NOTES TO THE FINANCIAL STATEMENTS

1. Principal activities

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

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

2. Summary of significant accounting policies

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

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

2.1 Basis of preparation

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

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

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretations already mandatorily effective for accounting periods beginning on 1 January 2011

Standard/ Interpretation	Content	Applicable for financial years beginning on/after	Currently relevant to the Group
HKAS 24 (Revised)	Related Party Disclosures	1 January 2011	Yes
HKAS 32 (Amendment)	Classification of Rights Issues	1 February 2010	No
HKFRS 1 (Revised)	First-time Adoption of Hong Kong Financial Reporting Standards – Limited exemption from comparative HKFRS 7 disclosures for first-time adopters	1 July 2010	No
HK(IFRIC)-Int 14 (Amendment)	The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	1 January 2011	No
HK(IFRIC)-Int 19	Extinguishing Financial Liabilities with Equity Instruments	1 July 2010	No

- HKAS 24 (Revised), 'Related Party Disclosures'. The Group early adopted the partial exemption regarding disclosure requirements for transactions with government-related entities in its annual financial statements for the year ended 31 December 2009. The application of the remainder of the revised standard this year which amends the definition of related parties will not have significant impact on the presentation and disclosure of the Group's financial statements.

NOTES TO THE FINANCIAL STATEMENTS

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards and amendments issued that are not yet mandatorily effective and have not been early adopted by the Group in 2011

The following standards and amendments have been issued and are mandatory for accounting periods beginning on or after 1 July 2011:

Standard	Content	Applicable for financial years beginning on/after	Currently relevant to the Group
HKAS 1 (Revised)	Presentation of Financial Statements	1 July 2012	Yes
HKAS 19 (2011)	Employee Benefits	1 January 2013	Yes
HKAS 27 (2011)	Separate Financial Statements	1 January 2013	Yes
HKAS 28 (2011)	Investments in Associates and Joint Ventures	1 January 2013	Yes
HKAS 32 (Amendment)	Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities	1 January 2014	Yes
HKFRS 1 (Revised)	First-time Adoption of HKFRS – Fixed Dates and Hyperinflation	1 July 2011	No
HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Transfer of Financial Assets	1 July 2011	Yes
HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities	1 January 2013	Yes
HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Transition to HKFRS 9	1 January 2015	Yes
HKFRS 9	Financial Instruments	1 January 2015	Yes
HKFRS 10	Consolidated Financial Statements	1 January 2013	Yes
HKFRS 11	Joint Arrangements	1 January 2013	Yes
HKFRS 12	Disclosure of Interests in Other Entities	1 January 2013	Yes
HKFRS 13	Fair Value Measurement	1 January 2013	Yes

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards and amendments issued that are not yet mandatorily effective and have not been early adopted by the Group in 2011 (continued)

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

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

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

- HKAS 32 (Amendment), 'Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities'. The amendment addresses inconsistencies in current practice when applying the offsetting criteria and clarifies the meaning of 'currently has a legally enforceable right of set-off'; and the application of offsetting criteria to some gross settlement systems (such as central clearing house systems) that may be considered equivalent to net settlement. The Group is considering the financial impact of the amendment.

- HKFRS 7 (Amendment), 'Financial Instruments: Disclosures – Transfer of Financial Assets'. The amendment introduces new quantitative disclosure requirements for transfers of financial assets that are either fully derecognised or derecognised not in their entirety. The adoption of this amendment will affect the disclosures of the Group's financial statements when the Group undertakes transfers of financial assets that fall within its scope.

- HKFRS 7 (Amendment), 'Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities'. The new disclosures, which are similar to the new US GAAP disclosure requirements, would provide users with information that is useful in (i) evaluating the effect or potential effect of netting arrangements on an entity's financial position and (ii) analysing and comparing financial statements prepared in accordance with HKFRSs and US GAAP. The adoption of this amended standard will affect the disclosure of the Group's financial statements.

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards and amendments issued that are not yet mandatorily effective and have not been early adopted by the Group in 2011 (continued)

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

  (i) Classification and Measurement

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

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

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

  (ii) Financial Liabilities and Derecognition

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

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

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards and amendments issued that are not yet mandatorily effective and have not been early adopted by the Group in 2011 (continued)

The mandatory effective date of HKFRS 9 is deferred from 1 January 2013 to 1 January 2015 with earlier adoption still permitted. The deferral will make it possible to have the same mandatory effective date for the entire standard. New transitional disclosures are required instead of comparative restatement. The Group is considering the financial impact of the standard and the timing of its application.

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

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

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

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards and amendments issued that are not yet mandatorily effective and have not been early adopted by the Group in 2011 (continued)

The above HKFRS 10, HKFRS 11, HKFRS 12, HKAS 27 (2011) and HKAS 28 (2011) issued in June 2011 are a group of five new standards that address the scope of reporting entity and will supersede HKAS 27 (Revised), HKAS 28, HKAS 31, HK(SIC)-Int 12 and HK(SIC)-Int 13. Earlier application of these standards are permitted but only when they are applied at the same time. The Group is assessing the impact on the financial statements of the Group as a result of the adoption of these new standards.

- HKFRS 13, 'Fair Value Measurement'. The new standard which was issued in June 2011 replaces the fair value measurement guidance contained in individual HKFRSs by providing a revised definition of fair value and a single source of fair value measurement and disclosure requirements for use across HKFRSs. The requirements do not extend the use of fair value accounting, but provide guidance on how it should be applied when its use is already required or permitted by other standards within HKFRSs. The Group is assessing the impact on the financial statements of the Group as a result of the adoption of this new standard.

(c) Improvements to HKFRS

'Improvements to HKFRS' contains numerous amendments to HKFRS which the HKICPA considers not urgent but necessary. It comprises amendments that result in accounting changes for presentation, recognition or measurement purpose as well as terminology or editorial amendments related to a variety of individual HKFRS. Most of the amendments are effective for annual periods beginning on or after 1 July 2010. For amendments that are effective for the financial year beginning on 1 January 2011, there is no material impact on the financial statements of the Group.

(d) Amendment issued that is not yet mandatorily effective but has been early adopted by the Group

Standard	Content	Applicable for financial years beginning on/after	Currently relevant to the Group	Year of early adoption
HKAS 12 (Amendment)	Income Taxes	1 January 2012	Yes	2010

- HKAS 12 (Amendment), 'Income Taxes'. The standard which was revised in December 2010 is mandatorily effective for reporting periods beginning on or after 1 January 2012. Earlier application is permitted. The Group considers that the required treatment under the revised standard better reflects the tax position of the investment properties of the Group, and has early adopted the amended standard retrospectively since the year ended 31 December 2010.

  Upon early adoption, deferred tax liabilities for the revaluation of investment properties have been calculated subject to a nil tax rate.

2. Summary of significant accounting policies (continued)

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.

(i) Business combinations not under common control

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

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

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

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

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

(1) Subsidiaries (continued)

(ii) Business combinations under common control

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

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

In the Company's balance sheet, the investments in subsidiaries are stated at cost less allowance for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

(2) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recognised in equity. Gains or losses on disposals to non-controlling interests are also recognised in equity.

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

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

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

(3) 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 accumulated 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.

2.4 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 end of the reporting period are recognised directly in the income statement.

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

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

2. Summary of significant accounting policies (continued)

2.4 Foreign currency translation (continued)

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

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

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

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

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

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

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

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

Hedge accounting is used for derivatives designated in this way.

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

2. Summary of significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting (continued)

(a) Fair value hedge

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

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

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

(b) Cash flow hedge

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

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

(c) Net investment hedge

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

2.6 Offsetting financial instruments

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

2. Summary of significant accounting policies (continued)

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

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

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

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

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

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

2.8 Financial assets

The Group classifies its financial assets into the following four categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity securities and available-for-sale financial assets. The Management determines the classification of investments at initial recognition. The classification depends on the purpose for which the financial assets 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 one of the criteria set out below, and is so designated by the Management:

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

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

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

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

Gains and losses from changes in the fair value of such assets (excluding the interest component) are reported in net trading gain/loss or net gain/loss on financial instruments designated at fair value through profit or loss. The interest component is reported as part of interest income. Dividends on equity instruments of this category are also recognised in net trading gain/loss 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. Where the Group sold held-to-maturity assets (i) other than due to an isolated event beyond the Group's control, non-recurring and could not have been reasonably anticipated by the Group, such as a significant deterioration in the issuer's creditworthiness or (ii) other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale. They are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method less allowances for impairment losses.

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

(4) Available-for-sale

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

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

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

2.9 Financial liabilities

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

(1) Trading liabilities

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

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

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

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

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

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

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

2. Summary of significant accounting policies (continued)

2.9 Financial liabilities (continued)

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

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

2.10 Financial guarantee contracts

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

Financial 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, accumulated 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.

2.11 Recognition and derecognition of financial instruments

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

Trading liabilities, financial liabilities designated at fair value through profit or loss and debt securities in issue are recognised on the trade date. Deposits that are not trading liabilities are recognised when money is received from customers, other liabilities are recognised when such obligations arise. Financial liabilities are derecognised from the balance sheet when and only when the obligation specified in the contract is discharged, cancelled or 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 gain/loss.

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

2. Summary of significant accounting policies (continued)

2.11 Recognition and derecognition of financial instruments (continued)

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

2.12 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.

2.13 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 end of the reporting period. Mark-to-market gains or losses on precious metals are included in net trading gain/loss.

2.14 Impairment of financial assets

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

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

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

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

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

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

2. Summary of significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

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

- adverse changes in the payment status of borrowers in the group; or

- national or local economic conditions that correlate with defaults on the assets in the group.

(1) Assets carried at amortised cost

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

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity securities has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan or held-to-maturity 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)

2.14 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 to the extent of such a decrease is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

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

(2) Assets classified as available-for-sale

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

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

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

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

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

2. Summary of significant accounting policies (continued)

2.16 Investment properties

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

Investment properties are recognised initially at cost, including related transaction costs. After initial recognition, investment properties are measured at fair value assessed by professional valuers on the basis of open market value. If information of open market value 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 valuation standards on properties published by The Hong Kong Institute of Surveyors.

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

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

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

2.17 Properties, plant and equipment

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

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

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

2. Summary of significant accounting policies (continued)

2.17 Properties, plant and equipment (continued)

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

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

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

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

At the end of each reporting period, both internal and external sources of information are considered to determine whether there is any indication that properties, plant and equipment, are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such 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 recognised in the income statement.

2.18 Leases

(1) Operating leases

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

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

2. Summary of significant accounting policies (continued)

2.18 Leases (continued)

(2) Finance leases

Leases of assets where lessee have obtained substantially all the risks and rewards of ownership are classified as finance leases. Government land leases in Hong Kong are classified as finance leases as market anticipates that the leases can be extended for a nominal amount, the risks and rewards of leasehold land would have already been substantially transferred to the lessee as if it were freehold.

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

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

2.19 Insurance contracts

(1) Insurance contracts classification, recognition and measurement

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

The Group's insurance subsidiary issues insurance contracts, which are contracts that transfer significant insurance risk. As a general guideline, the Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefit payable if the insured event did not occur. The Group'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.

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

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

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

2. Summary of significant accounting policies (continued)

2.19 Insurance contracts (continued)

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

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

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

(2) Liability adequacy test

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

2.20 Cash and cash equivalents

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

2.21 Provisions

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

2.22 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 end of the reporting period.

Compensated absences other than sick leave and special approved annual leaves are non-accumulating; they lapse if the current period's entitlement is not used in full. Except for unexpired annual leaves, they do not entitle employees to a cash payment for unused entitlement on leaving the Group. 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 that are expected to be settled longer than twelve months will be recognised using discounted cash flow method if the amounts are significant.

