies" which set out the framework and methodologies to identify, measure, monitor and control interest rate risk.

The Group's ALCO exercises its oversight of interest rate risk and RC sanctions the interest rate risk management policies formulated by ALCO. The interest rate risk is identified and measured on a daily basis. Asset and Liability Management Department ("ALMD") manages the interest rate risk according to the established policies and the results are reported to ALCO regularly. RMD reviews the policies, guidelines and limits proposed by the ALMD.

Gap analysis is one of the tools used to measure the Group's exposure to repricing risk. This provides the Group with a static view of the maturity and repricing characteristics of its balance sheet positions. The Group uses interest rate derivatives to hedge its interest rate exposures and in most cases, plain vanilla interest rate swaps are used.

4. Financial risk management (continued)

4.2 Market Risk (continued)

(c) Interest rate risk (continued)

Sensitivities of earnings and economic value to interest rate changes (Earnings at Risk and Economic Value at Risk) are assessed through a hypothetical interest rate shock of 200 basis points across the yield curve on both sides. Earnings at Risk and Economic Value at Risk are controlled respectively within an approved percentage of the projected net interest income for the year and the latest capital base as sanctioned by RC. The results are reported to ALCO and RC on a regular basis. Apart from the hypothetical scenario, business-as-usual ("BAU") scenario has been established based on a simpler and more reasonable principle. It generates results of the impact on earnings and economic value under interest rate change assuming constant strategic business development and customer behaviour.

The Group implemented PVBP and Option Greeks limits as daily monitoring measures to monitor price risk caused by interest rate movement and option risk of investment portfolio.

The impact of basis risk is gauged by the projected change in net interest income under scenarios of imperfect correlation in the adjustment of the rates earned and paid on different instruments. Ratios of assets to liabilities with similar pricing basis are established to monitor such risk.

Stress test on yield curve risk is performed to assess the impact on earnings and economic value due to the steepening or flattening of the yield curve. The impact of optionality of demand and savings deposits and prepayment of mortgage loans is also assessed under different stress test scenarios. The prepayment risk of ABS/MBS is assessed by the impact on earnings and economic value using the sensitivity of extended/contracted weighted average life.

The interest rate risk exposures in BOCHK are controlled through the use of limits:

1. Earnings at Risk limit

2. Economic Value at Risk limit

3. Interest Rate Mismatch Gap limits

Before launching a new product or business, the relevant departments are required to go through a risk assessment process, which includes assessment of underlying interest rate risk and consideration of the adequacy of current risk management mechanism. Any material impact on interest rate risk noted during the risk assessment process will be reported to both the Chief Financial Officer ("CFO") and CRO.

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.

	2009						
	Up to 1 month HK$'m	1-3 months HK$'m	3-12 months HK$'m	1-5 years HK$'m	Over 5 years HK$'m	Non-interest bearing HK$'m	Total HK$'m
Assets							
Cash and balances with banks and other financial institutions	132,002	–	–	–	–	28,786	160,788
Placements with banks and other financial institutions maturing between one and twelve months	–	26,170	34,112	–	–	–	60,282
Financial assets at fair value through profit or loss	10,862	2,567	2,223	11,269	13,407	4,266	44,594
Derivative financial instruments	–	–	–	–	–	17,584	17,584
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	38,310	38,310
Advances and other accounts	437,386	66,229	17,878	1,491	164	3,987	527,135
Investment in securities							
– Available-for-sale securities	24,086	42,303	15,488	119,124	24,355	3,257	228,613
– Held-to-maturity securities	16,968	28,856	11,241	10,920	4,454	–	72,439
– Loans and receivables	169	1,774	10,760	–	–	–	12,703
Interests in associates	–	–	–	–	–	217	217
Investment properties	–	–	–	–	–	9,364	9,364
Properties, plant and equipment	–	–	–	–	–	26,286	26,286
Other assets (including deferred tax assets)	–	–	–	–	–	14,476	14,476
Total assets	621,473	167,899	91,702	142,804	42,380	146,533	1,212,791
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	38,310	38,310
Deposits and balances of banks and other financial institutions	78,388	1,751	3,475	–	–	16,033	99,647
Financial liabilities at fair value through profit or loss	13,375	1,974	846	93	–	–	16,288
Derivative financial instruments	–	–	–	–	–	13,967	13,967
Deposits from customers	681,049	76,187	36,107	1,073	–	47,905	842,321
Other accounts and provisions (including current and deferred tax liabilities)	9,685	265	274	305	–	25,910	36,439
Insurance contract liabilities	–	–	–	–	–	33,408	33,408
Subordinated liabilities	–	–	26,776	–	–	–	26,776
Total liabilities	782,497	80,177	67,478	1,471	–	175,533	1,107,156
Interest sensitivity gap	(161,024)	87,722	24,224	141,333	42,380	(29,000)	105,635

4. Financial risk management (continued)

4.2 Market Risk (continued)

(c) Interest rate risk (continued)

	2008						
	Up to 1 month HK$'m	1-3 months HK$'m	3-12 months HK$'m	1-5 years HK$'m	Over 5 years HK$'m	Non-interest bearing HK$'m	Total HK$'m
Assets							
Cash and balances with banks and other financial institutions	134,723	–	–	–	–	18,546	153,269
Placements with banks and other financial institutions maturing between one and twelve months	–	38,622	51,096	–	–	–	89,718
Financial assets at fair value through profit or loss	5,103	7,473	2,311	9,415	17,136	2,374	43,812
Derivative financial instruments	–	–	–	–	–	19,628	19,628
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	34,200	34,200
Advances and other accounts	366,619	76,378	20,873	1,258	159	4,206	469,493
Investment in securities							
– Available-for-sale securities	31,282	28,066	42,437	47,155	21,995	1,686	172,621
– Held-to-maturity securities	24,837	38,406	12,514	17,371	13,337	–	106,465
– Loans and receivables	1,755	2,675	8,165	–	–	–	12,595
Interests in associates	–	–	–	–	–	88	88
Investment properties	–	–	–	–	–	7,727	7,727
Properties, plant and equipment	–	–	–	–	–	22,795	22,795
Other assets (including deferred tax assets)	–	–	–	–	–	14,833	14,833
Total assets	564,319	191,620	137,396	75,199	52,627	126,083	1,147,244
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	34,200	34,200
Deposits and balances of banks and other financial institutions	55,274	10,655	3,272	–	–	19,578	88,779
Financial liabilities at fair value through profit or loss	6,769	13,412	1,749	8	–	–	21,938
Derivative financial instruments	–	–	–	–	–	20,450	20,450
Deposits from customers	629,855	102,169	32,532	253	–	37,768	802,577
Debt securities in issue at amortised cost	459	148	435	–	–	–	1,042
Other accounts and provisions (including current and deferred tax liabilities)	8,036	116	493	136	–	29,332	38,113
Insurance contract liabilities	–	–	–	–	–	28,274	28,274
Subordinated liabilities	–	735	26,604	–	–	–	27,339
Total liabilities	700,393	127,235	65,085	397	–	169,602	1,062,712
Interest sensitivity gap	(136,074)	64,385	72,311	74,802	52,627	(43,519)	84,532

4. Financial risk management (continued)

4.2 Market Risk (continued)

(c) Interest rate risk (continued)

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

The Group is principally exposed to HKD and USD in terms of interest rate risk. At 31 December 2009, if HKD and USD market interest rates had been 100 basis point higher with other variables held constant, profit after tax for the year would have been reduced by HK$148 million (2008: HK$89 million). The negative impact is increased compared with 2008 because the short term negative interest sensitivity gaps are widened. Reserves would have been reduced by HK$3,091 million (2008: HK$1,390 million) because of the expected reduction in valuation of available-for-sale portfolio due to the above simulated market rates movement. The negative impact is increased compared with 2008 because the size of available-for-sale portfolio is increased. The sensitivity analysis set out above is illustrative only.

Interest rate exposures in banking book

The following is a summary of possible effects of market interest rates shocks on the Group's interest rate exposure for major currencies in its banking book:

	Impact on positions at 31 December	
Earnings perspective Scenarios	**2009 HK$'m**	2008 HK$'m
Down 100 basis points parallel shift in HK dollar yield curves	**(394)**	(257)
Up 100 basis points parallel shift in US dollar yield curves	**(571)**	(364)

The stress tests set out above are illustrative only. The projections illustrate that stressful changes in market interest rates in response to exceptional but plausible events would have adverse effects on earnings over the next twelve months. The stress tests measure the possible effect of interest rates shock on the budgeted earnings which is assessed by changes in net interest income. To construct stressful scenarios, severe assumptions are made, including a change in the correlation between HK dollar and US dollar interest rates, parallel movement of interest rates for the banking book positions of all repricing or maturity dates. 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.

4.3 Liquidity Risk

Liquidity risk is the risk that the Group may not be able to fund increases in assets, meet obligations as they fall due or take strategic opportunity without incurring unacceptable losses.

Liquidity risk management framework

The liquidity risk management framework of the Group comprises three levels. The Board of Directors and the Risk Committee are the ultimate decision making authority and are responsible for approving the liquidity management policy and assure the compliance with regulatory requirements. The senior management (including CE, CFO, CRO) and ALCO are responsible for the formulation of the liquidity management policy and procedures and monitoring of their implementation. The Asset and Liability Management Department, assisted by other functional departments, including the Investment Management, RMD as well as General Accounting and Accounting Policy Department, is responsible for daily management of liquidity to monitor the liquidity risk and provides regular reports to the Management and local regulatory bodies.

The liquidity management process is carried out both at the Group and subsidiary level. The principal subsidiaries execute their daily risk management processes independently, subject to risk policies that are consistent with those of the Group, and report to the Group's management on a regular basis.

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

Liquidity risk management framework (continued)

The Group has developed a robust liquidity risk management mechanism, by maintaining an appropriate size of highly-liquefiable assets and proper liability structure, enabling the Group to meet, even under adverse market conditions, the obligations as they fall due, and to fund the asset growth and strategic opportunities without forced liquidation of its assets at short notice.

At present, the Group has set up three Key Risk Indicators, which are 1-month liquidity ratio, 1-month mismatch ratio and loan-to-deposit ratio. The indicators mentioned are used as the major tools in the identification, measurement, monitoring and control of the liquidity risk on regular basis by setting limits, assessing and monitoring the ratios. Besides, the Group also monitors deposit stability, concentration of deposits from large depositors and liquidity profile of the investment portfolio.

The related risk management process includes:

– Perform cash-flow projections under normal and stressed scenarios, using the net mismatch gap between assets and liabilities to estimate the prospective net funding requirements;

– Set limits on mismatch ratios to control the size of the cumulative net mismatch positions;

– Maintain liquidity ratios to comply with both internal and external regulatory requirements;

– Maintain a diversified liability base to ensure sufficient funding sources;

– Maintain a proper level of highly liquid assets to serve as a liquidity buffer for emergency needs;

– Monitor the structure and stability of the deposit portfolio;

– Assess the ability to borrow from the inter-bank money market to avoid over-reliance on the money market funding;

– Maintain a proper contingency plan, which includes setting early warning signals (including internal indicators and market indicators) with timely monitoring procedures and establishing a management reporting system and contingency procedures.

Before launching a new product or business, relevant departments are required to go through a risk assessment process, which includes 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 both to the CRO and the CFO.