2.23 Current and deferred income taxes

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

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

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

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

2. Summary of significant accounting policies (continued)

2.23 Current and deferred income taxes (continued)

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

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

2.24 Repossessed assets

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

2.25 Fiduciary activities

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

2.26 Contingent liabilities and contingent assets

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

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

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

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

2.27 Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if that party controls, jointly controls or has significant influence over the Group; is a member of the same financial reporting group, such as parents, subsidiaries and fellow subsidiaries; is an associate or a joint venture of the Group or parent reporting group; is a key management personnel of the Group or parents, 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 carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Areas susceptible to changes in essential estimates and judgements, which affect the carrying amount of assets and liabilities, are set out below. The effect of changes to either the key assumptions or other estimation uncertainties will be presented below if it is practicable to determine. It is possible that actual results may require material adjustments to the estimates referred to below.

3.1 Impairment allowances on loans and advances

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

Carrying amounts of loans and advances as at 31 December 2011 are shown in Note 25 to the Financial Statements.

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

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

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

Carrying amounts of investment in securities as at 31 December 2011 are shown in Note 27 to the Financial Statements.

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

3.3 Fair values of derivative financial instruments

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

Carrying amounts of derivative financial instruments as at 31 December 2011 are shown in Note 24 to the Financial Statements.

3.4 Held-to-maturity securities

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

Carrying amounts of held-to-maturity securities as at 31 December 2011 are shown in Note 27 to the Financial Statements.

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

In determining the Group's long term business fund liabilities 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 Hong Kong Assured Lives Mortality Table HKA01 that reflect recent historical mortality experience, adjusted where appropriate to reflect the Group's own experience. For contracts that insure the risk of longevity, appropriate prudent allowances are made for expected mortality improvements. The estimated number of deaths determines the value of the benefit payments and the value of the valuation premiums. The main source of uncertainty is that epidemics such as AIDS, SARS, avian flu and wide-ranging lifestyle changes, such as in eating, smoking and exercise habits, could result in future mortality being significantly worse than in the past for the age groups in which the Group has significant exposure to mortality risk. However, continuing improvements in medical care and social conditions could result in improvements in longevity in excess of those allowed for in the estimates used to determine the liability for contracts where the Group is exposed to longevity risk.

Were the number of deaths in future years to differ by 10% from the Management's estimate, the long term business fund liability would increase by approximately HK$91 million (2010: approximately HK$52 million), which accounts for 0.2% (2010: 0.14%) 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)

3.5 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 the Management's estimates, the long term business fund liability would increase by approximately HK$993 million (2010: approximately HK$763 million). In this case, it is assumed there is no relief arising from reinsurance contracts held.

The Group has also assessed whether a provision for expense is necessary in accordance with the Insurance Companies Ordinance. A provision for expense is the amount required to meet the total net cost that would likely be incurred in fulfilling contracts if the Group were to cease to transact new business 12 months after the valuation date. 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 20 basis points (2010: 29 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.

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 risk management governance structure is designed to cover the whole process of all businesses and ensure various risks are properly managed and controlled in the course of conducting business. The Group has a sound risk management organisational structure. It implements 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 its committees, has the primary responsibility for formulating risk management strategies and ensuring that the Group has an effective risk management system to implement these strategies.

The Risk Committee ("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 Audit Committee assists the Board in fulfilling its role in overseeing the internal control system.

4. Financial risk management (continued)

Financial risk management framework (continued)

The Chief Executive ("CE") is responsible for managing the Group's various types of risks, approving detailed risk management policies, and 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. Moreover, the Group's non-banking subsidiaries, such as BOC Life, are subject to the Group's risk management requirements. These subsidiaries are required to formulate their respective risk management policies based on the characteristics of their own industries, perform daily risk management responsibilities and report to BOCHK on a regular basis. Risk management units of BOCHK monitor the risk management status of these subsidiaries respectively.

The Group has put in place appropriate internal control systems, including establishment of an organisation structure that sets 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.

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 Board and 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. 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. Financial risk management (continued)

4.1 Credit Risk

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

Credit risk management framework

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

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

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

In accordance with Group's operating principle, the Group's principal banking subsidiaries, 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 credit 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. 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. Corporate and financial institution credit applications are independently reviewed and objectively assessed by risk management units. Obligor ratings and facility grades are assigned to these portfolios. Retail internal rating systems are deployed in risk assessment of retail credit transactions, including small business retail exposures, residential mortgage loans, personal loans and credit cards. Loan grades, obligor ratings as well as loss estimates (if applicable) are used to support credit approval.

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

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

In addition to obligor ratings, the Group adopts a facility rating system (in the case of corporate and bank exposure) and expected loss (in the case of retail exposure) to assess the risk in the facility structure during credit approval. This two-dimensional rating approach to evaluate credit risk complies with the HKMA's requirements on IRB.

RMD provides regular credit management information reports and ad hoc reports to 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.

As of 31 December 2011, the Group continues to adopt loan grading criteria which divide credit assets into 5 categories with reference to HKMA's guidelines, as below:

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

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

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Credit risk measurement and control (continued)

Loans and advances (continued)

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

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

Debt securities and derivatives

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

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

Settlement risk arises mainly from foreign exchange transactions with counterparties and also from derivatives in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty or customer to cover all settlement risk arising from the Group's market transactions on any single day.

Collateral held as security and other credit enhancements

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

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

As at 31 December 2011 and 2010, 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

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

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

Balances and placements with banks and other financial institutions

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

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

Collateral is generally not sought on debt securities.

Derivative financial instruments

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

Advances and other accounts, contingent liabilities and commitments

The general types of collateral are disclosed on page 141. Advances and other accounts, contingent liabilities and commitments are collateralised to the extent considered appropriate by the Group taking account of the risk assessment of individual exposures. The collateral coverage of advances to customers is analysed on pages 150 to 151. The components and nature of contingent liabilities and commitments are disclosed in Note 45. Regarding the commitments that are unconditionally cancellable without prior notice, the Group would assess the necessity to withdraw the credit line in case where the credit quality of a borrower deteriorates. Accordingly, these commitments do not expose the Group to significant credit risk.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts

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

	2011 HK$'m	2010 HK$'m
Advances to customers		
Personal		
– Mortgages	**185,259**	163,027
– Credit cards	**9,655**	8,229
– Others	**20,801**	15,744
Corporate		
– Commercial loans	**424,156**	372,823
– Trade finance	**59,508**	53,396
	699,379	613,219
Trade bills	**56,506**	31,605
Advances to banks and other financial institutions	**2,174**	2,911
Total	**758,059**	647,735

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.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

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.

(a) Advances neither overdue nor impaired

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

	2011			
	Pass HK$'m	Special mention HK$'m	Substandard or below HK$'m	Total HK$'m
Advances to customers				
Personal				
– Mortgages	183,192	165	53	183,410
– Credit cards	9,395	–	–	9,395
– Others	20,447	117	9	20,573
Corporate				
– Commercial loans	418,412	4,369	98	422,879
– Trade finance	59,127	181	5	59,313
	690,573	4,832	165	695,570
Trade bills	56,103	398	5	56,506
Advances to banks and other financial institutions	2,174	–	–	2,174
Total	748,850	5,230	170	754,250

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(a) Advances neither overdue nor impaired (continued)

	2010			
	Pass HK$'m	Special mention HK$'m	Substandard or below HK$'m	Total HK$'m
Advances to customers				
Personal				
– Mortgages	161,218	131	73	161,422
– Credit cards	8,012	–	–	8,012
– Others	15,442	30	15	15,487
Corporate				
– Commercial loans	370,876	930	133	371,939
– Trade finance	52,983	240	6	53,229
	608,531	1,331	227	610,089
Trade bills	31,605	–	–	31,605
Advances to banks and other financial institutions	2,294	617	–	2,911
Total	642,430	1,948	227	644,605

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 tables.

NOTES TO THE FINANCIAL STATEMENTS

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(b) Advances overdue but not impaired

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

	2011				
	Overdue for three months or less HK$'m	**Overdue for six months or less but over three months HK$'m**	**Overdue for one year or less but over six months HK$'m**	**Overdue for over one year HK$'m**	**Total HK$'m**
Advances to customers					
Personal					
– Mortgages	**1,825**	**11**	**1**	**3**	**1,840**
– Credit cards	**239**	**–**	**–**	**–**	**239**
– Others	**181**	**2**	**1**	**10**	**194**
Corporate					
– Commercial loans	**1,017**	**3**	**1**	**37**	**1,058**
– Trade finance	**36**	**–**	**–**	**3**	**39**
Total	**3,298**	**16**	**3**	**53**	**3,370**

	2010				
	Overdue for three months or less HK$'m	Overdue for six months or less but over three months HK$'m	Overdue for one year or less but over six months HK$'m	Overdue for over one year HK$'m	Total HK$'m
Advances to customers					
Personal					
– Mortgages	1,558	7	7	26	1,598
– Credit cards	199	–	–	–	199
– Others	203	1	–	13	217
Corporate					
– Commercial loans	493	2	3	79	577
– Trade finance	79	–	–	5	84
Total	2,532	10	10	123	2,675

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(c) Impaired advances

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

	2011		2010	
	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	**9**	**5**	7	5
– Credit cards	**21**	**–**	18	–
– Others	**34**	**5**	40	22
Corporate				
– Commercial loans	**219**	**52**	307	71
– Trade finance	**156**	**97**	83	11
Total	**439**	**159**	455	109
Loan impairment allowances made in respect of such advances	**281**		344	

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

	2011 HK$'m	2010 HK$'m
Current market value of collateral held against the covered portion of such advances to customers	**159**	109
Covered portion of such advances to customers	**108**	80
Uncovered portion of such advances to customers	**331**	375

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(c) Impaired advances (continued)

Classified or impaired advances to customers are analysed as follows:

	2011 HK$'m	2010 HK$'m
Gross classified or impaired advances to customers	**710**	867
Gross classified or impaired advances to customers as a percentage of gross advances to customers	**0.10%**	0.14%
Individually assessed loan impairment allowances made in respect of such advances	**259**	326

Classified or impaired advances to customers follow the definitions set out in the Banking (Disclosure) Rules under the Banking Ordinance 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 three months

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

	2011		2010	
	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	**78**	**0.01%**	38	0.01%
– one year or less but over six months	**83**	**0.01%**	38	0.01%
– over one year	**227**	**0.04%**	359	0.05%
Advances overdue for over three months	**388**	**0.06%**	435	0.07%
Individually assessed loan impairment allowances made in respect of such advances	**219**		194	

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

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

	2011 HK$'m	2010 HK$'m
Current market value of collateral held against the covered portion of such advances to customers	**468**	558
Covered portion of such advances to customers	**116**	213
Uncovered portion of such advances to customers	**272**	222

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 2011 and 2010, there were no advances to banks and other financial institutions overdue for more than three months.

(e) Rescheduled advances

	2011		2010	
	Amount HK$'m	**% of gross advances to customers**	Amount HK$'m	% of gross advances to customers
Rescheduled advances to customers net of amounts included in "Advances overdue for more than three months"	**90**	**0.01%**	228	0.04%

As at 31 December 2011 and 2010, there were no rescheduled advances to banks and other financial institutions.