(A) Liquidity ratio

	2009	2008
Average liquidity ratio	**40.18%**	41.74%

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) Analysis of undiscounted cash flows by contractual maturities

(a) Non-derivative cash flows

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

	2009					
	Up to 1 month HK$'m	**1-3 months HK$'m**	**3-12 months HK$'m**	**1-5 years HK$'m**	**Over 5 years HK$'m**	**Total HK$'m**
Financial liabilities						
Hong Kong SAR currency notes in circulation	**38,310**	**–**	**–**	**–**	**–**	**38,310**
Deposits and balances of banks and other financial institutions	**94,461**	**1,774**	**3,505**	**–**	**–**	**99,740**
Financial liabilities at fair value through profit or loss	**13,168**	**868**	**2,160**	**111**	**–**	**16,307**
Deposits from customers	**728,951**	**74,999**	**37,589**	**1,184**	**–**	**842,723**
Subordinated liabilities	**–**	**–**	**607**	**2,629**	**29,640**	**32,876**
Other financial liabilities	**22,242**	**501**	**358**	**309**	**–**	**23,410**
Total financial liabilities	**897,132**	**78,142**	**44,219**	**4,233**	**29,640**	**1,053,366**

	2008					
	Up to 1 month HK$'m	1-3 months HK$'m	3-12 months HK$'m	1-5 years HK$'m	Over 5 years HK$'m	Total HK$'m
Financial liabilities						
Hong Kong SAR currency notes in circulation	34,200	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions	74,864	10,696	3,291	–	–	88,851
Financial liabilities at fair value through profit or loss	6,114	6,404	9,077	253	294	22,142
Deposits from customers	667,726	101,097	33,052	1,392	–	803,267
Debt securities in issue at amortised cost	459	148	436	–	–	1,043
Subordinated liabilities	–	7	1,051	4,978	32,233	38,269
Other financial liabilities	27,329	198	1,836	4	238	29,605
Total financial liabilities	810,692	118,550	48,743	6,627	32,765	1,017,377

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) 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:

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

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

	2009					
	Up to 1 month HK$'m	**1-3 months HK$'m**	**3-12 months HK$'m**	**1-5 years HK$'m**	**Over 5 years HK$'m**	**Total HK$'m**
Foreign exchange derivatives	**(9,015)**	**(10)**	**(417)**	**1**	**–**	**(9,441)**
Interest rate derivatives	**(97)**	**(292)**	**(1,463)**	**(3,344)**	**(328)**	**(5,524)**
Bullion derivatives	**(373)**	**–**	**–**	**–**	**–**	**(373)**
	(9,485)	**(302)**	**(1,880)**	**(3,343)**	**(328)**	**(15,338)**

	2008					
	Up to 1 month HK$'m	1-3 months HK$'m	3-12 months HK$'m	1-5 years HK$'m	Over 5 years HK$'m	Total HK$'m
Foreign exchange derivatives	(10,465)	(99)	(235)	–	–	(10,799)
Interest rate derivatives	–	(178)	(884)	(3,023)	(724)	(4,809)
Bullion derivatives	(91)	–	–	–	–	(91)
	(10,556)	(277)	(1,119)	(3,023)	(724)	(15,699)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(b) Derivative cash flows (continued)

(ii) Derivatives settled on a gross basis

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

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

	2009				
	Up to 1 month HK$'m	1-3 months HK$'m	3-12 months HK$'m	1-5 years HK$'m	Total HK$'m
Foreign exchange derivatives:					
– Outflow	(130,176)	(76,053)	(72,673)	(1,373)	(280,275)
– Inflow	130,225	76,997	73,048	1,355	281,625
Interest rate derivatives:					
– Outflow	–	–	–	–	–
– Inflow	–	–	–	–	–
Equity derivatives:					
– Outflow	(1)	–	–	–	(1)
– Inflow	16	5	–	–	21
Bullion derivatives:					
– Outflow	(22)	–	–	–	(22)
– Inflow	–	–	–	–	–
Total outflow	(130,199)	(76,053)	(72,673)	(1,373)	(280,298)
Total inflow	130,241	77,002	73,048	1,355	281,646

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(b) Derivative cash flows (continued)

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

	2008				
	Up to 1 month HK$'m	1-3 months HK$'m	3-12 months HK$'m	1-5 years HK$'m	Total HK$'m
Foreign exchange derivatives:					
– Outflow	(146,872)	(69,270)	(62,608)	(1,722)	(280,472)
– Inflow	145,552	68,892	62,246	1,709	278,399
Interest rate derivatives:					
– Outflow	–	–	–	–	–
– Inflow	316	–	–	–	316
Equity derivatives:					
– Outflow	(444)	(236)	(1,659)	–	(2,339)
– Inflow	462	237	1,659	–	2,358
Bullion derivatives:					
– Outflow	(226)	(131)	–	–	(357)
– Inflow	–	–	–	–	–
Total outflow	(147,542)	(69,637)	(64,267)	(1,722)	(283,168)
Total inflow	146,330	69,129	63,905	1,709	281,073

(c) Off-balance sheet items

Loan commitments

The contractual amounts of the Group's off-balance sheet financial instruments as at 31 December 2009 that the Group commits to extend credit to customers and other facilities amounting to HK$233,844 million (2008: HK$219,336 million). Those loan commitments can be drawn within 1 year.

Financial guarantees and other financial facilities

Financial guarantees and other financial facilities of the Group as at 31 December 2009 amounting to HK$42,580 million (2008: HK$34,053 million) are maturing no later than 1 year.

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) 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.

	2009							
	On demand HK$'m	Up to 1 month HK$'m	1-3 months HK$'m	3-12 months HK$'m	1-5 years HK$'m	Over 5 years HK$'m	Indefinite HK$'m	Total HK$'m
Assets								
Cash and balances with banks and other financial institutions	91,290	69,498	–	–	–	–	–	160,788
Placements with banks and other financial institutions maturing between one and twelve months	–	–	26,170	34,112	–	–	–	60,282
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held	–	–	–	–	–	–	–	–
– others	–	10,793	2,051	2,018	1,266	2,467	–	18,595
– debt securities designated at fair value through profit or loss								
– certificates of deposit held	–	–	–	53	1,845	687	–	2,585
– others	–	69	80	228	8,493	10,278	–	19,148
– fund and equity securities	–	–	–	–	–	–	4,266	4,266
Derivative financial instruments	13,825	606	1,082	845	995	231	–	17,584
Hong Kong SAR Government certificates of indebtedness	38,310	–	–	–	–	–	–	38,310
Advances and other accounts								
– advances to customers	28,490	10,667	31,118	76,503	216,468	148,265	1,192	512,703
– trade bills	–	3,820	5,130	150	–	–	–	9,100
– advances to banks and other financial institutions	10	–	–	3,044	2,278	–	–	5,332
Investment in securities								
– debt securities held for available-for-sale								
– certificates of deposit held	–	3,250	1,247	4,588	10,023	–	–	19,108
– others	–	7,625	15,721	16,775	134,620	30,152	1,355	206,248
– debt securities held for held-to-maturity								
– certificates of deposit held	–	1,679	922	2,695	3,924	613	–	9,833
– others	–	2,433	2,942	23,351	26,331	6,864	685	62,606
– debt securities held for loans and receivables	–	169	1,774	10,760	–	–	–	12,703
– equity securities	–	–	–	–	–	–	3,257	3,257
Interests in associates	–	–	–	–	–	–	217	217
Investment properties	–	–	–	–	–	–	9,364	9,364
Properties, plant and equipment	–	–	–	–	–	–	26,286	26,286
Other assets (including deferred tax assets)	2,917	11,187	4	75	162	–	131	14,476
Total assets	174,842	121,796	88,241	175,197	406,405	199,557	46,753	1,212,791
Liabilities								
Hong Kong SAR currency notes in circulation	38,310	–	–	–	–	–	–	38,310
Deposits and balances of banks and other financial institutions	76,858	17,563	1,751	3,475	–	–	–	99,647
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued	–	–	–	–	–	–	–	–
– others	–	13,166	864	2,159	99	–	–	16,288
Derivative financial instruments	9,389	570	152	536	2,514	806	–	13,967
Deposits from customers	564,595	164,327	74,942	37,384	1,073	–	–	842,321
Other accounts and provisions (including current and deferred tax liabilities)	15,657	12,653	901	2,353	4,875	–	–	36,439
Insurance contract liabilities	1,704	663	13	1,321	23,012	6,695	–	33,408
Subordinated liabilities	–	–	–	13	–	26,763	–	26,776
Total liabilities	706,513	208,942	78,623	47,241	31,573	34,264	–	1,107,156
Net liquidity gap	(531,671)	(87,146)	9,618	127,956	374,832	165,293	46,753	105,635

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) Maturity analysis (continued)

	2008							
	On demand HK$'m	Up to 1 month HK$'m	1-3 months HK$'m	3-12 months HK$'m	1-5 years HK$'m	Over 5 years HK$'m	Indefinite HK$'m	Total HK$'m
Assets								
Cash and balances with banks and other financial institutions	77,935	75,334	–	–	–	–	–	153,269
Placements with banks and other financial institutions maturing between one and twelve months	–	–	38,622	51,096	–	–	–	89,718
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held	–	–	–	–	–	–	–	–
– others	–	4,628	6,685	1,927	685	6	–	13,931
– debt securities designated at fair value through profit or loss								
– certificates of deposit held	–	25	–	–	2,008	1,536	–	3,569
– others	–	226	426	384	7,058	15,840	4	23,938
– fund and equity securities	–	–	–	–	–	–	2,374	2,374
Derivative financial instruments	14,844	756	1,253	1,439	1,216	120	–	19,628
Hong Kong SAR Government certificates of indebtedness	34,200	–	–	–	–	–	–	34,200
Advances and other accounts								
– advances to customers	21,980	17,656	31,084	51,336	197,399	137,684	1,007	458,146
– trade bills	–	2,910	4,022	677	–	–	–	7,609
– advances to banks and other financial institutions	27	–	–	885	2,826	–	–	3,738
Investment in securities								
– debt securities held for available-for-sale								
– certificates of deposit held	–	–	23	5,236	2,096	–	–	7,355
– others	–	19,849	13,349	40,054	58,135	26,164	6,029	163,580
– debt securities held for held-to-maturity								
– certificates of deposit held	–	2,040	2,173	2,162	6,073	–	–	12,448
– others	–	2,115	4,933	14,560	49,480	15,905	7,024	94,017
– debt securities held for loans and receivables	–	1,755	2,675	8,165	–	–	–	12,595
– equity securities	–	–	–	–	–	–	1,686	1,686
Interests in associates	–	–	–	–	–	–	88	88
Investment properties	–	–	–	–	–	–	7,727	7,727
Properties, plant and equipment	–	–	–	–	–	–	22,795	22,795
Other assets (including deferred tax assets)	2,185	12,027	11	126	157	–	327	14,833
Total assets	151,171	139,321	105,256	178,047	327,133	197,255	49,061	1,147,244
Liabilities								
Hong Kong SAR currency notes in circulation	34,200	–	–	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions	61,206	13,646	10,655	3,272	–	–	–	88,779
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued	–	–	–	858	–	–	–	858
– others	–	6,111	6,363	8,170	166	270	–	21,080
Derivative financial instruments	10,556	2,137	1,689	1,967	2,822	1,279	–	20,450
Deposits from customers	428,849	238,769	100,891	32,696	1,372	–	–	802,577
Debt securities in issue at amortised cost	–	459	148	435	–	–	–	1,042
Other accounts and provisions (including current and deferred tax liabilities)	16,328	16,003	204	2,341	2,857	232	148	38,113
Insurance contract liabilities	1,406	792	2	16	18,033	8,025	–	28,274
Subordinated liabilities	–	–	–	21	735	26,583	–	27,339
Total liabilities	552,545	277,917	119,952	49,776	25,985	36,389	148	1,062,712
Net liquidity gap	(401,374)	(138,596)	(14,696)	128,271	301,148	160,866	48,913	84,532

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(C) 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 "Repayable 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.

4.4 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 arrangement.

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 upon 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 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 for standard risks (from a medical point of view) to reinsurer under an excess of loss reinsurance arrangement.

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 and persistency. In order to assess the uncertainty due to the mortality assumption and lapse assumption, the Group conducts mortality study and lapse study in order to determine the appropriate assumptions. In these studies, consistent results are reflected in both assumptions with appropriate 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 Group periodically reviews its capital structure and adjusts the capital mix where appropriate to achieve the required rate of return on capital.

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. ALCO monitors the Group's capital adequacy. The Group has complied with all the statutory capital standards for the reported periods.

For the implementation of Basel II in 2007, the Group has adopted the standardised approach under Pillar one to calculate the capital charge on credit risk, market risk and operational risk in compliance with the Banking (Capital) Rules. This new regulatory capital framework aligns regulatory capital requirements more closely with the inherent risks.

The Group established an Internal Capital Adequacy Assessment Process (ICAAP). Through this process, each material risk from the Group's main activities is assessed by pre-defined assessment models, and a comprehensive judgment of the overall risk profile is decided subsequently by taking into account the Group's governance structure, risk management quality, internal control environment and capital strength. Finally, the minimum CAR is derived through the procedures to relate the Group's overall risk profile to its capital adequacy. The minimum CAR aims to cover the various material risks undertaken by the Group. The Group considers this ICAAP process as an on-going process for capital management and periodically reviews and adjusts its capital structure in relation to the overall risk profile.