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

NOTES TO THE FINANCIAL STATEMENTS

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers

(i) Sectoral analysis of gross advances to customers

The 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:

	2011					
	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	30,788	46.81%	3	3	–	112
– Property investment	72,910	85.78%	59	747	6	433
– Financial concerns	10,562	22.52%	–	4	–	58
– Stockbrokers	931	78.93%	–	–	–	3
– Wholesale and retail trade	32,755	69.51%	31	152	13	184
– Manufacturing	17,352	41.95%	67	132	36	115
– Transport and transport equipment	26,525	43.36%	61	4	1	108
– Recreational activities	605	15.87%	–	–	–	3
– Information technology	16,050	0.74%	2	2	1	58
– Others	29,079	41.17%	54	195	24	128
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	10,987	99.96%	48	324	–	9
– Loans for purchase of other residential properties	169,780	99.98%	44	1,443	–	99
– Credit card advances	9,655	–	21	260	–	71
– Others	16,561	62.65%	30	153	13	22
Total loans for use in Hong Kong	444,540	73.09%	420	3,419	94	1,403
Trade finance	59,508	15.85%	166	189	85	281
Loans for use outside Hong Kong	195,331	25.11%	124	184	80	887
Gross advances to customers	699,379	54.82%	710	3,792	259	2,571

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

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

	2010					
	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	29,542	34.21%	3	3	–	93
– Property investment	67,265	88.59%	87	273	7	374
– Financial concerns	9,011	30.57%	–	4	–	50
– Stockbrokers	556	69.32%	–	–	–	2
– Wholesale and retail trade	24,300	67.23%	29	127	12	131
– Manufacturing	15,125	44.57%	70	118	22	83
– Transport and transport equipment	23,409	34.39%	80	21	2	80
– Recreational activities	521	19.00%	–	–	–	2
– Information technology	14,212	0.62%	3	3	1	44
– Others	23,006	42.85%	48	168	7	86
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	12,291	99.96%	64	377	–	10
– Loans for purchase of other residential properties	147,424	99.99%	75	1,199	–	84
– Credit card advances	8,230	–	18	217	–	75
– Others	12,195	63.44%	44	179	20	15
Total loans for use in Hong Kong	387,087	72.71%	521	2,689	71	1,129
Trade finance	53,396	16.73%	95	141	57	228
Loans for use outside Hong Kong	172,736	24.45%	251	153	198	628
Gross advances to customers	613,219	54.24%	867	2,983	326	1,985

* 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 advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

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

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

	2011		2010	
	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	**28**	**–**	22	–
– Property investment	**75**	**1**	56	1
– Financial concerns	**14**	**–**	13	–
– Stockbrokers	**1**	**–**	–	–
– Wholesale and retail trade	**62**	**6**	54	45
– Manufacturing	**48**	**6**	27	14
– Transport and transport equipment	**30**	**–**	19	2
– Recreational activities	**1**	**–**	1	–
– Information technology	**16**	**–**	12	–
– Others	**59**	**15**	19	7
Individuals				
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**1**	**–**	1	–
– Loans for purchase of other residential properties	**15**	**–**	15	–
– Credit card advances	**103**	**103**	118	118
– Others	**43**	**39**	33	43
Total loans for use in Hong Kong	**496**	**170**	390	230
Trade finance	**135**	**26**	76	111
Loans for use outside Hong Kong	**235**	**25**	132	–
Gross advances to customers	**866**	**221**	598	341

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers

The following geographical analysis of advances to customers is based on the location of the counterparties, after taking into account the transfer of risk. In general, such transfer of risk takes place if the advances to customers are guaranteed by a party in a country which is different from that of the customer.

Gross advances to customers

	2011 HK$'m	2010 HK$'m
Hong Kong	**540,862**	460,306
Mainland China	**121,207**	116,353
Others	**37,310**	36,560
	699,379	613,219
Collectively assessed loan impairment allowances in respect of the gross advances to customers		
Hong Kong	**1,855**	1,422
Mainland China	**550**	437
Others	**166**	126
	2,571	1,985

Overdue advances

	2011 HK$'m	2010 HK$'m
Hong Kong	**3,506**	2,770
Mainland China	**182**	167
Others	**104**	46
	3,792	2,983
Individually assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**187**	139
Mainland China	**28**	62
Others	**36**	2
	251	203
Collectively assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**57**	51
Mainland China	**5**	4
Others	**2**	1
	64	56

NOTES TO THE FINANCIAL STATEMENTS

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

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

Classified or impaired advances

	2011 HK$'m	2010 HK$'m
Hong Kong	**574**	681
Mainland China	**79**	86
Others	**57**	100
	710	867
Individually assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**193**	166
Mainland China	**28**	62
Others	**38**	98
	259	326
Collectively assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**21**	19
Mainland China	**2**	2
Others	**1**	–
	24	21

During the year, the basis of the above analyses has been refined and the comparative amounts have been reclassified accordingly.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(C) Repossessed assets

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

	2011 HK$'m	2010 HK$'m
Commercial properties	**1**	–
Industrial properties	**–**	2
Residential properties	**10**	79
	11	81

The estimated market value of repossessed assets held by the Group as at 31 December 2011 amounted to HK$19 million (2010: HK$280 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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

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

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

	2011			
	Aaa to A3 HK$'m	**Lower than A3 HK$'m**	**Unrated HK$'m**	**Total HK$'m**
Central banks	**158,950**	**–**	**–**	**158,950**
Banks and other financial institutions	**161,436**	**15,731**	**44,163**	**221,330**
	320,386	**15,731**	**44,163**	**380,280**

	2010			
	Aaa to A3 HK$'m	Lower than A3 HK$'m	Unrated HK$'m	Total HK$'m
Central banks	336,923	–	–	336,923
Banks and other financial institutions	90,428	11,584	11,805	113,817
	427,351	11,584	11,805	450,740

As at 31 December 2011 and 2010, 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 tables below represent an analysis of the carrying value of debt securities by issue rating and credit risk characteristic.

	2011							
					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	Others HK$'m	Total HK$'m
Investment in securities								
US non-agency residential mortgage-backed								
– Subprime	150	35	94	–	–	–	–	279
– Alt-A	24	12	–	82	–	–	–	118
– Prime	65	4	94	82	–	–	–	245
Fannie Mae								
– mortgage-backed securities	–	–	–	–	–	6	–	6
Freddie Mac								
– issued debt securities	79	–	–	–	–	–	–	79
– mortgage-backed securities	–	–	–	–	–	377	–	377
Other MBS/ABS	1,588	40	17	2	–	8,937	–	10,584
Other debt securities	72,872	102,704	44,405	11,377	18,159	54,656	56,638	360,811
Subtotal	74,778	102,795	44,610	11,543	18,159	63,976	56,638	372,499
Financial assets at fair value through profit or loss								
Other MBS/ABS	–	–	5	–	–	–	–	5
Other debt securities	3,306	14,034	15,254	1,395	8,356	301	3,852	46,498
Subtotal	3,306	14,034	15,259	1,395	8,356	301	3,852	46,503
Total	78,084	116,829	59,869	12,938	26,515	64,277	60,490	419,002

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

	2010							
					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	Others HK$'m	Total HK$'m
Investment in securities								
US non-agency residential mortgage-backed								
– Subprime	351	1	5	–	–	–	–	357
– Alt-A	90	112	40	–	–	–	–	242
– Prime	391	64	87	53	–	–	–	595
Fannie Mae								
– mortgage-backed securities	–	–	–	–	–	15	–	15
Freddie Mac								
– issued debt securities	79	158	–	–	–	–	–	237
– mortgage-backed securities	–	–	–	–	–	602	–	602
Other MBS/ABS	2,490	282	–	–	–	7,334	–	10,106
Other debt securities	99,456	79,249	45,852	6,885	15,989	49,260	47,812	344,503
Subtotal	102,857	79,866	45,984	6,938	15,989	57,211	47,812	356,657
Financial assets at fair value through profit or loss								
Other MBS/ABS	19	–	–	–	–	–	–	19
Other debt securities	1,303	7,958	17,037	1,682	33,486	–	3,306	64,772
Subtotal	1,322	7,958	17,037	1,682	33,486	–	3,306	64,791
Total	104,179	87,824	63,021	8,620	49,475	57,211	51,118	421,448

The total amount of unrated issues amounted to HK$151,282 million (2010: HK$157,804 million) as at 31 December 2011, of which only HK$17,966 million (2010: HK$6,697 million) were without issuer ratings. For details, please refer to page 159.

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:

	2011					
	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	**30,974**	**56,273**	**11,293**	**1,349**	**14,192**	**114,081**
Held-to-maturity securities	**425**	**16,367**	**516**	**200**	**511**	**18,019**
Loans and receivables	**–**	**4,797**	**1,876**	**–**	**–**	**6,673**
Financial assets at fair value through profit or loss	**–**	**8,696**	**447**	**103**	**3,263**	**12,509**
Total	**31,399**	**86,133**	**14,132**	**1,652**	**17,966**	**151,282**

	2010					
	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	39,825	34,342	8,321	4,833	5,638	92,959
Held-to-maturity securities	668	10,910	1,119	–	–	12,697
Loans and receivables	–	11,187	4,169	–	–	15,356
Financial assets at fair value through profit or loss	–	33,581	2,152	–	1,059	36,792
Total	40,493	90,020	15,761	4,833	6,697	157,804

NOTES TO THE FINANCIAL STATEMENTS

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

The following tables present an analysis of debt securities neither overdue nor impaired as at 31 December by rating agency designation.

	2011					
	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	**59,547**	**92,171**	**36,142**	**9,916**	**114,081**	**311,857**
Held-to-maturity securities	**15,083**	**10,590**	**8,369**	**1,615**	**18,019**	**53,676**
Loans and receivables	**–**	**–**	**–**	**–**	**6,673**	**6,673**
Financial assets at fair value through profit or loss	**3,306**	**14,034**	**15,259**	**1,395**	**12,509**	**46,503**
Total	**77,936**	**116,795**	**59,770**	**12,926**	**151,282**	**418,709**

	2010					
	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	82,128	66,585	36,226	4,600	92,959	282,498
Held-to-maturity securities	20,336	13,229	9,673	2,055	12,697	57,990
Loans and receivables	–	–	–	–	15,356	15,356
Financial assets at fair value through profit or loss	1,322	7,958	17,037	1,682	36,792	64,791
Total	103,786	87,772	62,936	8,337	157,804	420,635

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

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

	2011						
	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	**19**	**–**	**11**	**12**	**–**	**42**	**2**
Held-to-maturity securities	**129**	**34**	**88**	**–**	**–**	**251**	**25**
Total	**148**	**34**	**99**	**12**	**–**	**293**	**27**
Of which accumulated impairment allowances	**15**	**4**	**7**	**1**	**–**	**27**	

	2010						
	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	90	–	85	244	–	419	99
Held-to-maturity securities	303	52	–	39	–	394	49
Total	393	52	85	283	–	813	148
Of which accumulated impairment allowances	53	14	21	60	–	148	

As at 31 December 2011 and 2010, there were no overdue debt securities.

4. Financial risk management (continued)

4.2 Market Risk

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

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

The Group's market risk management covers BOCHK and its subsidiaries. The Group establishes consistent market risk management policies to regulate BOCHK's and subsidiaries' market risk management work; meanwhile, the Group sets up Group VAR limit, which is allocated and monitored across the Group, according to subsidiaries' business requirements and risk tolerance level. In line with the requirements set in the Group policy, subsidiaries may, subject to prior consent by BOCHK, formulate the detailed policies and procedures and must bear the responsibility to manage daily market risk of the institution. Subsidiaries set up independent risk monitoring team to monitor daily market risk and limit compliance, and submit management information and reports to BOCHK on a regular basis.

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(A) VAR

The Group uses the VAR technique to measure potential losses and market risks of its trading book for reporting to RC and senior management on a periodic basis. The Group adopts a uniformed VAR calculation model, using historical simulation approach and 2-year historical data, to calculate VAR of the Group and subsidiaries over 1-day holding period with 99% confidence level, and set up VAR limit of the Group and subsidiaries.

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

	Year	At 31 December HK$'m	Minimum for the year HK$'m	Maximum for the year HK$'m	Average for the year HK$'m
VAR for all market risk	2011	14.4	6.8	19.5	11.6
	2010	9.8	5.7	15.7	9.5
VAR for foreign exchange risk products	2011	9.1	1.9	17.7	8.6
	2010	1.3	1.3	11.2	5.3
VAR for interest rate risk products	2011	10.6	5.1	11	7.8
	2010	10.4	3.6	13.6	7.9
VAR for equity risk products	2011	1.0	0.0	1.3	0.1
	2010	0.0	0.0	1.7	0.2
VAR for commodity risk products	2011	0.2	0.0	0.7	0.1
	2010	0.0	0.0	0.2	0.0

In 2011, the average daily revenue[2] of BOCHK earned from market risk-related trading activities was HK$7.34 million (2010: HK$5.75 million).

Notes:

1 Structural FX positions have been excluded.

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(A) VAR (continued)

Although 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% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and

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

The Group recognises these limitations by formulating stress test indicators and limits to assess and manage the market risk uncovered by VAR. The stress testing programme of the 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 Financial Crisis, 2001 9-11 event and 2008 Financial Tsunami, etc.

(B) Currency risk

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

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

	2011							
	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	222,388	30,932	17,138	1,991	2,390	543	3,413	278,795
Placements with banks and other financial institutions maturing between one and twelve months	93,278	10,689	3,443	–	25	–	475	107,910
Financial assets at fair value through profit or loss	4,547	11,833	32,146	–	–	–	76	48,602
Derivative financial instruments	843	4,586	21,330	4	–	–	24	26,787
Hong Kong SAR Government certificates of indebtedness	–	–	65,890	–	–	–	–	65,890
Advances and other accounts	54,189	214,930	472,415	3,105	1,835	84	8,671	755,229
Investment in securities								
– Available-for-sale securities	27,671	149,143	58,883	9,467	44,335	251	26,648	316,398
– Held-to-maturity securities	17,015	20,522	8,262	1,089	2,125	–	4,914	53,927
– Loans and receivables	–	–	–	1,876	–	4,640	157	6,673
Interests in associates	–	–	234	–	–	–	–	234
Investment properties	106	–	12,335	–	–	–	–	12,441
Properties, plant and equipment	554	1	39,095	–	–	–	–	39,650
Other assets (including deferred tax assets)	9,381	412	15,007	423	381	72	298	25,974
Total assets	429,972	443,048	746,178	17,955	51,091	5,590	44,676	1,738,510
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	65,890	–	–	–	–	65,890
Deposits and balances from banks and other financial institutions	155,582	40,110	38,668	40	181	5	2,108	236,694
Financial liabilities at fair value through profit or loss	203	51	2,665	–	–	–	318	3,237
Derivative financial instruments	886	4,025	16,752	393	1	1	223	22,281
Deposits from customers	245,375	231,136	596,308	13,634	1,756	14,434	43,308	1,145,951
Debt securities in issue at amortised cost	–	5,868	117	–	–	–	–	5,985
Other accounts and provisions (including current and deferred tax liabilities)	5,607	14,309	26,225	670	806	778	1,018	49,413
Insurance contract liabilities	10,728	6,501	29,991	–	–	–	–	47,220
Subordinated liabilities	–	22,031	–	6,625	–	–	–	28,656
Total liabilities	418,381	324,031	776,616	21,362	2,744	15,218	46,975	1,605,327
Net on-balance sheet position	11,591	119,017	(30,438)	(3,407)	48,347	(9,628)	(2,299)	133,183
Off-balance sheet net notional position*	604	(110,908)	148,444	3,118	(48,403)	9,634	2,402	4,891
Contingent liabilities and commitments	25,032	102,857	253,398	3,572	1,158	857	3,311	390,185

NOTES TO THE FINANCIAL STATEMENTS

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

	2010							
	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	369,368	18,084	22,058	2,762	657	1,884	999	415,812
Placements with banks and other financial institutions maturing between one and twelve months	8,886	22,840	6,279	42	–	144	1,308	39,499
Financial assets at fair value through profit or loss	1,560	16,413	51,716	112	–	–	75	69,876
Derivative financial instruments	122	2,540	21,144	18	–	–	30	23,854
Hong Kong SAR Government certificates of indebtedness	–	–	46,990	–	–	–	–	46,990
Advances and other accounts	25,299	190,935	413,767	5,447	1,260	53	8,663	645,424
Investment in securities								
– Available-for-sale securities	15,279	155,583	46,438	22,876	4,421	1,767	40,080	286,444
– Held-to-maturity securities	6,577	28,811	11,567	1,743	2,028	15	7,643	58,384
– Loans and receivables	–	5,791	9,565	–	–	–	–	15,356
Interests in associates	–	–	212	–	–	–	–	212
Investment properties	96	–	10,246	–	–	–	–	10,342
Properties, plant and equipment	420	–	30,629	–	–	–	–	31,049
Other assets (including deferred tax assets)	2,200	404	14,916	77	89	40	72	17,798
Total assets	429,807	441,401	685,527	33,077	8,455	3,903	58,870	1,661,040
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	46,990	–	–	–	–	46,990
Deposits and balances from banks and other financial institutions	241,539	42,496	13,393	99	252	15	15,990	313,784
Financial liabilities at fair value through profit or loss	–	76	25,280	–	–	–	137	25,493
Derivative financial instruments	130	3,599	16,863	681	2	–	80	21,355
Deposits from customers	156,391	184,993	612,360	15,764	1,921	16,745	38,859	1,027,033
Other accounts and provisions (including current and deferred tax liabilities)	4,430	10,799	24,267	535	48	642	691	41,412
Insurance contract liabilities	2,761	6,963	30,083	–	–	–	–	39,807
Subordinated liabilities	–	20,029	–	6,848	–	–	–	26,877
Total liabilities	405,251	268,955	769,236	23,927	2,223	17,402	55,757	1,542,751
Net on-balance sheet position	24,556	172,446	(83,709)	9,150	6,232	(13,499)	3,113	118,289
Off-balance sheet net notional position*	(17,769)	(165,279)	192,604	(9,078)	(6,290)	13,368	(3,256)	4,300
Contingent liabilities and commitments	11,813	85,973	227,256	5,720	1,559	1,076	3,313	336,710

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk

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

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

– Basis risk: different pricing basis for different transactions 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 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.

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

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

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

The Group uses scenario analysis and stress test to assess the banking book interest rate risk the Group would face under adverse circumstances. Scenario analysis and stress test are also devised to assess the impact on net interest income and economic value as well as capital base arising from the optionality of demand and savings deposits, the prepayment of mortgage loans and the prepayment of ABS/MBS due to extension/contraction of weighted average life.

The Group is principally exposed to HK Dollar, US Dollar, onshore and offshore Renminbi in terms of interest rate risk. As at 31 December 2011, if HK Dollar, US Dollar and Renminbi market interest rates had a 100 basis point parallel upward shift of the yield curve in relevant currency with other variables held constant, the impacts on net interest income over a twelve-month period and on reserves would have been as follows:

	Impact on net interest income over the next twelve months at 31 December		Impact on reserves at 31 December	
	2011 HK$'m	2010 HK$'m	**2011 HK$'m**	2010 HK$'m
HK Dollar	**896**	905	**(219)**	(257)
US Dollar	**(589)**	(1,414)	**(4,025)**	(3,698)
Renminbi	**(560)**	119	**(433)**	(172)

The overall negative impact on net interest income of the above currencies has decreased when compared with 2010 and is mainly because of the narrowed short term negative gaps in relevant currencies. Reserves would have been reduced because of the expected reduction in valuation of available-for-sale portfolio due to the above simulated market rates movement. The reduction of reserves is larger compared with 2010 because the size and duration of available-for-sale portfolio is increased.

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

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

	2011						
	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	269,960	–	–	–	–	8,835	278,795
Placements with banks and other financial institutions maturing between one and twelve months	–	48,637	59,273	–	–	–	107,910
Financial assets at fair value through profit or loss	5,732	10,339	5,474	13,080	11,878	2,099	48,602
Derivative financial instruments	–	–	–	–	–	26,787	26,787
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	65,890	65,890
Advances and other accounts	554,348	128,984	54,042	12,563	31	5,261	755,229
Investment in securities							
– Available-for-sale securities	60,433	64,432	42,885	97,200	46,949	4,499	316,398
– Held-to-maturity securities	5,336	14,862	8,299	17,992	7,438	–	53,927
– Loans and receivables	2,033	–	4,640	–	–	–	6,673
Interests in associates	–	–	–	–	–	234	234
Investment properties	–	–	–	–	–	12,441	12,441
Properties, plant and equipment	–	–	–	–	–	39,650	39,650
Other assets (including deferred tax assets)	–	–	–	–	–	25,974	25,974
Total assets	897,842	267,254	174,613	140,835	66,296	191,670	1,738,510
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	65,890	65,890
Deposits and balances from banks and other financial institutions	211,777	1,807	1,429	–	–	21,681	236,694
Financial liabilities at fair value through profit or loss	1,116	802	824	473	22	–	3,237
Derivative financial instruments	–	–	–	–	–	22,281	22,281
Deposits from customers	867,556	138,977	74,731	9,134	162	55,391	1,145,951
Debt securities in issue at amortised cost	96	20	13	5,856	–	–	5,985
Other accounts and provisions (including current and deferred tax liabilities)	13,137	1,001	2,849	–	–	32,426	49,413
Insurance contract liabilities	–	–	–	–	–	47,220	47,220
Subordinated liabilities	–	–	6,625	–	22,031	–	28,656
Total liabilities	1,093,682	142,607	86,471	15,463	22,215	244,889	1,605,327
Interest sensitivity gap	(195,840)	124,647	88,142	125,372	44,081	(53,219)	133,183

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

	2010						
	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	409,210	–	–	–	–	6,602	415,812
Placements with banks and other financial institutions maturing between one and twelve months	–	19,346	20,153	–	–	–	39,499
Financial assets at fair value through profit or loss	3,439	30,225	3,638	14,214	13,275	5,085	69,876
Derivative financial instruments	–	–	–	–	–	23,854	23,854
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	46,990	46,990
Advances and other accounts	513,018	92,528	27,356	7,659	119	4,744	645,424
Investment in securities							
– Available-for-sale securities	34,227	41,732	49,471	125,084	32,403	3,527	286,444
– Held-to-maturity securities	7,142	16,570	9,808	16,132	8,732	–	58,384
– Loans and receivables	5,791	3,402	6,163	–	–	–	15,356
Interests in associates	–	–	–	–	–	212	212
Investment properties	–	–	–	–	–	10,342	10,342
Properties, plant and equipment	–	–	–	–	–	31,049	31,049
Other assets (including deferred tax assets)	–	–	–	–	–	17,798	17,798
Total assets	972,827	203,803	116,589	163,089	54,529	150,203	1,661,040
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	46,990	46,990
Deposits and balances from banks and other financial institutions	298,078	8,729	969	–	–	6,008	313,784
Financial liabilities at fair value through profit or loss	4,996	16,993	3,316	168	20	–	25,493
Derivative financial instruments	–	–	–	–	–	21,355	21,355
Deposits from customers	787,316	107,409	73,421	5,010	–	53,877	1,027,033
Other accounts and provisions (including current and deferred tax liabilities)	11,005	1,070	2,163	394	–	26,780	41,412
Insurance contract liabilities	–	–	–	–	–	39,807	39,807
Subordinated liabilities	–	–	6,848	–	20,029	–	26,877
Total liabilities	1,101,395	134,201	86,717	5,572	20,049	194,817	1,542,751
Interest sensitivity gap	(128,568)	69,602	29,872	157,517	34,480	(44,614)	118,289

4. Financial risk management (continued)

4.3 Liquidity Risk

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

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

RC, a standing committee established by the Board of Directors, is the decision making authority of liquidity risk management, and assumes the ultimate responsibility of liquidity risk management. As authorised by RC, ALCO exercises its oversight of liquidity risk and ensures the daily operations of the Group are in accordance with risk appetite and policies as set by RC. Market Risk Management Division of RMD is the unit responsible for overseeing the Group's liquidity risk. It cooperates with Financial Management Department (Assets and Liabilities Management), Investment Management, etc. to assist ALCO to perform liquidity management functions according to their specific responsibilities.