In addition, the annual capital plans of the Group are drawn up and discussed by the ALCO and submitted to the board for approval. 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. Based on this study, our future capital demand and the way to obtain the capital sources are derived. The plan is to ensure the Group's capital adequacy and achieve optimal capital structure in order to align with its business development needs and risk profile.

(a) Capital adequacy ratio

	2009	2008
Capital adequacy ratio	**16.85%**	16.17%
Core capital ratio	**11.64%**	10.86%

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

The differences between the basis of consolidation for accounting and regulatory purposes are described in "Appendix – Subsidiaries of the Company" on page 245.

4. Financial risk management (continued)

4.5 Capital Management (continued)

(b) Components of capital base after deductions

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

	2009 HK$'m	2008 HK$'m
Core capital:		
Paid up ordinary share capital	**43,043**	43,043
Reserves	**26,154**	18,049
Profit and loss account	**2,039**	2,956
Minority interests	**1,229**	1,124
	72,465	65,172
Deductions from core capital	**(334)**	(1,536)
Core capital	**72,131**	63,636
Supplementary capital:		
Fair value gains arising from holdings of available-for-sale securities	**237**	87
Collective loan impairment allowances	**1,598**	1,502
Regulatory reserve	**4,040**	4,503
Term subordinated debt	**26,763**	26,583
	32,638	32,675
Deductions from supplementary capital	**(334)**	(1,536)
Supplementary capital	**32,304**	31,139
Total capital base after deductions	**104,435**	94,775

Subsidiaries which are not included in the consolidation group for the calculation of capital adequacy ratios are denoted in "Appendix – Subsidiaries of the Company" on pages 243 to 245. Investment costs in such subsidiaries are deducted from the capital base.

Term subordinated debt represents subordinated loans qualified as Tier 2 Capital of BOCHK pursuant to the regulatory requirements of the HKMA.

4. Financial risk management (continued)

4.5 Capital Management (continued)

(c) Capital charge for credit, market and operational risks

The capital adequacy ratios shown above are calculated on the consolidation basis for regulatory purposes in accordance with the Banking (Capital) Rules. The table below summaries the capital requirements and capital charge calculated by applying 8% on the risk-weighted amounts, computed on the same consolidation basis for credit, market, and operational risks.

	2009 HK$'m	2008 HK$'m
Credit risk	**46,270**	43,609
Market risk	**962**	728
Operational risk	**3,788**	3,531
	51,020	47,868

(i) Capital requirements for credit risk

	2009					
	Total exposures HK$'m	Exposures after CRM* Rated HK$'m	Exposures after CRM* Unrated HK$'m	Risk-weighted amount Rated HK$'m	Risk-weighted amount Unrated HK$'m	Capital requirement** HK$'m
On-balance sheet exposures						
Sovereign	140,906	153,328	–	672	–	54
Public sector entity	7,558	23,213	–	4,055	–	324
Multilateral development bank	24,491	24,491	–	–	–	–
Bank	302,210	293,289	17,512	99,877	6,518	8,512
Securities firm	230	–	132	–	66	5
Corporate	371,929	80,871	266,387	40,203	266,386	24,527
Cash items	43,557	–	43,557	–	–	–
Regulatory retail	31,025	–	27,542	–	20,657	1,653
Residential mortgage loans	161,044	–	145,155	–	57,565	4,605
Other exposures which are not past due	39,243	–	38,755	–	38,755	3,100
Past due exposures	939	–	939	–	1,148	92
Total for on-balance sheet exposures	1,123,132	575,192	539,979	144,807	391,095	42,872
Off-balance sheet exposures						
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	39,923	9,007	30,916	4,724	30,508	2,818
OTC derivative transactions	7,732	6,845	887	2,329	718	244
Total for off-balance sheet exposures	47,655	15,852	31,803	7,053	31,226	3,062
Total for non-securitisation exposures	1,170,787	591,044	571,782	151,860	422,321	45,934
Securitisation exposures	7,413	7,413	–	4,193	–	336
	1,178,200	598,457	571,782	156,053	422,321	46,270

4. Financial risk management (continued)

4.5 Capital Management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk (continued)

	2008					
	Total exposures HK$'m	Exposures after CRM* Rated HK$'m	Exposures after CRM* Unrated HK$'m	Risk-weighted amount Rated HK$'m	Risk-weighted amount Unrated HK$'m	Capital requirement** HK$'m
On-balance sheet exposures						
Sovereign	137,693	142,513	–	602	–	48
Public sector entity	5,289	21,507	–	4,301	–	344
Multilateral development bank	5,887	5,887	–	–	–	–
Bank	321,992	318,872	12,807	96,789	5,909	8,216
Securities firm	12	–	–	–	–	–
Corporate	321,192	67,091	234,426	34,821	234,426	21,540
Cash items	39,451	–	39,451	–	–	–
Regulatory retail	31,919	–	30,312	–	22,734	1,819
Residential mortgage loans	149,084	–	132,716	–	53,708	4,296
Other exposures which are not past due	34,896	–	34,313	–	34,313	2,745
Past due exposures	800	–	800	–	871	70
Total for on-balance sheet exposures	1,048,215	555,870	484,825	136,513	351,961	39,078
Off-balance sheet exposures						
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	46,045	11,156	34,889	6,144	34,113	3,221
OTC derivative transactions	6,243	5,750	493	1,871	448	186
Total for off-balance sheet exposures	52,288	16,906	35,382	8,015	34,561	3,407
Total for non-securitisation exposures	1,100,503	572,776	520,207	144,528	386,522	42,485
Securitisation exposures	24,144	24,144	–	14,057	–	1,124
	1,124,647	596,920	520,207	158,585	386,522	43,609

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

** For disclosure purposes, capital requirement is calculated by applying 8% on the risk-weighted amount, which may differ from the Group's actual regulatory capital.

As at 31 December 2009, credit exposures deducted from the capital base amounted to HK$32 million (2008: HK$2,571 million).

The Group used the STC approach for calculation of credit risk.

4. Financial risk management (continued)

4.5 Capital Management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk (continued)

The ECAIs recognised by the Group includes Standard & Poor's, Moody's and Fitch. The Group adopted external rating based approach to determine the risk weight of the following classes of exposures, including those of securitisation exposures:

– Sovereign

– Public sector entity

– Multilateral development bank

– Bank

– Securities firm

– Corporate

The process the Group used to map ECAI issuer ratings to exposures booked in the banking book is a process prescribed in Part 4 of the Banking (Capital) Rules.

Counterparty credit risk exposures

The Group's counterparty credit risk arising from over-the-counter ("OTC") derivative transactions, repo-style transactions both in trading and banking book is subject to the same risk management framework as above mentioned. The Group established credit limit through formal credit approval procedures to control the pre-settlement credit risk arising from derivatives transactions and settlement limit to control the settlement risk arising from foreign exchange-related transactions in both the trading book and banking book. The Group monitors the risk exposure due to fluctuations in the market value by determining the current exposure value of the transactions. Exceptions or excesses are timely and closely identified and monitored by credit risk management units.

As the Group has not implemented capital allocation policy, there is no internal capital assigned for counterparty credit exposures.

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

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

4. Financial risk management (continued)

4.5 Capital Management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk (continued)

Counterparty credit risk exposures (continued)

The following table summarises the Group's exposures to counterparty credit risk arising from OTC derivative transactions:

	2009 HK$'m	2008 HK$'m
Gross total positive fair value	**3,382**	3,120
Credit equivalent amount	**7,732**	6,243
Less: recognised collateral	**–**	–
Net credit equivalent amount	**7,732**	6,243
Net credit equivalent amount analysed by type of issuer:		
Sovereign	**–**	4
Bank	**7,184**	5,830
Corporate	**548**	406
Others	**–**	3
	7,732	6,243
Risk weighted amount analysed by type of issuer:		
Sovereign	**–**	4
Bank	**2,499**	1,908
Corporate	**548**	405
Others	**–**	3
	3,047	2,320
Notional amount of recognised credit derivative contracts which provide credit protection	**–**	–

There is no effect of valid bilateral netting agreement on the credit equivalent amounts of the derivative transactions as at 31 December 2009 (2008: Nil).

There are no outstanding repo-style transactions or credit derivative contracts as at 31 December 2009 and 2008.

4. Financial risk management (continued)

4.5 Capital Management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk (continued)

Credit risk mitigation

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

The main types of recognised collaterals include cash deposit, gold bullion, debt securities, equities and funds for non past-due exposures. In addition, real property collateral is also recognised for past due exposures. Those collaterals taken by the Group are compliant with the comprehensive approach in its treatment of recognised collateral for credit risk mitigation in capital calculation as mentioned in the Banking (Capital) Rules.

According to the Banking (Capital) Rules, the recognised guarantees for credit risk mitigation under STC approach includes the guarantee given by sovereign, public sector entity, multilateral development bank, bank, securities firm with a lower risk weights than the counterparty; or corporate with external credit rating A- or above.

The concentration risk management for collaterals is embedded in the collateral management policy, including stress testing. To cope with the requirement under Pillar two, we have adopted a scorecard methodology to assess our credit concentration risk and consider whether add-on capital charge is needed to cover this risk.

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

Exposures, other than those arising from OTC derivative transactions and repo-style transactions, covered by recognised credit risk mitigation are analysed as follows:

	2009		2008	
	Covered by recognised collateral HK$'m	**Covered by recognised guarantees HK$'m**	Covered by recognised collateral HK$'m	Covered by recognised guarantees HK$'m
On-balance sheet exposures				
Public sector entity	**–**	**184**	–	70
Bank	**–**	**103**	–	–
Securities firm	**99**	**–**	12	–
Corporate	**6,134**	**34,190**	5,266	23,915
Regulatory retail	**1,189**	**2,251**	1,575	40
Residential mortgage loans	**51**	**15,838**	84	16,283
Other exposures which are not past due	**488**	**–**	583	–
Past due exposures	**471**	**25**	688	34
Off-balance sheet exposures	**7,736**	**12,095**	11,145	8,161
	16,168	**64,686**	19,353	48,503

4. Financial risk management (continued)

4.5 Capital Management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk (continued)

Asset securitisation

The Group has not acted as an originating institution in respect of securitisation transactions during the year. Securitisation exposures arising from the Group's investing activities are analysed as follows:

	2009			
	Total exposures HK$'m	**Risk weighted amounts HK$'m**	**Capital requirement HK$'m**	**Exposures deducted from capital base HK$'m**
Traditional securitisations				
Residential mortgages	**5,719**	**3,847**	**308**	**–**
Commercial mortgages	**160**	**32**	**3**	**–**
Student loans	**1,374**	**275**	**22**	**–**
Auto loans	**160**	**39**	**3**	**–**
	7,413	**4,193**	**336**	**–**

	2008			
	Total exposures HK$'m	Risk weighted amounts HK$'m	Capital requirement HK$'m	Exposures deducted from capital base HK$'m
Traditional securitisations				
Residential mortgages	19,830	13,175	1,054	1,769
Commercial mortgages	1,382	277	22	–
Student loans	1,953	390	31	–
Auto loans	785	176	14	–
Credit card receivables	194	39	3	–
	24,144	14,057	1,124	1,769

4. Financial risk management (continued)

4.5 Capital Management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(ii) Capital charge for market risk

	2009 HK$'m	2008 HK$'m
Interest rate exposures	**785**	569
Equity exposures	**24**	14
Foreign exchange exposures	**148**	142
Commodity exposures	**5**	3
	962	728

The Group used the STM approach for calculation of market risk.

The Group's positions covered by the STM approach are as follows:

	2009		2008	
	Long HK$'m	**Short HK$'m**	Long HK$'m	Short HK$'m
Interest rate exposures	**434,435**	**431,856**	383,286	382,934
Equity exposures	**144**	**37**	82	22
Foreign exchange exposures (Net)	**1,620**	**–**	1,463	–
Commodities exposures	**32**	**4**	11	15
	436,231	**431,897**	384,842	382,971

Equity exposures in banking book

Equity holdings in other entities are accounted for in accordance with the underlying intentions of holdings, at the outset of the acquisition of the respective equity exposures. Bookings for the equity holdings taken for relationship and strategic reasons will be separated from the bookings for equity holdings taken for other reasons (including the reason of capital appreciation).