The Group established liquidity risk management indicators and limits to identify, measure, monitor and control liquidity risk. Such indicators and limits include (but are not limited to) liquidity ratio, deposit stability ratio, loan-to-deposit ratio, Maximum Cumulative Outflow ("MCO") and liquidity buffer asset portfolio. The Group applies cash flow analysis (under normal and stress conditions) and liquidity stress test (including institution specific and world wide crisis) to assess the Group's capability to withstand various severe liquidity crises. Also, Assets and Liabilities Management System ("ALM") is developed to provide data support for facilitating the liquidity risk management duties.

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

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

(A) Liquidity ratio

	2011	2010
Average liquidity ratio	**36.17%**	38.77%

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

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

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis

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

	2011							
	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	213,787	65,008	–	–	–	–	–	278,795
Placements with banks and other financial institutions maturing between one and twelve months	–	–	48,637	59,273	–	–	–	107,910
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held	–	–	–	15	62	–	–	77
– others	–	5,052	9,587	2,740	2,944	4,633	–	24,956
– debt securities designated at fair value through profit or loss								
– certificates of deposit held	–	–	8	7	927	496	–	1,438
– others	–	282	301	2,672	9,661	7,116	–	20,032
– fund and equity securities	–	–	–	–	–	–	2,099	2,099
Derivative financial instruments	18,640	541	732	1,341	1,934	3,599	–	26,787
Hong Kong SAR Government certificates of indebtedness	65,890	–	–	–	–	–	–	65,890
Advances and other accounts								
– advances to customers	55,319	21,353	52,703	140,462	232,840	193,258	614	696,549
– trade bills	31	10,577	21,847	24,046	–	–	5	56,506
– advances to banks and other financial institutions	–	–	155	2,019	–	–	–	2,174
Investment in securities								
– debt securities held for available-for-sale								
– certificates of deposit held	–	3,170	2,316	12,561	9,495	–	–	27,542
– others	–	43,824	44,025	40,829	105,225	50,412	42	284,357
– debt securities held for held-to-maturity								
– certificates of deposit held	–	226	192	2,293	333	–	–	3,044
– others	–	1,510	5,251	10,853	24,187	8,831	251	50,883
– debt securities held for loans and receivables	–	2,033	–	4,640	–	–	–	6,673
– equity securities	–	–	–	–	–	–	4,499	4,499
Interests in associates	–	–	–	–	–	–	234	234
Investment properties	–	–	–	–	–	–	12,441	12,441
Properties, plant and equipment	–	–	–	–	–	–	39,650	39,650
Other assets (including deferred tax assets)	8,749	8,548	21	152	7,350	1,126	28	25,974
Total assets	362,416	162,124	185,775	303,903	394,958	269,471	59,863	1,738,510
Liabilities								
Hong Kong SAR currency notes in circulation	65,890	–	–	–	–	–	–	65,890
Deposits and balances from banks and other financial institutions	216,490	16,968	1,801	1,435	–	–	–	236,694
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued	–	–	–	–	–	–	–	–
– others	–	1,116	802	825	472	22	–	3,237
Derivative financial instruments	13,661	700	771	1,491	3,945	1,713	–	22,281
Deposits from customers	583,005	337,186	137,991	76,830	10,777	162	–	1,145,951
Debt securities in issue at amortised cost	–	96	20	45	5,824	–	–	5,985
Other accounts and provisions (including current and deferred tax liabilities)	30,772	6,137	2,191	4,423	5,890	–	–	49,413
Insurance contract liabilities	1,530	729	866	4,379	26,458	13,258	–	47,220
Subordinated liabilities	–	–	419	1	–	28,236	–	28,656
Total liabilities	911,348	362,932	144,861	89,429	53,366	43,391	–	1,605,327
Net liquidity gap	(548,932)	(200,808)	40,914	214,474	341,592	226,080	59,863	133,183

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	2010							
	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	374,818	40,994	–	–	–	–	–	415,812
Placements with banks and other financial institutions maturing between one and twelve months	–	–	19,346	20,153	–	–	–	39,499
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held	–	–	568	1,678	2	–	–	2,248
– others	–	3,209	27,603	2,628	3,179	5,054	–	41,673
– debt securities designated at fair value through profit or loss								
– certificates of deposit held	–	–	118	422	1,316	474	–	2,330
– others	–	63	180	722	9,964	7,611	–	18,540
– fund and equity securities	–	–	–	–	–	–	5,085	5,085
Derivative financial instruments	19,539	507	509	1,080	1,167	1,052	–	23,854
Hong Kong SAR Government certificates of indebtedness	46,990	–	–	–	–	–	–	46,990
Advances and other accounts								
– advances to customers	43,572	17,031	43,051	107,513	232,575	166,473	693	610,908
– trade bills	53	10,109	16,190	5,253	–	–	–	31,605
– advances to banks and other financial institutions	–	1	147	1,209	1,554	–	–	2,911
Investment in securities								
– debt securities held for available-for-sale								
– certificates of deposit held	–	303	501	11,577	11,248	–	–	23,629
– others	–	18,164	12,873	48,637	142,051	37,144	419	259,288
– debt securities held for held-to-maturity								
– certificates of deposit held	–	3	41	1,280	2,910	366	–	4,600
– others	–	1,054	3,743	11,637	26,645	10,311	394	53,784
– debt securities held for loans and receivables	–	5,791	3,402	6,163	–	–	–	15,356
– equity securities	–	–	–	–	–	–	3,527	3,527
Interests in associates	–	–	–	–	–	–	212	212
Investment properties	–	–	–	–	–	–	10,342	10,342
Properties, plant and equipment	–	–	–	–	–	–	31,049	31,049
Other assets (including deferred tax assets)	4,609	10,744	6	211	2,125	–	103	17,798
Total assets	489,581	107,973	128,278	220,163	434,736	228,485	51,824	1,661,040
Liabilities								
Hong Kong SAR currency notes in circulation	46,990	–	–	–	–	–	–	46,990
Deposits and balances from banks and other financial institutions	260,453	43,633	8,729	969	–	–	–	313,784
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued	–	–	–	–	–	–	–	–
– others	–	4,996	16,994	3,316	167	20	–	25,493
Derivative financial instruments	14,706	1,040	495	1,287	3,082	745	–	21,355
Deposits from customers	599,586	239,253	107,982	74,014	6,198	–	–	1,027,033
Other accounts and provisions (including current and deferred tax liabilities)	22,967	8,579	1,829	3,237	4,800	–	–	41,412
Insurance contract liabilities	1,407	1,131	55	3,413	25,351	8,450	–	39,807
Subordinated liabilities	–	–	419	1	–	26,457	–	26,877
Total liabilities	946,109	298,632	136,503	86,237	39,598	35,672	–	1,542,751
Net liquidity gap	(456,528)	(190,659)	(8,225)	133,926	395,138	192,813	51,824	118,289

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

The above maturity classifications have been prepared in accordance with relevant provisions under the Banking (Disclosure) Rules. The Group has reported assets such as advances and debt securities which have been overdue for not more than one month as "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.

(C) Analysis of undiscounted cash flows by contractual maturities

(a) Non-derivative cash flows

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

	2011					
	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	65,890	–	–	–	–	65,890
Deposits and balances from banks and other financial institutions	233,472	1,840	1,450	–	–	236,762
Financial liabilities at fair value through profit or loss	1,116	804	829	477	22	3,248
Deposits from customers	920,349	138,367	77,730	11,752	220	1,148,418
Debt securities in issue at amortised cost	97	21	231	6,701	–	7,050
Subordinated liabilities	–	539	707	4,983	30,069	36,298
Other financial liabilities	29,580	1,312	3,269	6	–	34,167
Total financial liabilities	1,250,504	142,883	84,216	23,919	30,311	1,531,833

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(a) Non-derivative cash flows (continued)

	2010					
	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	46,990	–	–	–	–	46,990
Deposits and balances from banks and other financial institutions	304,106	8,804	1,013	–	–	313,923
Financial liabilities at fair value through profit or loss	4,997	17,001	3,320	179	23	25,520
Deposits from customers	838,895	108,138	74,604	6,641	–	1,028,278
Subordinated liabilities	–	539	682	4,973	31,579	37,773
Other financial liabilities	25,977	1,192	2,302	269	–	29,740
Total financial liabilities	1,220,965	135,674	81,921	12,062	31,602	1,482,224

(b) Derivative cash flows

(i) Derivatives settled on a net basis

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

– Exchange rate contracts: non-deliverable OTC currency options, currency futures, non-deliverable currency forwards;

– Interest rate contracts: interest rate swaps;

– Bullion contracts: bullion margin contracts; and

– Equity contracts: exchange traded equity options and equity linked swaps.

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(b) Derivative cash flows (continued)

(i) Derivatives settled on a net basis (continued)

The tables below analyse 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 tables are the net contractual undiscounted cash flows of derivatives with net negative fair value.

	2011					
	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**
Exchange rate contracts	**(13,030)**	**(223)**	**(236)**	**24**	**–**	**(13,465)**
Interest rate contracts	**(154)**	**(357)**	**(1,572)**	**(3,724)**	**(192)**	**(5,999)**
Bullion contracts	**(717)**	**–**	**–**	**–**	**–**	**(717)**
Equity contracts	**–**	**(1)**	**–**	**–**	**–**	**(1)**
	(13,901)	**(581)**	**(1,808)**	**(3,700)**	**(192)**	**(20,182)**

	2010					
	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
Exchange rate contracts	(13,838)	(148)	(296)	129	–	(14,153)
Interest rate contracts	(192)	(417)	(2,003)	(4,150)	(605)	(7,367)
Bullion contracts	(899)	–	–	–	–	(899)
	(14,929)	(565)	(2,299)	(4,021)	(605)	(22,419)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(b) Derivative cash flows (continued)

(ii) Derivatives settled on a gross basis

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

The tables below analyse 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 tables are the gross contractual undiscounted cash flows for all derivatives that are settled on a gross basis.

	2011					
	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**
Exchange rate contracts:						
– Outflow	**(235,421)**	**(91,921)**	**(138,311)**	**(22,614)**	**(964)**	**(489,231)**
– Inflow	**235,286**	**91,899**	**138,285**	**22,619**	**962**	**489,051**
Bullion contracts:						
– Outflow	**(3,792)**	**–**	**–**	**–**	**–**	**(3,792)**
– Inflow	**–**	**–**	**–**	**–**	**–**	**–**
Equity contracts:						
– Outflow	**(1)**	**–**	**–**	**–**	**–**	**(1)**
– Inflow	**8**	**1**	**–**	**–**	**–**	**9**
Total outflow	**(239,214)**	**(91,921)**	**(138,311)**	**(22,614)**	**(964)**	**(493,024)**
Total inflow	**235,294**	**91,900**	**138,285**	**22,619**	**962**	**489,060**

	2010					
	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
Exchange rate contracts:						
– Outflow	(195,060)	(82,467)	(53,436)	(10,163)	(1,017)	(342,143)
– Inflow	194,521	82,463	53,436	10,070	1,013	341,503
Bullion contracts:						
– Outflow	(3,021)	(867)	–	–	–	(3,888)
– Inflow	–	–	–	–	–	–
Equity contracts:						
– Outflow	(2)	–	–	–	–	(2)
– Inflow	19	13	–	–	–	32
Total outflow	(198,083)	(83,334)	(53,436)	(10,163)	(1,017)	(346,033)
Total inflow	194,540	82,476	53,436	10,070	1,013	341,535

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(c) Off-balance sheet items

Loan commitments

The contractual amounts of the Group's off-balance sheet financial instruments as at 31 December 2011 that the Group commits to extend credit to customers and other facilities amounting to HK$319,768 million (2010: HK$281,138 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 2011 amounting to HK$70,417 million (2010: HK$55,572 million) are maturing no later than 1 year.