Gains or losses related to equity exposures are summarised below:

	2009 HK$'m	2008 HK$'m
Realised gains from sales	**–**	97
Unrealised gains on revaluation recognised in reserves but not through profit or loss	**275**	163
Unrealised gains included in supplementary capital	**237**	87

4. Financial risk management (continued)

4.5 Capital Management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(iii) Capital charge for operational risk

	2009 HK$'m	2008 HK$'m
Capital charge for operational risk	**3,788**	3,531

The Group used the STO approach for calculation of operational risk.

4.6 Fair values of financial assets and liabilities

(a) Financial instruments not measured at fair value

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

Balances with banks and other financial institutions and Trade bills

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

Advances to customers, banks and other financial institutions

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

Held-to-maturity securities

Fair value for held-to-maturity securities is based on market prices or broker/dealer price quotations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. The carrying value and fair value as at 31 December 2009 amounted to HK$72,439 million (2008: HK$106,465 million) and HK$72,249 million (2008: HK$103,220 million) respectively.

Loans and receivables, Certificates of deposit issued and Debt securities in issue

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

Deposits from customers

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

Subordinated liabilities

All the subordinated liabilities are on floating rate terms, bear interest at prevailing market interest rates and their carrying value approximates fair value.

4. Financial risk management (continued)

4.6 Fair values of financial assets and liabilities (continued)

(b) Financial instruments measured at fair value

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

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

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

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

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

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

For certain illiquid debt securities and unlisted private equity held by the Group, management obtains valuation quotations from counterparties. The fair value of these financial instruments may be based on unobservable inputs which may have significant impact on the valuation of these financial instruments, and 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.

There have been no significant transfers between level 1 and 2 during the year 2009.

4. Financial risk management (continued)

4.6 Fair values of financial assets and liabilities (continued)

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

(i) Fair value hierarchy

	2009			
	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				
– Trading securities				
– Debt securities	**155**	**18,440**	**–**	**18,595**
– Equity securities	**37**	**111**	**–**	**148**
– Financial assets designated at fair value through profit or loss				
– Debt securities	**–**	**21,597**	**136**	**21,733**
– Fund	**2,757**	**–**	**–**	**2,757**
– Equity securities	**1,361**	**–**	**–**	**1,361**
Derivative financial instruments	**13,813**	**3,771**	**–**	**17,584**
Available-for-sale securities				
– Debt securities	**42,028**	**179,035**	**4,293**	**225,356**
– Equity securities	**2,630**	**484**	**143**	**3,257**
Financial liabilities				
Financial liabilities at fair value through profit or loss				
– Trading liabilities	**–**	**(14,156)**	**–**	**(14,156)**
– Financial liabilities designated at fair value through profit or loss	**–**	**(2,132)**	**–**	**(2,132)**
Derivative financial instruments	**(9,387)**	**(4,580)**	**–**	**(13,967)**

4. Financial risk management (continued)

4.6 Fair values of financial assets and liabilities (continued)

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

(ii) Reconciliation of level 3 items

	2009		
	Financial assets		
	Financial assets designated at fair value through profit or loss	Available-for-sale securities	
	Debt securities HK$'m	Debt securities HK$'m	Equity securities HK$'m
At 1 January 2009	2,284	5,131	141
(Losses)/gains			
– Profit or loss	(173)	345	–
– Other comprehensive income	–	102	2
Purchases	–	3,412	–
Sales	(916)	(4,641)	–
Transfers out of level 3	(1,059)	(56)	–
At 31 December 2009	136	4,293	143
Total losses for the year included in profit or loss for assets held as at 31 December 2009	(55)	(21)	–

(Losses)/gains included in profit or loss for the year as well as losses relating to assets held as at 31 December 2009 are presented in "Net trading income", "Net loss on financial instruments designated at fair value through profit or loss" or "Net reversal/(charge) of impairment allowances" depending on the nature or the category of the related financial instruments.

5. Net interest income

	2009 HK$'m	2008 HK$'m
Interest income		
Cash and due from banks and other financial institutions	**2,931**	5,523
Advances to customers	**10,499**	16,246
Listed investments	**2,992**	3,042
Unlisted investments	**5,117**	10,067
Others	**145**	403
	21,684	35,281
Interest expense		
Due to banks, customers and other financial institutions	**(2,753)**	(13,968)
Debt securities in issue	**(20)**	(130)
Subordinated liabilities	**(922)**	(250)
Others	**(57)**	(776)
	(3,752)	(15,124)
Net interest income	**17,932**	20,157

Included within interest income is HK$17 million (2008: HK$20 million) of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2009. Interest accrued on impaired investment in securities amounted to HK$484 million (2008: HK$362 million).

Included within interest income and interest expense are HK$21,233 million (2008: HK$33,664 million) and HK$3,688 million (2008: HK$14,338 million) for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

With effect from 1 January 2009, interest income and expense for interest rate derivatives held for trading have been reclassified from "Net interest income" to "Net trading income". The impact on the respective line items is not material in either 2009 or 2008 and as such comparative figures have not been restated.

6. Net fees and commission income

	2009 HK$'m	2008 HK$'m
Fees and commission income		
Securities brokerage		
– Stockbroking	**3,638**	2,380
– Bonds	**39**	259
Credit cards	**1,511**	1,417
Loan commissions	**922**	513
Bills commissions	**627**	683
Payment services	**495**	486
Currency exchange	**213**	204
Insurance	**212**	209
Safe deposit box	**191**	188
Trust services	**178**	173
Funds distribution	**97**	218
Others	**413**	484
	8,536	7,214
Fees and commission expenses		
Credit cards	**(1,100)**	(912)
Securities brokerage	**(563)**	(369)
Payment services	**(83)**	(79)
Others	**(282)**	(675)
	(2,028)	(2,035)
Net fees and commission income	**6,508**	5,179
Of which arise from		
– financial assets or financial liabilities not at fair value through profit or loss		
– Fees and commission income	**1,062**	680
– Fees and commission expenses	**(3)**	(42)
	1,059	638
– trust and other fiduciary activities		
– Fees and commission income	**410**	296
– Fees and commission expenses	**(6)**	(6)
	404	290

7. Net trading income

	2009 HK$'m	2008 HK$'m
Net gain/(loss) from:		
– foreign exchange and foreign exchange products	**1,273**	1,809
– interest rate instruments	**62**	(127)
– equity instruments	**26**	119
– commodities	**124**	113
	1,485	1,914

8. Net loss on investment in securities

	2009 HK$'m	2008 HK$'m
Net gain/(loss) from disposal of available-for-sale securities	**51**	(14)
Net loss from disposal/redemption of held-to-maturity securities	**(183)**	–
Net loss from disposal of loans and receivables	**–**	(1)
	(132)	(15)

9. Net insurance premium income

	2009 HK$'m	2008 HK$'m
Gross earned premiums	**7,762**	5,921
Less: Gross written premiums ceded to reinsurers	**(18)**	(30)
Net insurance premium income	**7,744**	5,891

10. Other operating income

	2009 HK$'m	2008 HK$'m
Dividend income from investment in securities		
– listed investments	**25**	109
– unlisted investments	**22**	17
Gross rental income from investment properties	**356**	320
Less: Outgoings in respect of investment properties	**(55)**	(52)
Others	**134**	167
	482	561

Included in the "Outgoings in respect of investment properties" is HK$8 million (2008: HK$2 million) of direct operating expenses related to investment properties that were not let during the year.

11. Net insurance benefits and claims

	2009 HK$'m	2008 HK$'m
Claims, benefits and surrenders paid	**2,537**	1,297
Movement in liabilities	**4,757**	6,419
Gross claims, benefits and surrenders paid and movement in liabilities	**7,294**	7,716
Less: Reinsurers' share of claims, benefits and surrenders paid and movement in liabilities	**(8)**	(7)
Net insurance claims, benefits and surrenders paid and movement in liabilities	**7,286**	7,709

12. Net reversal/(charge) of impairment allowances

	2009 HK$'m	2008 HK$'m
Advances to customers		
Individually assessed		
– new allowances	**(391)**	(813)
– releases	**150**	83
– recoveries	**446**	722
Net reversal/(charge) of individually assessed loan impairment allowances (Note 27)	**205**	(8)
Collectively assessed		
– new allowances	**(358)**	(691)
– releases	**15**	10
– recoveries	**35**	28
Net charge of collectively assessed loan impairment allowances (Note 27)	**(308)**	(653)
Net charge of loan impairment allowances	**(103)**	(661)
Available-for-sale securities		
Net reversal/(charge) of impairment losses on available-for-sale securities – Individually assessed	**612**	(7,839)
Held-to-maturity securities		
Net reversal/(charge) of impairment allowances on held-to-maturity securities – Individually assessed (Note 28)	**690**	(4,061)
Others	**(9)**	(12)
Net reversal/(charge) of impairment allowances	**1,190**	(12,573)

13. Operating expenses

	2009 HK$'m	2008 HK$'m
Staff costs (including directors' emoluments)		
– salaries and other costs	**4,659**	4,128
– termination benefit	**43**	55
– pension cost	**389**	371
	5,091	4,554
Premises and equipment expenses (excluding depreciation)		
– rental of premises	**491**	408
– information technology	**381**	411
– others	**288**	257
	1,160	1,076
Depreciation (Note 32)	**1,018**	992
Auditor's remuneration		
– audit services	**29**	33
– non-audit services	**6**	5
Lehman Brothers related products*	**3,278**	769
Other operating expenses	**1,559**	1,342
	12,141	8,771

* Expenses incurred on Lehman Brothers related products were primarily in relation to the Lehman Brothers minibonds ("Minibonds") repurchase arrangements announced on 22 July 2009 as summarised below.

Under the Repurchase Scheme (details are disclosed in note 3.7), the Group has, without admission of liability, made an offer to repurchase at a price equivalent to 60% of the nominal value of the principal invested for eligible customers below the age of 65 as at 1 July 2009 or at 70% of the nominal value of the principal invested for eligible customers aged 65 or above as at 1 July 2009. If any recovery is made from the Minibonds, the Group will make further payments to eligible customers who have accepted the Repurchase Scheme according to the terms set out in the scheme. The Group has also made a voluntary offer to pay an ex gratia amount to customers who would have qualified as eligible customers but for their previous settlements with the Group, to bring them in line with the Repurchase Scheme offer. The Group has further made available an amount equivalent to the total commission income received as a Minibonds distributor of approximately HK$160 million to the trustee of the Minibonds to fund the trustee's expenses in realising the value of the underlying collateral in respect of the outstanding Minibonds.

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

	2009 HK$'m	2008 HK$'m
Net gain on disposal of investment properties	**9**	14
Net gain/(loss) on fair value adjustments on investment properties (Note 31)	**1,554**	(132)
	1,563	(118)

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

	2009 HK$'m	2008 HK$'m
Net gain on disposal of premises	**45**	35
Net loss on disposal of other fixed assets	**(10)**	(4)
Net gain/(loss) on revaluation of premises (Note 32)	**15**	(24)
	50	7

16. Taxation

Taxation in the income statement represents:

	2009 HK$'m	2008 HK$'m
Hong Kong profits tax		
Current tax		
– current year taxation	**2,339**	1,326
– over-provision in prior years	**(4)**	(13)
	2,335	1,313
Deferred tax charge/(credit) (Note 39)		
– origination/(reversal) of temporary differences	**225**	(341)
– impact of change of Hong Kong tax rate	**–**	(123)
	225	(464)
Hong Kong profits tax	**2,560**	849
Overseas taxation	**118**	222
	2,678	1,071

Hong Kong profits tax has been provided at the rate of 16.5% (2008: 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.

16. Taxation (continued)

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:

	2009 HK$'m	2008 HK$'m
Profit before taxation	**16,724**	4,078
Calculated at a taxation rate of 16.5% (2008: 16.5%)	**2,759**	673
Effect of different taxation rates in other countries	**8**	64
Income not subject to taxation	**(139)**	(295)
Expenses not deductible for taxation purposes	**58**	522
Tax losses not recognised	**1**	137
Utilisation of previously unrecognised tax losses	**(5)**	(17)
Over-provision in prior years	**(4)**	(13)
Taxation charge	**2,678**	1,071
Effective tax rate	**16.0%**	26.3%

17. Profit attributable to the equity holders of the Company

The profit of the Company for the year ended 31 December 2009 attributable to the equity holders of the Company and dealt with in the financial statements of the Company amounted to HK$10,293 million (2008: HK$1,372 million).

18. Dividends

	2009		2008	
	Per share HK$	Total HK$'m	Per share HK$	Total HK$'m
Interim dividend paid	**0.285**	**3,013**	0.438	4,631
Proposed final dividend	**0.570**	**6,027**	–	–
	0.855	**9,040**	0.438	4,631

At a meeting held on 27 August 2009, the Board declared an interim dividend of HK$0.285 per ordinary share for the first half of 2009 amounting to approximately HK$3,013 million.

At a meeting held on 23 March 2010, the Board proposed to declare a final dividend of HK$0.57 per ordinary share for the year ended 31 December 2009 amounting to approximately HK$6,027 million. This declared 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 2010.

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 2009 of approximately HK$13,725 million (2008: HK$3,343 million) and on the ordinary shares in issue of 10,572,780,266 shares (2008: 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 2009 (2008: 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 20 years of service, or at a scale ranging from 20% to 95% for employees who have completed between 3 to 20 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 2009 amounted to approximately HK$317 million (2008: approximately HK$312 million), after a deduction of forfeited contributions of approximately HK$7 million (2008: approximately HK$10 million). For the MPF Scheme, the Group contributed approximately HK$36 million (2008: approximately HK$38 million) for the year ended 31 December 2009.

21. Share option schemes

(a) Share Option Scheme and Sharesave Plan

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

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

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

No options were granted pursuant to the Share Option Scheme or the Sharesave Plan during the year 2009 (2008: Nil).

21. Share option schemes (continued)

(b) Pre-Listing Share Option Scheme

On 5 July 2002, several directors together with approximately 60 senior management personnel of the Group and employees of BOC were granted options by BOC (BVI), the immediate holding company of the Company, pursuant to a Pre-Listing Share Option Scheme to purchase from BOC (BVI) an aggregate of 31,132,600 existing issued shares of the Company. The Group has taken advantage of the transitional provisions set out in paragraph 53 of HKFRS 2 under which the new recognition and measurement policies have not been applied to all options granted to employees on or before 7 November 2002.

Details of the share options outstanding as at 31 December 2009 and 2008 are disclosed as follows:

	Directors	Senior management	Others*	Total number of share options	Average exercise price (HK$ per share)
At 1 January 2009	**6,290,100**	**1,361,200**	**–**	**7,651,300**	**8.5**
Transfer	**(1,590,600)**	**–**	**1,590,600**	**–**	**8.5**
Less: Share options exercised during the year	**(723,000)**	**(286,900)**	**(1,590,600)**	**(2,600,500)**	**8.5**
At 31 December 2009	**3,976,500**	**1,074,300**	**–**	**5,050,800**	**8.5**
Exercisable at 31 December 2009	**3,976,500**	**1,074,300**	**–**	**5,050,800**	**8.5**
At 1 January 2008	6,651,600	2,253,100	1,446,000	10,350,700	8.5
Less: Share options exercised during the year	(361,500)	(891,900)	(1,446,000)	(2,699,400)	8.5
At 31 December 2008	6,290,100	1,361,200	–	7,651,300	8.5
Exercisable at 31 December 2008	6,290,100	1,361,200	–	7,651,300	8.5

* Represented share options held by ex-directors of the Group.

Share options were exercised on a regular basis throughout the year, the weighted average share price during the year was HK$16.83 (2008: HK$18.65).

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

22. Directors' and senior management's emoluments

(a) Directors' emoluments

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

For the year 2009	Directors' fees HK$'000	Basic salaries, allowances and benefits in kind HK$'000	Contributions to pension schemes HK$'000	Bonus HK$'000	Total HK$'000
Executive Directors					
He Guangbei	100	6,210	–	2,777	9,087
Lee Raymond Wing Hung	137	2,617	93	–	2,847
Gao Yingxin	100	4,485	–	1,677	6,262
	337	13,312	93	4,454	18,196
Non-executive Directors					
Xiao Gang	–	–	–	–	–
Li Lihui	154	–	–	–	154
Sun Changji	146	–	–	–	146
Li Zaohang	253	–	–	–	253
Zhou Zaiqun	420	–	–	–	420
Zhang Yanling	253	–	–	–	253
Fung Victor Kwok King*	300	–	–	–	300
Koh Beng Seng*	350	–	–	–	350
Shan Weijian*	350	–	–	–	350
Tung Chee Chen*	300	–	–	–	300
Tung Savio Wai-Hok*	350	–	–	–	350
Yang Linda Tsao*	400	–	–	–	400
	3,276	–	–	–	3,276
	3,613	13,312	93	4,454	21,472

During the year, Mr. Li Lihui was appointed as non-executive director on 26 June 2009. Mr. Lee Raymond Wing Hung and Mr. Sun Changji resigned as executive director on 1 June 2009 and non-executive director on 26 June 2009 respectively.

22. Directors' and senior management's emoluments (continued)

(a) Directors' emoluments (continued)

For the year 2008	Directors' fees HK$'000	Basic salaries, allowances and benefits in kind HK$'000	Contributions to pension schemes HK$'000	Bonus HK$'000	Total HK$'000
Executive Directors					
He Guangbei	100	6,013	–	–	6,113
Lee Raymond Wing Hung	414	6,979	247	–	7,640
Gao Yingxin	100	4,308	–	–	4,408
	614	17,300	247	–	18,161
Non-executive Directors					
Xiao Gang	–	–	–	–	–
Sun Changji	300	–	–	–	300
Li Zaohang	250	–	–	–	250
Zhou Zaiqun	365	–	–	–	365
Zhang Yanling	250	–	–	–	250
Fung Victor Kwok King*	300	–	–	–	300
Koh Beng Seng*	350	–	–	–	350
Shan Weijian*	350	–	–	–	350
Tung Chee Chen*	300	–	–	–	300
Tung Savio Wai-Hok*	350	–	–	–	350
Yang Linda Tsao*	400	–	–	–	400
	3,215	–	–	–	3,215
	3,829	17,300	247	–	21,376

Note:

* Independent Non-executive Directors

In July 2002, options were granted to several directors of the Company by the immediate holding company, BOC (BVI), under the Pre-Listing Share Option Scheme as set out in Note 21(b). Full details of the scheme are stated in Note 21. During the year, certain options were exercised, but no benefits arising from the granting of these share options were included in the directors' emoluments disclosed above or recognised in the income statement.

For the year ended 31 December 2009, one of the directors waived emoluments of HK$200,000 (2008: HK$200,000).

22. Directors' and senior management's emoluments (continued)

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include 2 (2008: 2) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining 3 (2008: 3) individuals during the year are as follows:

	2009 HK$'m	2008 HK$'m
Basic salaries and allowances	**18**	13
Bonuses	**3**	–
Contributions to pension schemes	**1**	1
Directors' fee from subsidiaries	**1**	1
	23	15

Emoluments of individuals were within the following bands:

	Number of individuals	
	2009	2008
HK$4,000,001 – HK$4,500,000	**–**	1
HK$4,500,001 – HK$5,000,000	**–**	1
HK$5,500,001 – HK$6,000,000	**1**	1
HK$6,000,001 – HK$6,500,000	**1**	–
HK$10,500,001 – HK$11,000,000	**1**	–

23. Cash and balances with banks and other financial institutions

	2009 HK$'m	2008 HK$'m
Cash	**3,409**	4,232
Balances with central banks	**81,790**	66,158
Balances with banks and other financial institutions	**6,091**	7,545
Placements with banks and other financial institutions maturing within one month	**69,498**	75,334
	160,788	153,269

24. Financial assets at fair value through profit or loss

	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	2009 HK$'m	2008 HK$'m	**2009 HK$'m**	2008 HK$'m	**2009 HK$'m**	2008 HK$'m
At fair value						
Debt securities						
– Listed in Hong Kong	**333**	412	**1,063**	557	**1,396**	969
– Listed outside Hong Kong	**2,408**	35	**3,264**	3,095	**5,672**	3,130
	2,741	447	**4,327**	3,652	**7,068**	4,099
– Unlisted	**15,854**	13,484	**17,406**	23,855	**33,260**	37,339
	18,595	13,931	**21,733**	27,507	**40,328**	41,438
Fund						
– Unlisted	**–**	–	**2,757**	2,168	**2,757**	2,168
Equity securities						
– Listed in Hong Kong	**37**	20	**1,361**	124	**1,398**	144
– Unlisted	**111**	62	**–**	–	**111**	62
	148	82	**1,361**	124	**1,509**	206
Total	**18,743**	14,013	**25,851**	29,799	**44,594**	43,812

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

	2009 HK$'m	2008 HK$'m
Sovereigns	**15,970**	13,082
Public sector entities	**1,496**	1,791
Banks and other financial institutions	**21,853**	25,668
Corporate entities	**5,275**	3,271
	44,594	43,812

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

	2009 HK$'m	2008 HK$'m
Treasury bills	**14,419**	12,458
Certificates of deposit held	**2,585**	3,569
Other financial assets at fair value through profit or loss	**27,590**	27,785
	44,594	43,812

25. Derivative financial instruments and hedge accounting

The Group enters into the following equity, foreign exchange, interest rate and precious metal related derivative financial instruments 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 contracted 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 (i.e. cross-currency interest rate swaps). Except for certain currency swap contracts, no exchange of principal takes place.

Foreign currency, interest rate, equity and precious metal 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 consolidated balance sheet. However, they do not necessarily indicate the amounts of future cash flows involved or the current fair values of the instruments and, therefore, do not indicate the Group's exposure to credit or market risks. The derivative financial instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates, foreign exchange rates or equity and metal prices relative to their terms. The aggregate fair values of derivative financial instruments assets and liabilities can fluctuate significantly from time to time.

(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 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 and management alert limit (MAL) in profit and loss is set. Every derivative transaction must be input into the relevant system for settlement, mark to market revaluation, reporting and control.

25. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

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

	2009			
	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting* HK$'m	Total HK$'m
Exchange rate contracts				
Spot and forwards	264,014	–	3,718	267,732
Swaps	269,978	1,112	68	271,158
Foreign currency option contracts				
– Options purchased	1,387	–	–	1,387
– Options written	1,603	–	–	1,603
	536,982	1,112	3,786	541,880
Interest rate contracts				
Futures	655	–	–	655
Swaps	140,088	32,471	23,665	196,224
Interest rate option contracts				
– Bond options written	853	–	–	853
	141,596	32,471	23,665	197,732
Bullion contracts	8,290	–	–	8,290
Equity contracts	209	–	–	209
Other contracts	117	–	–	117
Total	687,194	33,583	27,451	748,228

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

25. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

	2008			
	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting HK$'m	Total HK$'m
Exchange rate contracts				
Spot and forwards	182,624	–	–	182,624
Swaps	248,956	–	68	249,024
Foreign currency option contracts				
– Options purchased	2,518	–	–	2,518
– Options written	2,754	–	–	2,754
	436,852	–	68	436,920
Interest rate contracts				
Futures	4,290	–	–	4,290
Swaps	68,392	19,931	10,045	98,368
Interest rate option contracts				
– Bond options written	775	–	–	775
	73,457	19,931	10,045	103,433
Bullion contracts	3,880	–	–	3,880
Equity contracts	5,070	–	–	5,070
Other contracts	144	–	–	144
Total	519,403	19,931	10,113	549,447

25. 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:

	2009							
	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 and forwards	13,472	–	–	13,472	(9,268)	–	(3)	(9,271)
Swaps	2,083	17	5	2,105	(741)	(20)	(6)	(767)
Foreign currency option contracts								
– Options purchased	10	–	–	10	–	–	–	–
– Options written	–	–	–	–	(9)	–	–	(9)
	15,565	17	5	15,587	(10,018)	(20)	(9)	(10,047)
Interest rate contracts								
Futures	2	–	–	2	–	–	–	–
Swaps	1,255	92	15	1,362	(2,246)	(1,203)	(92)	(3,541)
Interest rate option contracts								
– Bond options written	–	–	–	–	(4)	–	–	(4)
	1,257	92	15	1,364	(2,250)	(1,203)	(92)	(3,545)
Bullion contracts	631	–	–	631	(374)	–	–	(374)
Equity contracts	2	–	–	2	(1)	–	–	(1)
Total	17,455	109	20	17,584	(12,643)	(1,223)	(101)	(13,967)

25. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

	2008							
	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 and forwards	15,152	–	–	15,152	(10,962)	–	–	(10,962)
Swaps	1,624	–	1	1,625	(3,933)	–	(3)	(3,936)
Foreign currency option contracts								
– Options purchased	21	–	–	21	–	–	–	–
– Options written	–	–	–	–	(24)	–	–	(24)
	16,797	–	1	16,798	(14,919)	–	(3)	(14,922)
Interest rate contracts								
Futures	2	–	–	2	(6)	–	–	(6)
Swaps	1,420	–	18	1,438	(2,329)	(1,769)	(166)	(4,264)
Interest rate option contracts								
– Bond options written	–	–	–	–	(25)	–	–	(25)
	1,422	–	18	1,440	(2,360)	(1,769)	(166)	(4,295)
Bullion contracts	248	–	–	248	(91)	–	–	(91)
Equity contracts	1,142	–	–	1,142	(1,142)	–	–	(1,142)
Total	19,609	–	19	19,628	(18,512)	(1,769)	(169)	(20,450)

25. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

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

	2009 HK$'m	2008 HK$'m
Exchange rate contracts		
Forwards	**580**	318
Swaps	**1,728**	1,377
Foreign currency option contracts		
– Options purchased	**1**	4
Interest rate contracts		
Futures	**–**	2
Swaps	**737**	577
Bullion contracts	**1**	5
Equity contracts	**–**	37
	3,047	2,320

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

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

(b) Hedge accounting

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

	2009		2008	
	Assets HK$'m	**Liabilities HK$'m**	Assets HK$'m	Liabilities HK$'m
Fair value hedges	**92**	**(1,203)**	–	(1,769)
Cash flow hedges	**17**	**(20)**	–	–
	109	**(1,223)**	–	(1,769)

25. 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 arising from movements in market interest rates.