4.4 Insurance Risk

The Group is in the business of insuring against the risk of mortality, morbidity, disability, critical illness, accidents and related risks. The Group manages these risks through the application of its underwriting policies and reinsurance 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 on the Group's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts, and relate to circumstances where significant liabilities could arise.

For the in-force insurance contracts, most of the underlying insurance liabilities are related to endowment 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. For some of the insurance liabilities dominated in Renminbi, the Group's insurance subsidiary has entered into another reinsurance arrangement that reinsures most of insurance risk.

Uncertainty in the estimation of future benefit payments and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality 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 requirements of the HKMA for the reported periods in respect of banking operation as further elaborated below.

In prior years, the Group adopted the standardised (credit risk) ("STC") approach and the standardised (market risk) ("STM") approach to calculate credit risk capital charge and market risk capital charge respectively.

With the HKMA approval from 1 January 2011, the Group has migrated to the foundation internal ratings-based ("FIRB") approach to calculate the credit risk capital charge for the majority of its non-securitisation exposures and internal ratings-based (securitisation) approach to calculate the credit risk capital charge for its securitisation exposures. A small residual credit exposures was approved by HKMA to be exempted from FIRB approach and remained under STC approach.

BOCHK has adopted the internal models approach to calculate general market risk capital charge for foreign exchange and interest rate exposures as at 31 December 2011, while the remaining of the Group continued to adopt STM approach to calculate the market risk capital charge.

The Group continues to adopt standardised (operational risk) ("STO") approach to calculate the minimum capital charge for operational risk in year 2011.

In compliance with the Banking (Capital) Rules, this regulatory capital framework aligns regulatory capital requirements more closely with the inherent risks. Following announcement of the Basel III regulations by Basel Committee, the Group has conducted a detailed impact analysis on the expected new capital rules, and participated in the "Implementation Monitoring Process" organised by the Basel Committee on Banking Supervision, and well prepared for the future implementation of the new regulatory requirements.

The Group has continued to adopt an internal capital adequacy assessment process ("ICAAP") in capital management in 2011. Through this process, each material risk associated with the Group's main activities is assessed by pre-defined scorecard methods, and a comprehensive judgment of the overall risk profile is made subsequently with consideration of Group's governance structure, risk management quality, internal control environment and capital strength. As a result, the minimum CAR is derived and 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 capital plan of the Group is drawn up annually and then submitted to the Board for approval after endorsement of ALCO. The plan is built up by assessing the implications of various factors upon capital adequacy such as the business strategies, return on equity, risk appetite, credit rating, as well as regulatory requirements. Hence, the future capital requirement is determined and capital sources are identified also. The plan is to ensure the Group's capital adequacy and achieve optimal capital structure in order to align with its business development needs and risk profile.

4. Financial risk management (continued)

4.5 Capital Management (continued)

As a result of the change in the bases of regulatory capital calculation, the amounts shown below are not directly comparable.

(A) Capital adequacy ratio

	2011	2010
Capital adequacy ratio	**16.90%**	16.14%
Core capital ratio	**12.51%**	11.29%

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 268.

(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:

	2011 HK$'m	2010 HK$'m
Core capital:		
Paid up ordinary share capital	**43,043**	43,043
Reserves	**31,947**	28,475
Profit and loss account	**8,318**	5,332
Non-controlling interests	**1,605**	1,425
	84,913	78,275
Deductions from core capital	**(313)**	(332)
Core capital	**84,600**	77,943
Supplementary capital:		
Fair value gains arising from holdings of available-for-sale securities	**290**	588
Fair value gains arising from holdings of securities designated at fair value through profit or loss	**18**	29
Collective loan impairment allowances	**91**	1,985
Regulatory reserve	**253**	5,076
Surplus provisions	**3,354**	–
Term subordinated debt	**25,961**	26,198
	29,967	33,876
Deductions from supplementary capital	**(313)**	(332)
Supplementary capital	**29,654**	33,544
Total capital base after deductions	**114,254**	111,487

4. Financial risk management (continued)

4.5 Capital Management (continued)

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

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 265 to 268. Investment costs in such subsidiaries are deducted from the capital base.

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

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. Their carrying value approximates fair value.

Loans and receivables

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.

Debt securities in issue at amortised cost

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

Subordinated liabilities

The subordinated loans are on floating rate terms, bear interest at prevailing market interest rates and their carrying value approximates fair value. Fair value for subordinated notes is based on market prices or broker/dealer price quotations. The carrying value and fair value of subordinated notes as at 31 December 2011 amounted to HK$22,031 million (2010: HK$20,029 million) and HK$20,704 million (2010: HK$20,834 million) respectively.

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

The main parameters used in valuation techniques for financial instruments held by the Group include bond prices, interest rates, foreign exchange rates, equity and stock prices, volatilities, counterparty credit spreads and others, which are 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 2011 and 2010.

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

	2011			
	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	–	25,033	–	25,033
– Equity securities	12	161	–	173
– Financial assets designated at fair value through profit or loss				
– Debt securities	–	21,336	134	21,470
– Fund	1,103	–	–	1,103
– Equity securities	823	–	–	823
Derivative financial instruments	18,611	8,176	–	26,787
Available-for-sale securities				
– Debt securities	65,235	243,842	2,822	311,899
– Equity securities	3,752	563	184	4,499
Financial liabilities				
Financial liabilities at fair value through profit or loss				
– Trading liabilities	–	2,598	–	2,598
– Financial liabilities designated at fair value through profit or loss	–	436	203	639
Derivative financial instruments	13,655	8,626	–	22,281

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 (continued)

	2010			
	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	–	43,821	100	43,921
– Equity securities	38	97	–	135
– Financial assets designated at fair value through profit or loss				
– Debt securities	–	20,607	263	20,870
– Fund	3,028	–	–	3,028
– Equity securities	1,922	–	–	1,922
Derivative financial instruments	19,527	4,327	–	23,854
Available-for-sale securities				
– Debt securities	39,048	237,914	5,955	282,917
– Equity securities	2,971	390	166	3,527
Financial liabilities				
Financial liabilities at fair value through profit or loss				
– Trading liabilities	–	25,259	–	25,259
– Financial liabilities designated at fair value through profit or loss	–	234	–	234
Derivative financial instruments	14,705	6,650	–	21,355

NOTES TO THE FINANCIAL STATEMENTS

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

	2011				
	Financial assets				Financial liabilities
	Trading securities	Financial assets designated at fair value through profit or loss	Available-for-sale securities		Financial liabilities designated at fair value through profit or loss
	Debt securities HK$'m	Debt securities HK$'m	Debt securities HK$'m	Equity securities HK$'m	HK$'m
At 1 January 2011	100	263	5,955	166	–
(Losses)/gains					
– Profit or loss	–	(10)	(30)	–	–
– Other comprehensive income	–	–	(21)	18	–
Purchases	–	–	1,812	10	–
Issues	–	–	–	–	203
Sales	(100)	(119)	(3,379)	(10)	–
Transfers out of level 3	–	–	(1,515)	–	–
At 31 December 2011	–	134	2,822	184	203
Total losses for the year included in profit or loss for assets and liabilities held as at 31 December 2011	–	(10)	–	–	–

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 (continued)

	2010			
	Financial assets			
	Trading securities	Financial assets designated at fair value through profit or loss	Available-for-sale securities	
	Debt securities HK$'m	Debt securities HK$'m	Debt securities HK$'m	Equity securities HK$'m
At 1 January 2010	–	136	4,293	143
(Losses)/gains				
– Profit or loss	–	(7)	29	–
– Other comprehensive income	–	–	23	23
Purchases	100	141	3,492	–
Sales	–	(7)	(3,697)	–
Transfers into level 3	–	–	1,815	–
At 31 December 2010	100	263	5,955	166
Total losses for the year included in profit or loss for assets held as at 31 December 2010	–	(7)	–	–

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

5. Net interest income

	2011 HK$'m	2010 HK$'m
Interest income		
Due from banks and other financial institutions	**8,455**	2,972
Advances to customers	**13,386**	11,466
Listed investments	**4,470**	4,181
Unlisted investments	**5,387**	4,631
Others	**233**	199
	31,931	23,449
Interest expense		
Due to banks and other financial institutions	**(2,917)**	(1,086)
Deposits from customers	**(6,275)**	(2,938)
Debt securities in issue	**(26)**	–
Subordinated liabilities	**(562)**	(510)
Others	**(172)**	(181)
	(9,952)	(4,715)
Net interest income	**21,979**	18,734

Included within interest income is HK$3 million (2010: HK$6 million) of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2011. Interest income accrued on impaired investment in securities amounted to HK$16 million (2010: HK$88 million).

Included within interest income and interest expense are HK$31,850 million (2010: HK$23,272 million) and HK$10,573 million (2010: HK$5,169 million), before hedging effect, for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

6. Net fee and commission income

	2011 HK$'m	2010 HK$'m
Fee and commission income		
Credit card business	**2,887**	2,222
Securities brokerage	**2,782**	3,338
Loan commissions	**1,160**	961
Insurance	**1,097**	561
Bills commissions	**854**	751
Payment services	**637**	568
Trust and custody services	**379**	249
Funds distribution	**337**	160
Safe deposit box	**211**	200
Currency exchange	**156**	113
Others	**358**	356
	10,858	9,479
Fee and commission expense		
Credit card business	**(2,106)**	(1,542)
Securities brokerage	**(431)**	(504)
Payment services	**(91)**	(87)
Others	**(397)**	(302)
	(3,025)	(2,435)
Net fee and commission income	**7,833**	7,044
Of which arise from		
– financial assets or financial liabilities not at fair value through profit or loss		
– Fee and commission income	**1,363**	1,149
– Fee and commission expense	**(5)**	(7)
	1,358	1,142
– trust and other fiduciary activities		
– Fee and commission income	**571**	438
– Fee and commission expense	**(6)**	(6)
	565	432

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

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7. Net trading gain

	2011 HK$'m	2010 HK$'m
Net gain/(loss) from:		
– foreign exchange and foreign exchange products	**1,430**	999
– interest rate instruments and items under fair value hedge	**12**	262
– equity instruments	**82**	(8)
– commodities	**186**	116
	1,710	1,369

8. Net gain on other financial assets

	2011 HK$'m	2010 HK$'m
Net gain from disposal of available-for-sale securities	**469**	665
Net loss from disposal/redemption of held-to-maturity securities	**(19)**	(9)
Others	**(142)**	–
	308	656

9. Other operating income

	2011 HK$'m	2010 HK$'m
Dividend income from investment in securities		
– listed investments	**93**	73
– unlisted investments	**27**	24
Gross rental income from investment properties	**386**	339
Less: Outgoings in respect of investment properties	**(72)**	(69)
Others	**91**	100
	525	467

Included in the "Outgoings in respect of investment properties" is HK$4 million (2010: HK$12 million) of direct operating expenses related to investment properties that were not let during the year.