Gains or losses on fair value hedges for the year are as follows:

	2009 HK$'m	2008 HK$'m
Net gain/(loss) on		
– hedging instruments	**707**	(1,656)
– hedged items	**(699)**	1,677
	8	21

(ii) Cash flow hedges

The Group uses cross-currency interest rate swaps to hedge against variability in future cash flows.

There are no ineffective cash flow hedges during the year 2009 (2008: Nil).

26. Advances and other accounts

	2009 HK$'m	2008 HK$'m
Personal loans and advances	**161,439**	151,784
Corporate loans and advances	**353,533**	308,663
Advances to customers	**514,972**	460,447
Loan impairment allowances		
– Individually assessed	**(671)**	(800)
– Collectively assessed	**(1,598)**	(1,501)
	512,703	458,146
Trade bills	**9,100**	7,609
Advances to banks and other financial institutions	**5,332**	3,738
Total	**527,135**	469,493

As at 31 December 2009, advances to customers included accrued interest on gross advances of HK$619 million (2008: HK$1,293 million).

As at 31 December 2009 and 2008, no impairment allowance was made in respect of trade bills and advances to banks and other financial institutions.

27. Loan impairment allowances

	2009		
	Individual assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2009	71	729	800
Credited to income statement (Note 12)	(48)	(157)	(205)
Loans written off during the year as uncollectible	(10)	(343)	(353)
Recoveries	28	418	446
Unwind of discount on allowance	(1)	(16)	(17)
At 31 December 2009	40	631	671

	2009		
	Collective assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2009	179	1,322	1,501
Charged to income statement (Note 12)	198	110	308
Loans written off during the year as uncollectible	(242)	(4)	(246)
Recoveries	35	–	35
At 31 December 2009	170	1,428	1,598

27. Loan impairment allowances (continued)

	2008		
	Individual assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2008	82	299	381
(Credited)/charged to income statement (Note 12)	(30)	38	8
Loans written off during the year as uncollectible	(13)	(286)	(299)
Recoveries	33	689	722
Unwind of discount on allowance	(1)	(11)	(12)
At 31 December 2008	71	729	800

	2008		
	Collective assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2008	173	831	1,004
Charged to income statement (Note 12)	156	497	653
Loans written off during the year as uncollectible	(175)	(1)	(176)
Recoveries	28	–	28
Unwind of discount on allowance	(3)	(5)	(8)
At 31 December 2008	179	1,322	1,501

28. Investment in securities

	2009 HK$'m	2008 HK$'m
The Group		
(a) Available-for-sale securities		
Debt securities, at fair value		
– Listed in Hong Kong	**8,439**	4,588
– Listed outside Hong Kong	**84,389**	44,692
	92,828	49,280
– Unlisted	**132,528**	121,655
	225,356	170,935
Equity securities, at fair value		
– Listed in Hong Kong	**2,630**	1,256
– Unlisted	**627**	430
	3,257	1,686
	228,613	172,621
(b) Held-to-maturity securities		
Listed, at amortised cost		
– in Hong Kong	**1,693**	4,082
– outside Hong Kong	**21,167**	21,302
	22,860	25,384
Unlisted, at amortised cost	**49,691**	85,521
	72,551	110,905
Impairment allowances	**(112)**	(4,440)
	72,439	106,465
(c) Loans and receivables		
Unlisted, at amortised cost	**12,703**	12,595
Total	**313,755**	291,681
Market value of listed held-to-maturity securities	**22,711**	24,354

	2009 HK$'m	2008 HK$'m
The Company		
Available-for-sale securities		
Equity securities, at fair value		
– Listed in Hong Kong	**2,630**	1,256

28. Investment in securities (continued)

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

	2009			
	Available-for-sale securities HK$'m	**Held-to-maturity securities HK$'m**	**Loans and receivables HK$'m**	**Total HK$'m**
The Group				
Sovereigns	**57,583**	**3,271**	**–**	**60,854**
Public sector entities	**27,902**	**5,131**	**–**	**33,033**
Banks and other financial institutions	**129,629**	**56,806**	**12,703**	**199,138**
Corporate entities	**13,499**	**7,231**	**–**	**20,730**
	228,613	**72,439**	**12,703**	**313,755**

	2008			
	Available-for-sale securities HK$'m	Held-to-maturity securities HK$'m	Loans and receivables HK$'m	Total HK$'m
The Group				
Sovereigns	70,274	1,079	–	71,353
Public sector entities	9,202	12,481	–	21,683
Banks and other financial institutions	71,832	72,498	12,595	156,925
Corporate entities	21,313	20,407	–	41,720
	172,621	106,465	12,595	291,681

As at 31 December 2009 and 2008, all of the available-for-sale securities held by the Company are issued by banks and other financial institutions.

The movements in investment in securities are summarised as follows:

	2009		
	Available-for-sale securities HK$'m	**Held-to-maturity securities HK$'m**	**Loans and receivables HK$'m**
The Group			
At 1 January 2009	**172,621**	**106,465**	**12,595**
Additions	**304,167**	**22,855**	**37,609**
Disposals, redemptions and maturity	**(258,913)**	**(58,303)**	**(37,909)**
Amortisation	**555**	**(519)**	**239**
Change in fair value	**6,901**	**–**	**–**
Impairment reversal (Note 12)	**–**	**690**	**–**
Exchange differences	**3,282**	**1,251**	**169**
At 31 December 2009	**228,613**	**72,439**	**12,703**

28. Investment in securities (continued)

	2008		
	Available-for-sale securities HK$'m	Held-to-maturity securities HK$'m	Loans and receivables HK$'m
The Group			
At 1 January 2008	104,653	165,428	31,102
Additions	182,457	57,186	33,918
Disposals, redemptions and maturity	(101,229)	(106,014)	(52,627)
Amortisation	544	(1,035)	640
Change in fair value	(10,570)	–	–
Impairment losses (Note 12)	–	(4,061)	–
Exchange differences	(3,234)	(5,039)	(438)
At 31 December 2008	172,621	106,465	12,595

	Available-for-sale securities	
	2009 HK$'m	2008 HK$'m
The Company		
At 1 January	**1,256**	4,135
Change in fair value	**1,374**	(2,879)
At 31 December	**2,630**	1,256

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

	Available-for-sale securities		Held-to-maturity securities	
	2009 HK$'m	2008 HK$'m	**2009 HK$'m**	2008 HK$'m
The Group				
Treasury bills	**22,955**	60,980	**1,041**	100
Certificates of deposit held	**19,108**	7,355	**9,833**	12,448
Others	**186,550**	104,286	**61,565**	93,917
	228,613	172,621	**72,439**	106,465

28. Investment in securities (continued)

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

	2009 HK$'m	2008 HK$'m
The Group		
At 1 January	**4,440**	1,682
(Credited)/charged to income statement (Note 12)	**(690)**	4,061
Disposals	**(3,638)**	(1,303)
At 31 December	**112**	4,440

29. Investment in subsidiaries

	2009 HK$'m	2008 HK$'m
Unlisted shares, at cost	**54,784**	54,019

The particulars of all direct and indirect subsidiaries of the Company are set out in the Appendix of the Annual Report, "Subsidiaries of the Company". The following is a list of principal subsidiaries as at 31 December 2009:

Name	Country of incorporation & place of operation	Particulars of issued share 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	286,800,000 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	250,000 ordinary shares of HK$100 each	100%	Commodities brokerage
Nanyang Commercial Bank (China), Limited	PRC	Registered capital RMB4,100,000,000	100%	Banking business

* Shares held directly by the Company

30. Interests in associates

	2009 HK$'m	2008 HK$'m
At 1 January	**88**	83
Investment cost addition	**129**	–
Share of result	**10**	9
Share of tax	**(3)**	(2)
Dividends received	**(4)**	(2)
Disposal of an associate	**(3)**	–
At 31 December	**217**	88

The Group's interests in its associates, all of which are unlisted, are as follows:

Name	**Joint Electronic Teller Services Limited**		**BOC Services Company Limited**		**BOC Expresspay Company Limited**	
Place of incorporation	**2009** and 2008 **Hong Kong**		**2009** and 2008 **PRC**		**2009** **PRC**	
Particulars of issued share capital/registered capital	**100,238 ordinary shares of HK$100 each**		**Registered capital RMB50,000,000**		**Registered capital RMB450,000,000**	
Principal activities	**Operation of a private inter-bank message switching network in respect of ATM services**		**Credit card back-end service support**		**Prepay debit card services**	
	2009 **HK$'000**	2008 HK$'000	**2009** **HK$'000**	2008 HK$'000	**2009** **HK$'000**	2008 HK$'000
Assets	**418,652**	371,144	**162,324**	108,145	**514,906**	–
Liabilities	**131,861**	86,283	**90,559**	45,250	**4,967**	–
Revenues	**70,243**	75,297	**270,602**	118,274	**–**	–
Profit/(loss) after taxation	**31,864**	34,752	**8,757**	5,166	**(317)**	–
	2009	2008	**2009**	2008	**2009**	2008
Interest held	**19.96%**	19.96%	**45.00%**	45.00%	**25.33%**	–

On 1 December 2009, the Group disposed its entire interest in CJM Insurance Brokers Limited.

BOC Expresspay Company Limited was incorporated in China on 16 August 2009.

31. Investment properties

	2009 HK$'m	2008 HK$'m
At 1 January	**7,727**	8,058
Disposals	**(77)**	(186)
Fair value gains/(losses) (Note 14)	**1,554**	(132)
Reclassification from/(to) properties, plant and equipment (Note 32)	**160**	(13)
At 31 December	**9,364**	7,727

As at 31 December 2009, investment properties are included in the consolidated balance sheet at valuation carried out at 31 December 2009 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited.