10. Gross insurance benefits and claims

	2011 HK$'m	2010 HK$'m
Claims, benefits and surrenders paid	**6,437**	3,650
Movement in liabilities	**7,407**	6,403
	13,844	10,053

11. Net (charge)/reversal of impairment allowances

	2011 HK$'m	2010 HK$'m
Advances to customers		
Individually assessed		
– new allowances	**(146)**	(70)
– releases	**134**	219
– recoveries	**327**	416
Net reversal of individually assessed loan impairment allowances (Note 26)	**315**	565
Collectively assessed		
– new allowances	**(720)**	(528)
– releases	**–**	–
– recoveries	**26**	33
Net charge of collectively assessed loan impairment allowances (Note 26)	**(694)**	(495)
Net (charge)/reversal of loan impairment allowances	**(379)**	70
Available-for-sale securities		
Net reversal of impairment allowances on available-for-sale securities		
– Individually assessed	**7**	208
Held-to-maturity securities		
Net (charge)/reversal of impairment allowances on held-to-maturity securities		
– Individually assessed (Note 27)	**(124)**	46
Others	**(10)**	(9)
Net (charge)/reversal of impairment allowances	**(506)**	315

12. Operating expenses

	2011 HK$'m	2010 HK$'m
Staff costs (including directors' emoluments)		
– salaries and other costs	**5,606**	4,966
– pension cost	**432**	391
	6,038	5,357
Premises and equipment expenses (excluding depreciation)		
– rental of premises	**613**	506
– information technology	**429**	400
– others	**348**	295
	1,390	1,201
Depreciation (Note 31)	**1,277**	1,131
Auditor's remuneration		
– audit services	**32**	31
– non-audit services	**6**	4
Lehman Brothers related products*	**(2,797)**	89
Other operating expenses	**1,916**	1,771
	7,862	9,584

* The final resolution of certain series of Lehman Brothers minibonds was announced on 15 June 2011. The net amount of HK$2,854 million recovered by the Group from the underlying collateral of the Lehman Brothers minibonds, after deducting the ex gratia payments and provision for trustee expenses, was credited to operating expenses in 2011.

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

	2011 HK$'m	2010 HK$'m
Net gain from disposal of investment properties	**13**	–
Net gain from fair value adjustments on investment properties (Note 30)	**2,200**	1,511
	2,213	1,511

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

	2011 HK$'m	2010 HK$'m
Net loss from disposal of premises	(2)	–
Net loss from disposal of other fixed assets	(32)	(10)
Net gain from revaluation of premises (Note 31)	–	4
	(34)	(6)

15. Taxation

Taxation in the consolidated income statement represents:

	2011 HK$'m	2010 HK$'m
Hong Kong profits tax		
Current tax		
– current year taxation	3,718	2,930
– under-provision in prior years	7	8
	3,725	2,938
Deferred tax credit (Note 39)	(159)	(30)
Hong Kong profits tax	3,566	2,908
Overseas taxation	301	144
	3,867	3,052

Hong Kong profits tax has been provided at the rate of 16.5% (2010: 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.

15. 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:

	2011 HK$'m	2010 HK$'m
Profit before taxation	**24,680**	19,742
Calculated at a taxation rate of 16.5% (2010: 16.5%)	**4,072**	3,257
Effect of different taxation rates in other countries	**37**	23
Income not subject to taxation	**(432)**	(300)
Expenses not deductible for taxation purposes	**104**	52
Tax losses not recognised	**24**	1
Utilisation of previously unrecognised tax losses	**(2)**	(45)
Under-provision in prior years	**7**	8
Foreign withholding tax	**57**	56
Taxation charge	**3,867**	3,052
Effective tax rate	**15.7%**	15.5%

16. Profit attributable to the equity holders of the Company

The profit of the Company for the year ended 31 December 2011 attributable to the equity holders of the Company and dealt with in the financial statements of the Company amounted to HK$12,823 million (2010: HK$9,584 million).

17. Dividends

	2011		2010	
	Per share HK$	Total HK$'m	Per share HK$	Total HK$'m
Interim dividend paid	**0.630**	**6,661**	0.400	4,229
Proposed final dividend	**0.558**	**5,899**	0.572	6,048
	1.188	**12,560**	0.972	10,277

At a meeting held on 24 August 2011, the Board declared an interim dividend of HK$0.63 per ordinary share for the first half of 2011 amounting to approximately HK$6,661 million.

At a meeting held on 29 March 2012, the Board proposed to declare a final dividend of HK$0.558 per ordinary share for the year ended 31 December 2011 amounting to approximately HK$5,899 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 2012.

18. 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 2011 of approximately HK$20,430 million (2010: HK$16,196 million) and on the ordinary shares in issue of 10,572,780,266 shares (2010: 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 2011 (2010: Nil).

19. Retirement benefit costs

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

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

The Group's total contributions made to the ORSO schemes for the year ended 31 December 2011 amounted to approximately HK$327 million (2010: approximately HK$308 million), after a deduction of forfeited contributions of approximately HK$4 million (2010: approximately HK$13 million). For the MPF Scheme, the Group contributed approximately HK$51 million (2010: approximately HK$44 million) for the year ended 31 December 2011.

20. 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.

20. Share option schemes (continued)

(a) Share Option Scheme and Sharesave Plan (continued)

No options were granted pursuant to the Share Option Scheme or the Sharesave Plan during the year 2011 (2010: Nil).

(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 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 2011 and 2010 are disclosed as follows:

	Directors	Senior management	Others*	Total number of share options	Average exercise price (HK$ per share)
At 1 January 2011	**3,976,500**	**247,300**	**–**	**4,223,800**	**8.5**
Transfer	**(1,446,000)**	**–**	**1,446,000**	**–**	**8.5**
At 31 December 2011	**2,530,500**	**247,300**	**1,446,000**	**4,223,800**	**8.5**
Exercisable at 31 December 2011	**2,530,500**	**247,300**	**1,446,000**	**4,223,800**	**8.5**
At 1 January 2010	3,976,500	1,074,300	–	5,050,800	8.5
Less: Share options exercised during the year	–	(827,000)	–	(827,000)	8.5
At 31 December 2010	3,976,500	247,300	–	4,223,800	8.5
Exercisable at 31 December 2010	3,976,500	247,300	–	4,223,800	8.5

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

No share options were exercised during the year. Share options were exercised on a regular basis throughout the year of 2010 and its weighted average share price was HK$22.73.

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.

21. 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:

	2011			
	Directors' fee HK$'000	Basic salaries, allowances and benefits in kind HK$'000	Bonus HK$'000	Total HK$'000
Executive Directors				
He Guangbei	100	7,265	4,836	12,201
Gao Yingxin	100	5,077	3,042	8,219
	200	12,342	7,878	20,420
Non-executive Directors				
Xiao Gang	–	–	–	–
Li Lihui	–	–	–	–
Li Zaohang	–	–	–	–
Zhou Zaiqun#	2,435	–	–	2,435
Zhang Yanling	–	–	–	–
Chen Siqing	–	–	–	–
Fung Victor Kwok King*	310	–	–	310
Koh Beng Seng*	350	–	–	350
Shan Weijian*	350	–	–	350
Tung Chee Chen*	300	–	–	300
Tung Savio Wai-Hok*	350	–	–	350
	4,095	–	–	4,095
	4,295	12,342	7,878	24,515

Madam Zhang Yanling resigned as a Non-executive Director of the Company and Mr. Chen Siqing was appointed as a Non-executive Director of the Company with effect from 15 December 2011.

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

(a) Directors' emoluments (continued)

	2010			
	Directors' fee HK$'000	Basic salaries, allowances and benefits in kind HK$'000	Bonus HK$'000	Total HK$'000
Executive Directors				
He Guangbei	100	6,614	3,419	10,133
Gao Yingxin	100	4,742	2,465	7,307
	200	11,356	5,884	17,440
Non-executive Directors				
Xiao Gang	–	–	–	–
Li Lihui	–	–	–	–
Li Zaohang	–	–	–	–
Zhou Zaiqun	–	–	–	–
Zhang Yanling	–	–	–	–
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*	155	–	–	155
	1,805	–	–	1,805
	2,005	11,356	5,884	19,245

Note:

\# Includes fee as Chairman and Non-executive Director of Nanyang Commercial Bank, Limited

* 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 20(b). Full details of the scheme are stated in Note 20. During the year, no options were exercised and no benefits arising from the granting of these share options were included in the directors' emoluments disclosed above or recognised in the income statement (2010: Nil).

For the year ended 31 December 2011, certain directors waived emoluments of HK$2 million (2010: HK$2 million), which include directors' fee from subsidiaries.

21. 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 two (2010: two) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining three (2010: three) individuals during the year are as follows:

	2011 HK$'m	2010 HK$'m
Basic salaries and allowances	**14**	16
Bonus	**7**	5
Contributions to pension schemes	**–**	1
Directors' fee from subsidiaries	**1**	–
Amount paid as an inducement to join the Group	**–**	2
	22	24

Emoluments of individuals were within the following bands:

	Number of individuals	
	2011	2010
HK$5,000,001 – HK$5,500,000	**1**	–
HK$5,500,001 – HK$6,000,000	**1**	–
HK$6,000,001 – HK$6,500,000	**–**	2
HK$11,000,001 – HK$11,500,000	**1**	1

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

(c) Remuneration for the Senior Management and Key Personnel

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

(i) Remuneration awarded during the year

	2011					
	Senior Management			Key Personnel		
	Non-deferred HK$'m	Deferred HK$'m	Total HK$'m	Non-deferred HK$'m	Deferred HK$'m	Total HK$'m
Fixed remuneration						
Cash	44	–	44	47	–	47
Variable remuneration						
Cash	15	7	22	22	8	30
Total	59	7	66	69	8	77

	2010					
	Senior Management			Key Personnel		
	Non-deferred HK$'m	Deferred HK$'m	Total HK$'m	Non-deferred HK$'m	Deferred HK$'m	Total HK$'m
Fixed remuneration						
Cash	45	–	45	42	–	42
Variable remuneration						
Cash	13	3	16	19	1	20
Total	58	3	61	61	1	62

The remuneration above includes 11 (2010: 11) members of Senior Management and 21 (2010: 18) members of Key Personnel.