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

	2009 HK$'m	2008 HK$'m
Held in Hong Kong		
On long-term lease (over 50 years)	**1,474**	7,040
On medium-term lease (10 – 50 years)	**7,683**	505
On short-term lease (less than 10 years)	**23**	–
Held outside Hong Kong		
On long-term lease (over 50 years)	**1**	1
On medium-term lease (10 – 50 years)	**183**	177
On short-term lease (less than 10 years)	**–**	4
	9,364	7,727

32. Properties, plant and equipment

	Premises HK$'m	Equipment, fixtures and fittings HK$'m	Total HK$'m
Net book value at 1 January 2009	**20,105**	**2,690**	**22,795**
Additions	**1**	**573**	**574**
Disposals	**(140)**	**(12)**	**(152)**
Revaluation	**4,247**	**–**	**4,247**
Depreciation for the year (Note 13)	**(386)**	**(632)**	**(1,018)**
Reclassification to investment properties (Note 31)	**(157)**	**(3)**	**(160)**
Transfer	**31**	**(31)**	**–**
Net book value at 31 December 2009	**23,701**	**2,585**	**26,286**
At 31 December 2009			
Cost or valuation	**23,701**	**6,531**	**30,232**
Accumulated depreciation and impairment	**–**	**(3,946)**	**(3,946)**
Net book value at 31 December 2009	**23,701**	**2,585**	**26,286**
Net book value at 1 January 2008	20,783	2,510	23,293
Additions	42	776	818
Disposals	(68)	(5)	(73)
Revaluation	(265)	–	(265)
Depreciation for the year (Note 13)	(400)	(592)	(992)
Reclassification from investment properties (Note 31)	13	–	13
Exchange difference	–	1	1
Net book value at 31 December 2008	20,105	2,690	22,795
At 31 December 2008			
Cost or valuation	20,105	6,239	26,344
Accumulated depreciation and impairment	–	(3,549)	(3,549)
Net book value at 31 December 2008	20,105	2,690	22,795
The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2009			
At cost	**–**	**6,531**	**6,531**
At valuation	**23,701**	**–**	**23,701**
	23,701	**6,531**	**30,232**
At 31 December 2008			
At cost	–	6,239	6,239
At valuation	20,105	–	20,105
	20,105	6,239	26,344

32. Properties, plant and equipment (continued)

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

	2009 HK$'m	2008 HK$'m
Held in Hong Kong		
On long-term lease (over 50 years)	**8,618**	12,825
On medium-term lease (10 – 50 years)	**14,691**	6,873
Held outside Hong Kong		
On long-term lease (over 50 years)	**69**	75
On medium-term lease (10 – 50 years)	**276**	306
On short-term lease (less than 10 years)	**47**	26
	23,701	20,105

As at 31 December 2009, premises are included in the consolidated balance sheet at valuation carried out at 31 December 2009 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited.

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 respectively as follows:

	2009 HK$'m	2008 HK$'m
Increase/(decrease) in valuation credited/(charged) to premises revaluation reserve	**4,208**	(250)
Increase/(decrease) in valuation credited/(charged) to income statement (Note 15)	**15**	(24)
Increase in valuation credited to non-controlling interests	**24**	9
	4,247	(265)

As at 31 December 2009, the net book value of premises that would have been included in the Group's consolidated balance sheet had the assets been carried at cost less accumulated depreciation and impairment losses was HK$6,257 million (2008: HK$6,123 million).

33. Other assets

	2009 HK$'m	2008 HK$'m
Repossessed assets	**95**	124
Precious metals	**2,432**	1,347
Accounts receivable and prepayments	**11,800**	13,208
	14,327	14,679

34. 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.

35. Financial liabilities at fair value through profit or loss

	2009 HK$'m	2008 HK$'m
Trading liabilities		
– Short positions in Exchange Fund Bills	**14,156**	12,141
Financial liabilities designated at fair value through profit or loss		
– Structured deposits (Note 36)	**2,132**	8,939
– Certificates of deposit issued	**–**	858
	2,132	9,797
	16,288	21,938

The carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2009 is less than the amount that the Group would be contractually required to pay at maturity to the holders by HK$1 million, and it was more than the amount that the Group would be contractually required to pay at maturity to the holders by HK$5 million as at 31 December 2008. 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 credit risk is insignificant.

36. Deposits from customers

	2009 HK$'m	2008 HK$'m
Current, savings and other deposit accounts (per consolidated balance sheet)	**842,321**	802,577
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 35)	**2,132**	8,939
	844,453	811,516
Analysed by:		
Demand deposits and current accounts		
– corporate customers	**51,043**	35,867
– individual customers	**14,397**	10,175
	65,440	46,042
Savings deposits		
– corporate customers	**141,560**	115,918
– individual customers	**353,952**	261,355
	495,512	377,273
Time, call and notice deposits		
– corporate customers	**110,941**	150,526
– individual customers	**172,560**	237,675
	283,501	388,201
	844,453	811,516

37. Other accounts and provisions

	2009 HK$'m	2008 HK$'m
Other accounts payable	29,592	34,297
Provisions	338	576
	29,930	34,873

	2009 HK$'m	2008 HK$'m
Movements of provisions		
At 1 January	576	9
Allowance for the year, net	3,301	742
Utilised during the year	(3,539)	(175)
At 31 December	338	576

The provisions were primarily in relation to the Lehman Brothers related products.

38. Assets pledged as security

As at 31 December 2009, liabilities of the Group amounting to HK$13,330 million (2008: HK$12,141 million) were secured by assets deposited with central depositories to facilitate settlement operations. The amount of assets pledged by the Group to secure these liabilities was HK$13,407 million (2008: HK$12,243 million) included in "Trading securities" and "Available-for-sale securities".

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 consolidated balance sheet, and the movements during the year are as follows:

	2009					
	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 2009	545	3,464	(126)	(254)	(984)	2,645
(Credited)/charged to income statement (Note 16)	(5)	214	(13)	(20)	49	225
Charged to other comprehensive income	–	681	–	–	891	1,572
At 31 December 2009	540	4,359	(139)	(274)	(44)	4,442

39. Deferred taxation (continued)

	2008					
	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 2008	533	3,777	(15)	(169)	(182)	3,944
Charged/(credited) to income statement (Note 16)	12	(205)	(111)	(85)	(75)	(464)
Credited to other comprehensive income	–	(108)	–	–	(727)	(835)
At 31 December 2008	545	3,464	(126)	(254)	(984)	2,645

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 consolidated balance sheet:

	2009 HK$'m	2008 HK$'m
Deferred tax assets	**(149)**	(154)
Deferred tax liabilities	**4,591**	2,799
	4,442	2,645

	2009 HK$'m	2008 HK$'m
Deferred tax assets to be recovered after more than twelve months	**(137)**	(154)
Deferred tax liabilities to be settled after more than twelve months	**4,633**	3,762
	4,496	3,608

The deferred tax charged/(credited) for each component of other comprehensive income during the year is as follows:

	2009 HK$'m	2008 HK$'m
Fair value changes of available-for-sale securities	**884**	(727)
Revaluation of premises	**678**	(109)
Non-controlling interests	**10**	1
	1,572	(835)

40. Insurance contract liabilities

	2009 HK$'m	2008 HK$'m
Gross and net		
At 1 January	**28,274**	22,497
Benefits paid	**(2,012)**	(1,359)
Claims incurred and movement in liabilities	**7,146**	7,136
At 31 December	**33,408**	28,274

41. Subordinated liabilities

	2009 HK$'m	2008 HK$'m
Subordinated loans		
EUR 660m*	**7,377**	7,210
USD 2,500m**	**19,399**	19,394
HKD 735m***	**–**	735
	26,776	27,339

The Group obtained floating-rate subordinated loans from BOC, the intermediate holding company. The EUR 660 million and USD 2,500 million subordinated loans are repayable prior to maturity after the first 5-year tenure at the option of the borrower. Amounts qualified as supplementary capital for regulatory purposes are shown in Note 4.5(b).

* 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.

** Interest rate at 6-month LIBOR plus 2.00% for the first 5 years, 6-month LIBOR plus 2.50% for the remaining tenure payable semi-annually, due December 2018.

*** Interest rate at applicable HIBOR plus 3.00%, fully repaid in July 2009.

42. Share capital

	2009 HK$'m	2008 HK$'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 111 to 112 of the financial statements.

44. Notes to consolidated cash flow statement

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

	2009 HK$'m	2008 HK$'m
Operating profit	**15,104**	4,182
Depreciation	**1,018**	992
Net (reversal)/charge of impairment allowances	**(1,190)**	12,573
Unwind of discount on impairment	**(17)**	(20)
Advances written off net of recoveries	**(118)**	275
Interest expense on subordinated liabilities	**922**	250
Change in cash and balances with banks and other financial institutions with original maturity over three months	**8,363**	7,781
Change in placements with banks and other financial institutions with original maturity over three months	**21,178**	(26,893)
Change in financial assets at fair value through profit or loss	**67**	(1,096)
Change in derivative financial instruments	**(4,439)**	4,207
Change in advances and other accounts	**(57,611)**	(50,175)
Change in investment in securities	**(14,590)**	(3,954)
Change in other assets	**343**	6,166
Change in deposits and balances of banks and other financial institutions	**10,868**	28,180
Change in financial liabilities at fair value through profit or loss	**(5,650)**	10,533
Change in deposits from customers	**39,744**	8,971
Change in debt securities in issue at amortised cost	**(1,042)**	(1,047)
Change in other accounts and provisions	**(4,943)**	1,529
Change in insurance contract liabilities	**5,134**	5,777
Exchange difference	**180**	(728)
Operating cash inflow before taxation	**13,321**	7,503
Cash flows from operating activities included:		
– Interest received	**25,451**	36,379
– Interest paid	**6,764**	15,206
– Dividend received	**47**	126

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

	2009 HK$'m	2008 HK$'m
Cash and balances with banks and other financial institutions with original maturity within three months	**143,886**	128,004
Placements with banks and other financial institutions with original maturity within three months	**15,352**	23,610
Treasury bills with original maturity within three months	**19,147**	22,277
Certificates of deposit held with original maturity within three months	**4,323**	1,035
	182,708	174,926

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 corresponding aggregate credit risk weighted amount:

	2009 HK$'m	2008 HK$'m
Direct credit substitutes	**2,065**	1,419
Transaction-related contingencies	**9,055**	10,153
Trade-related contingencies	**31,460**	22,481
Commitments that are unconditionally cancellable without prior notice	**165,829**	103,684
Other commitments with an original maturity of		
– up to one year	**15,842**	63,252
– over one year	**52,173**	52,400
	276,424	253,389
Credit risk weighted amount	**35,229**	40,251

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:

	2009 HK$'m	2008 HK$'m
Authorised and contracted for but not provided for	**96**	121
Authorised but not contracted for	**9**	15
	105	136

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:

	2009 HK$'m	2008 HK$'m
Land and buildings		
– not later than one year	**435**	427
– later than one year but not later than five years	**450**	531
– later than five years	**13**	14
	898	972

Certain non-cancellable operating leases included in the tables above were subject to renegotiation and rent adjustment with reference to market rates prevailing at specified agreed dates.

47. Operating lease commitments (continued)

(b) The Group as lessor

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

	2009 **HK$'m**	2008 HK$'m
Land and buildings		
– not later than one year	**275**	270
– later than one year but not later than five years	**193**	234
	468	504

The Group leases its investment properties (Note 31) 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 periodic rent adjustments according to the prevailing market conditions. None of the leases includes contingent rentals.

48. Litigation

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

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

49. Segmental reporting

The Group has adopted the new HKFRS 8 "Operating Segments" effective this year. After assessing the internal financial reporting process, it was concluded that the original segments classification has already complied with the new standard. However, consistent with internal management reporting, the charge on inter-segment funding has changed from the corresponding money market rates to money market rates adjusted with pre-determined margins. These margins reflect differentiation based on product features. Since the impact of this change on prior year figures is immaterial, no restatement has been made.

The Group engages in many businesses in several regions. For segmental reporting purposes, information is solely provided in respect of business segments. Geographical segment information is not presented because over 90% of the Group's revenues, profits before tax and assets are derived from Hong Kong.

Information about four business segments is provided in segmental reporting. They 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 segments provide general banking services. Personal Banking serves individual customers while Corporate Banking deals with non individual customers. The Treasury segment is responsible for managing the capital, liquidity, and the interest rate and foreign exchange positions of the Group in addition to proprietary trades. The Insurance segment shows business relates to the Group's long-term life insurance products, including traditional and linked individual life insurance and group life insurance products. "Others" refers to those items related to the Group as a whole rather than directly attributable to the other four business segments, including the Group's holdings of premises, investment properties, equity investments and interests in associates.

Revenues, expenses, assets and liabilities of any business segment mainly include items directly attributable to the segment. In relation to occupation of the Group's premises, rentals are internally charged on market rates according to the areas occupied. For management overheads, allocations are made on reasonable bases. Inter-segment funding is charged according to the internal funds transfer pricing mechanism of the Group.

49. Segmental reporting (continued)

	2009							
	Personal HK$'m	Corporate HK$'m	Treasury HK$'m	Insurance HK$'m	Others HK$'m	Subtotal HK$'m	Eliminations HK$'m	Consolidated HK$'m
Net interest income/(expenses)								
– external	2,452	6,120	8,091	1,271	(2)	17,932	–	17,932
– inter-segment	3,343	(618)	(2,669)	–	(56)	–	–	–
	5,795	5,502	5,422	1,271	(58)	17,932	–	17,932
Net fees and commission income/(expenses)	4,329	2,487	24	(342)	66	6,564	(56)	6,508
Net trading income/(expenses)	497	164	827	(1)	(3)	1,484	1	1,485
Net gain/(loss) on financial instruments designated at fair value through profit or loss	–	–	261	(939)	–	(678)	–	(678)
Net loss on investment in securities	–	–	(132)	–	–	(132)	–	(132)
Net insurance premium income	–	–	–	7,757	–	7,757	(13)	7,744
Other operating income	27	34	2	11	1,803	1,877	(1,395)	482
Total operating income	10,648	8,187	6,404	7,757	1,808	34,804	(1,463)	33,341
Net insurance benefits and claims	–	–	–	(7,286)	–	(7,286)	–	(7,286)
Net operating income before impairment allowances	10,648	8,187	6,404	471	1,808	27,518	(1,463)	26,055
Net (charge)/reversal of impairment allowances	(161)	49	1,302	–	–	1,190	–	1,190
Net operating income	10,487	8,236	7,706	471	1,808	28,708	(1,463)	27,245
Operating expenses	(5,983)	(2,321)	(742)	(176)	(4,382)*	(13,604)	1,463	(12,141)
Operating profit/(loss)	4,504	5,915	6,964	295	(2,574)	15,104	–	15,104
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	1,563	1,563	–	1,563
Net gain from disposal/revaluation of properties, plant and equipment	–	–	–	–	50	50	–	50
Share of profits less losses of associates	–	–	–	–	7	7	–	7
Profit/(loss) before taxation	4,504	5,915	6,964	295	(954)	16,724	–	16,724
Assets								
Segment assets	178,026	372,443	593,807	37,963	45,007	1,227,246	(14,672)	1,212,574
Interests in associates	–	–	–	–	217	217	–	217
	178,026	372,443	593,807	37,963	45,224	1,227,463	(14,672)	1,212,791
Liabilities								
Segment liabilities	570,566	304,882	195,956	35,355	15,069	1,121,828	(14,672)	1,107,156
Other information								
Additions of properties, plant and equipment	23	2	–	10	539	574	–	574
Depreciation	293	143	88	2	492	1,018	–	1,018
Amortisation of securities	–	–	136	139	–	275	–	275

49. Segmental reporting (continued)

	2008							
	Personal HK$'m	Corporate HK$'m	Treasury HK$'m	Insurance HK$'m	Others HK$'m	Subtotal HK$'m	Eliminations HK$'m	Consolidated HK$'m
Net interest (expenses)/income								
– external	(3,241)	6,924	15,322	1,122	30	20,157	–	20,157
– inter-segment	9,752	(975)	(8,144)	–	(633)	–	–	–
	6,511	5,949	7,178	1,122	(603)	20,157	–	20,157
Net fees and commission income/(expenses)	3,597	2,032	(95)	(277)	35	5,292	(113)	5,179
Net trading income/(expenses)	548	186	1,298	–	(119)	1,913	1	1,914
Net loss on financial instruments designated at fair value through profit or loss	–	–	(316)	(136)	–	(452)	–	(452)
Net loss on investment in securities	–	–	(15)	–	–	(15)	–	(15)
Net insurance premium income	–	–	–	5,899	–	5,899	(8)	5,891
Other operating income	34	44	7	17	1,829	1,931	(1,370)	561
Total operating income	10,690	8,211	8,057	6,625	1,142	34,725	(1,490)	33,235
Net insurance benefits and claims	–	–	–	(7,709)	–	(7,709)	–	(7,709)
Net operating income/(expense) before impairment allowances	10,690	8,211	8,057	(1,084)	1,142	27,016	(1,490)	25,526
Net charge of impairment allowances	(129)	(544)	(9,170)	–	(2,730)	(12,573)	–	(12,573)
Net operating income/(expense)	10,561	7,667	(1,113)	(1,084)	(1,588)	14,443	(1,490)	12,953
Operating expenses	(5,669)	(2,143)	(831)	(147)	(1,471)*	(10,261)	1,490	(8,771)
Operating profit/(loss)	4,892	5,524	(1,944)	(1,231)	(3,059)	4,182	–	4,182
Net loss from disposal of/fair value adjustments on investment properties	–	–	–	–	(118)	(118)	–	(118)
Net gain from disposal/revaluation of properties, plant and equipment	–	–	–	–	7	7	–	7
Share of profits less losses of associates	–	–	–	–	7	7	–	7
Profit/(loss) before taxation	4,892	5,524	(1,944)	(1,231)	(3,163)	4,078	–	4,078
Assets								
Segment assets	165,148	324,606	603,965	31,703	32,578	1,158,000	(10,844)	1,147,156
Interests in associates	–	–	–	–	88	88	–	88
	165,148	324,606	603,965	31,703	32,666	1,158,088	(10,844)	1,147,244
Liabilities								
Segment liabilities	523,682	309,254	203,481	30,977	6,162	1,073,556	(10,844)	1,062,712
Other information								
Additions of properties, plant and equipment	12	5	–	5	796	818	–	818
Depreciation	271	132	108	3	478	992	–	992
Amortisation of securities	–	–	149	–	–	149	–	149

* Including the expenses incurred on Lehman Brothers related products (Note 13).

50. 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:

	2009 HK$'m	2008 HK$'m
Aggregate amount of relevant loans outstanding at year end	**3,476**	655
Maximum aggregate amount of relevant loans outstanding during the year	**3,576**	667

51. Significant related party transactions

Related parties are those parties that have the ability to control the other party or exercise significant influence over the other party in making financial or operating decisions. Parties are also considered to be related if they are subject to common control. Related parties may be individual or other entities.

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.

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

(i) 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 and management.

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

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

(ii) 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 and affiliates and other state controlled entities in the normal course of business and commercial terms.

These transactions may 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.

51. Significant related party transactions (continued)

(b) *Summary of transactions entered into during the ordinary course of business with associates and other related parties*

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

	2009	
	Associates HK$'m	**Other related parties HK$'m**
Income statement items:		
Interest expense	**–**	**–**
Insurance premium paid	**(1)**	**–**
Administrative services fees received/receivable	**–**	**8**
Balance sheet items:		
Deposits from customers	**51**	**–**

	2008	
	Associates HK$'m	Other related parties HK$'m
Income statement items:		
Interest expense	(1)	–
Insurance premium paid	–	–
Administrative services fees received/receivable	–	8
Balance sheet items:		
Deposits from customers	46	–

(c) *Key management personnel*

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

The key management compensation for the year ended 31 December 2009 and 2008 is detailed as follows:

	2009 HK$'m	2008 HK$'m
Salaries and other short-term employee benefits	**60**	53
Post-employment benefits	**1**	1
	61	54

52. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions. The net options position is calculated based on the basis of delta-weighted positions of all foreign exchange options contracts.

	2009							
	Equivalent in million of HK$							
	US Dollars	**Japanese Yen**	**Euro**	**Australian Dollars**	**Pound Sterling**	**Renminbi**	**Others**	**Total**
Spot assets	**368,346**	**17,647**	**40,265**	**43,780**	**3,486**	**80,453**	**14,894**	**568,871**
Spot liabilities	**(234,622)**	**(2,304)**	**(24,465)**	**(30,795)**	**(15,579)**	**(79,443)**	**(23,456)**	**(410,664)**
Forward purchases	**419,917**	**19,012**	**21,741**	**23,307**	**31,121**	**71,103**	**34,469**	**620,670**
Forward sales	**(542,094)**	**(34,296)**	**(37,537)**	**(36,557)**	**(19,273)**	**(70,644)**	**(25,910)**	**(766,311)**
Net options position	**233**	**(2)**	**(5)**	**(7)**	**1**	**–**	**7**	**227**
Net long/(short) position	**11,780**	**57**	**(1)**	**(272)**	**(244)**	**1,469**	**4**	**12,793**
Net structural position	**295**	**–**	**–**	**–**	**–**	**2,958**	**–**	**3,253**

	2008							
	Equivalent in million of HK$							
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi	Others	Total
Spot assets	329,063	45,677	39,953	26,578	13,662	69,588	11,006	535,527
Spot liabilities	(282,888)	(10,671)	(26,033)	(28,009)	(16,730)	(68,161)	(22,252)	(454,744)
Forward purchases	328,459	28,024	31,497	17,948	18,249	22,282	39,376	485,835
Forward sales	(364,547)	(62,847)	(45,720)	(16,688)	(15,190)	(22,273)	(28,126)	(555,391)
Net options position	131	2	7	8	(9)	–	3	142
Net long/(short) position	10,218	185	(296)	(163)	(18)	1,436	7	11,369
Net structural position	158	–	–	–	–	1,719	–	1,877

53. Cross-border claims

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

	Banks HK$'m	Public sector entities HK$'m	Others HK$'m	Total HK$'m
At 31 December 2009				
Asia, other than Hong Kong				
– Mainland China	**90,168**	**58,893**	**46,813**	**195,874**
– Japan	**15,961**	**16,374**	**1,511**	**33,846**
– Others	**46,558**	**674**	**22,676**	**69,908**
	152,687	**75,941**	**71,000**	**299,628**
North America				
– United States	**7,231**	**39,587**	**32,240**	**79,058**
– Others	**12,493**	**1,754**	**1,425**	**15,672**
	19,724	**41,341**	**33,665**	**94,730**
Western Europe				
– Germany	**35,335**	**3,387**	**574**	**39,296**
– Others	**99,832**	**8,477**	**6,513**	**114,822**
	135,167	**11,864**	**7,087**	**154,118**
Total	**307,578**	**129,146**	**111,752**	**548,476**

	Banks HK$'m	Public sector entities HK$'m	Others HK$'m	Total HK$'m
At 31 December 2008				
Asia, other than Hong Kong				
– Mainland China	62,948	52,228	47,650	162,826
– Japan	19,475	39,462	1,522	60,459
– Others	46,292	54	16,293	62,639
	128,715	91,744	65,465	285,924
North America				
– United States	8,235	29,065	62,240	99,540
– Others	20,380	686	150	21,216
	28,615	29,751	62,390	120,756
Western Europe				
– Germany	37,262	664	1,252	39,178
– Others	135,312	353	6,992	142,657
	172,574	1,017	8,244	181,835
Total	329,904	122,512	136,099	588,515

54. Non-bank Mainland China exposures

Non-bank counterparties are identified in accordance with the definitions set out in the prudential return "Quarterly Analysis of Loans and Advances and Provisions" issued by the HKMA. Exposures in Mainland China arising from non-bank counterparties at 31 December are summarised as follows:

	2009			
	On-balance sheet exposure HK$'m	**Off-balance sheet exposure HK$'m**	**Total exposure HK$'m**	**Individually assessed impairment allowances HK$'m**
Mainland China entities	**101,935**	**44,217**	**146,152**	**73**
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	**26,176**	**18,260**	**44,436**	**81**
Other non-bank Mainland China exposures	**22,203**	**7,605**	**29,808**	**42**
	150,314	**70,082**	**220,396**	**196**

	2008			
	On-balance sheet exposure HK$'m	Off-balance sheet exposure HK$'m	Total exposure HK$'m	Individually assessed impairment allowances HK$'m
Mainland China entities	78,600	66,102	144,702	53
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	25,979	13,701	39,680	119
Other non-bank Mainland China exposures	14,095	7,824	21,919	56
	118,674	87,627	206,301	228

55. 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.

56. Events after the balance sheet date

On 11 February 2010, BOCHK issued Subordinated Notes with aggregate principal amount of US$1,600 million. The offering price of the Subordinated Notes was 99.591% of the principal amount of the Subordinated Notes. The Subordinated Notes are denominated in US dollars, have a maturity of 10 years due in 2020, and bear a fixed interest rate of 5.55% per annum during its term with interest payable semi-annually in arrears.

The Subordinated Notes qualify as Tier 2 Capital of BOCHK pursuant to the regulatory requirements of the HKMA.

BOCHK applied the proceeds from the issue of the Subordinated Notes to partly repay the Subordinated Credit Facility provided by BOC to BOCHK in December 2008. HKMA has approved such early repayment of the Subordinated Credit Facility, and BOC and BOCHK entered into an agreement to provide for the same.

57. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 23 March 2010.