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

(c) Remuneration for the Senior Management and Key Personnel (continued)

(ii) Deferred remuneration outstanding

	2011		2010	
	Senior Management HK$'m	**Key Personnel HK$'m**	Senior Management HK$'m	Key Personnel HK$'m
Deferred remuneration				
Vested	**1**	**1**	–	–
Unvested	**9**	**8**	3	1
	10	**9**	3	1
At 1 January	**3**	**1**	–	–
Awarded	**7**	**8**	3	1
Paid out	**(1)**	**(1)**	–	–
Reduced through performance adjustments	**–**	**–**	–	–
At 31 December	**9**	**8**	3	1

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

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

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

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22. Cash and balances with banks and other financial institutions

	2011 **HK$'m**	2010 HK$'m
Cash	**6,425**	4,571
Balances with central banks	**158,950**	336,923
Balances with banks and other financial institutions	**48,412**	33,324
Placements with banks and other financial institutions maturing within one month	**65,008**	40,994
	278,795	415,812

23. Financial assets at fair value through profit or loss

	Trading securities		**Financial assets designated at fair value through profit or loss**		**Total**	
	2011 **HK$'m**	2010 HK$'m	**2011** **HK$'m**	2010 HK$'m	**2011** **HK$'m**	2010 HK$'m
At fair value						
Debt securities						
– Listed in Hong Kong	**3,628**	1,398	**776**	829	**4,404**	2,227
– Listed outside Hong Kong	**4,732**	5,188	**5,376**	3,253	**10,108**	8,441
	8,360	6,586	**6,152**	4,082	**14,512**	10,668
– Unlisted	**16,673**	37,335	**15,318**	16,788	**31,991**	54,123
	25,033	43,921	**21,470**	20,870	**46,503**	64,791
Fund						
– Unlisted	**–**	–	**1,103**	3,028	**1,103**	3,028
Equity securities						
– Listed in Hong Kong	**12**	38	**823**	1,810	**835**	1,848
– Listed outside Hong Kong	**–**	–	**–**	112	**–**	112
– Unlisted	**161**	97	**–**	–	**161**	97
	173	135	**823**	1,922	**996**	2,057
Total	**25,206**	44,056	**23,396**	25,820	**48,602**	69,876

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

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

	2011 HK$'m	2010 HK$'m
Sovereigns	**19,524**	35,223
Public sector entities*	**285**	302
Banks and other financial institutions	**17,731**	25,135
Corporate entities	**11,062**	9,216
	48,602	69,876

* Included financial assets at fair value through profit or loss of HK$263 million (2010: HK$258 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

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

	2011 HK$'m	2010 HK$'m
Treasury bills	**14,691**	32,840
Certificates of deposit held	**1,515**	4,578
Other financial assets at fair value through profit or loss	**32,396**	32,458
	48,602	69,876

24. Derivative financial instruments and hedge accounting

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

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

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

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

24. Derivative financial instruments and hedge accounting (continued)

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 foreign exchange rates, market interest rates, metal prices or equity prices relative to their terms. The aggregate fair values of derivative financial instruments assets and liabilities can fluctuate significantly from time to time.

(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 is set. Every derivative transaction must be input into the relevant system for settlement, mark to market revaluation, reporting and control.

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

	2011			
	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting* HK$'m	Total HK$'m
Exchange rate contracts				
Spot and forwards	311,393	–	–	311,393
Swaps	394,781	4,234	5,181	404,196
Foreign currency options				
– Options purchased	2,595	–	–	2,595
– Options written	3,556	–	–	3,556
	712,325	4,234	5,181	721,740
Interest rate contracts				
Futures	4,035	–	–	4,035
Swaps	340,641	34,587	49,359	424,587
Interest rate options				
– Swaptions purchased	1,005	–	–	1,005
– Swaptions written	505	–	–	505
	346,186	34,587	49,359	430,132
Bullion contracts	13,010	–	–	13,010
Equity contracts	372	–	–	372
Other contracts	82	–	–	82
Total	1,071,975	38,821	54,540	1,165,336

* 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.

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

	2010			
	Trading HK$'m	Hedging HK$'m	Not qualified for hedge accounting HK$'m	Total HK$'m
Exchange rate contracts				
Spot and forwards	332,032	–	111	332,143
Swaps	310,451	4,437	2,993	317,881
Foreign currency options				
– Options purchased	1,543	–	–	1,543
– Options written	2,601	–	–	2,601
	646,627	4,437	3,104	654,168
Interest rate contracts				
Futures	7,735	–	–	7,735
Swaps	266,326	46,345	3,144	315,815
	274,061	46,345	3,144	323,550
Bullion contracts	13,761	–	–	13,761
Equity contracts	145	–	–	145
Other contracts	99	–	–	99
Total	934,693	50,782	6,248	991,723

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

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

	2011							
	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	18,484	–	–	18,484	(13,804)	–	–	(13,804)
Swaps	1,531	59	89	1,679	(1,553)	(100)	(150)	(1,803)
Foreign currency options								
– Options purchased	18	–	–	18	–	–	–	–
– Options written	–	–	–	–	(23)	–	–	(23)
	20,033	59	89	20,181	(15,380)	(100)	(150)	(15,630)
Interest rate contracts								
Futures	1	–	–	1	(1)	–	–	(1)
Swaps	2,695	2,946	–	5,641	(4,688)	(1,110)	(128)	(5,926)
Interest rate options								
– Swaptions purchased	1	–	–	1	–	–	–	–
– Swaptions written	–	–	–	–	(5)	–	–	(5)
	2,697	2,946	–	5,643	(4,694)	(1,110)	(128)	(5,932)
Bullion contracts	961	–	–	961	(717)	–	–	(717)
Equity contracts	2	–	–	2	(2)	–	–	(2)
Total	23,693	3,005	89	26,787	(20,793)	(1,210)	(278)	(22,281)

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

	2010							
	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	19,376	–	1	19,377	(14,673)	–	–	(14,673)
Swaps	843	56	63	962	(1,315)	(74)	(83)	(1,472)
Foreign currency options								
– Options purchased	11	–	–	11	–	–	–	–
– Options written	–	–	–	–	(12)	–	–	(12)
	20,230	56	64	20,350	(16,000)	(74)	(83)	(16,157)
Interest rate contracts								
Futures	–	–	–	–	(3)	–	–	(3)
Swaps	1,592	869	1	2,462	(2,339)	(1,842)	(114)	(4,295)
	1,592	869	1	2,462	(2,342)	(1,842)	(114)	(4,298)
Bullion contracts	1,040	–	–	1,040	(899)	–	–	(899)
Equity contracts	2	–	–	2	(1)	–	–	(1)
Total	22,864	925	65	23,854	(19,242)	(1,916)	(197)	(21,355)

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

	2011 HK$'m	2010 HK$'m
Exchange rate contracts		
Forwards	**1,487**	1,938
Swaps	**1,325**	1,365
Foreign currency options		
– Options purchased	**2**	–
Interest rate contracts		
Swaps	**1,733**	1,165
Bullion contracts	**14**	2
Equity contracts	**5**	–
	4,566	4,470

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

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

The Group adopted the FIRB approach in respect of banking operation to calculate credit risk exposures as at 31 December 2011, as opposed to the STC approach that was used as at 31 December 2010. As a result of the change in the basis used, the risk weighted amounts shown above are not directly comparable.

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 as at 31 December are as follows:

	2011		2010	
	Assets HK$'m	**Liabilities HK$'m**	Assets HK$'m	Liabilities HK$'m
Fair value hedges	**2,946**	**(1,110)**	869	(1,842)
Cash flow hedges	**59**	**(100)**	56	(74)
	3,005	**(1,210)**	925	(1,916)

(i) Fair value hedges

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

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

	2011		2010	
	Hedged assets HK$'m	**Hedged liabilities HK$'m**	Hedged assets HK$'m	Hedged liabilities HK$'m
Net loss				
– hedging instruments	**(634)**	**2,064**	(504)	348
– hedged items	**589**	**(2,066)**	474	(395)
	(45)	**(2)**	(30)	(47)

24. Derivative financial instruments and hedge accounting (continued)

(b) Hedge accounting (continued)

(ii) Cash flow hedges

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

There are no gains or losses on ineffective portion recognised in the income statement during the year (2010: Nil).

(iii) Hedges of net investments in foreign operations

As at 31 December 2011, a proportion of the Group's RMB-denominated deposits from customers of HK$2,642 million (2010: HK$2,525 million) are designated as a hedging instrument to hedge against the net investments in foreign operations.

There are no gains or losses on ineffective portion recognised in the income statement during the year (2010: Nil).

25. Advances and other accounts

	2011 HK$'m	2010 HK$'m
Personal loans and advances	**215,715**	187,000
Corporate loans and advances	**483,664**	426,219
Advances to customers*	**699,379**	613,219
Loan impairment allowances		
– Individually assessed	**(259)**	(326)
– Collectively assessed	**(2,571)**	(1,985)
	696,549	610,908
Trade bills	**56,506**	31,605
Advances to banks and other financial institutions	**2,174**	2,911
Total	**755,229**	645,424

As at 31 December 2011, advances to customers included accrued interest of HK$1,305 million (2010: HK$886 million).

As at 31 December 2011 and 2010, no impairment allowance was made in respect of trade bills and advances to banks and other financial institutions.

* Included advances to customers denominated in HK dollars of HK$470,898 million (2010: HK$415,585 million) and US dollars equivalent to HK$179,888 million (2010: HK$159,766 million).

26. Loan impairment allowances

	2011		
	Individual assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2011	23	303	326
Credited to income statement (Note 11)	(2)	(313)	(315)
Loans written off during the year as uncollectible	(7)	(71)	(78)
Recoveries	14	313	327
Unwind of discount on impairment allowances	–	(3)	(3)
Exchange difference	–	2	2
At 31 December 2011	28	231	259

	2011		
	Collective assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2011	186	1,799	1,985
Charged to income statement (Note 11)	167	527	694
Loans written off during the year as uncollectible	(142)	(1)	(143)
Recoveries	26	–	26
Exchange difference	–	9	9
At 31 December 2011	237	2,334	2,571

26. Loan impairment allowances (continued)

	2010		
	Individual assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2010	40	631	671
Credited to income statement (Note 11)	(21)	(544)	(565)
Loans written off during the year as uncollectible	(14)	(179)	(193)
Recoveries	18	398	416
Unwind of discount on impairment allowances	–	(6)	(6)
Exchange difference	–	3	3
At 31 December 2010	23	303	326

	2010		
	Collective assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2010	170	1,428	1,598
Charged to income statement (Note 11)	130	365	495
Loans written off during the year as uncollectible	(147)	(1)	(148)
Recoveries	33	–	33
Exchange difference	–	7	7
At 31 December 2010	186	1,799	1,985

27. Investment in securities

	2011 HK$'m	2010 HK$'m
The Group		
(a) Available-for-sale securities		
Debt securities, at fair value		
– Listed in Hong Kong	**9,614**	10,176
– Listed outside Hong Kong	**102,098**	111,966
	111,712	122,142
– Unlisted	**200,187**	160,775
	311,899	282,917
Equity securities, at fair value		
– Listed in Hong Kong	**3,660**	2,971
– Listed outside Hong Kong	**92**	–
	3,752	2,971
– Unlisted	**747**	556
	4,499	3,527
	316,398	286,444
(b) Held-to-maturity securities		
Listed, at amortised cost		
– in Hong Kong	**1,164**	1,121
– outside Hong Kong	**14,125**	19,296
	15,289	20,417
Unlisted, at amortised cost	**38,663**	38,016
	53,952	58,433
Impairment allowances	**(25)**	(49)
	53,927	58,384
(c) Loans and receivables		
Unlisted, at amortised cost	**6,673**	15,356
Total	**376,998**	360,184
Market value of listed held-to-maturity securities	**15,288**	20,414

	2011 HK$'m	2010 HK$'m
The Company		
Available-for-sale securities		
Equity securities, at fair value		
– Listed in Hong Kong	**2,506**	2,775

27. Investment in securities (continued)

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

	2011			
	Available-for-sale securities HK$'m	**Held-to-maturity securities HK$'m**	**Loans and receivables HK$'m**	**Total HK$'m**
The Group				
Sovereigns	**104,799**	**20,882**	**–**	**125,681**
Public sector entities*	**36,458**	**6,509**	**–**	**42,967**
Banks and other financial institutions	**148,056**	**23,107**	**6,673**	**177,836**
Corporate entities	**27,085**	**3,429**	**–**	**30,514**
	316,398	**53,927**	**6,673**	**376,998**

	2010			
	Available-for-sale securities HK$'m	Held-to-maturity securities HK$'m	Loans and receivables HK$'m	Total HK$'m
The Group				
Sovereigns	73,394	10,507	–	83,901
Public sector entities*	32,975	7,741	–	40,716
Banks and other financial institutions	165,201	34,647	15,356	215,204
Corporate entities	14,874	5,489	–	20,363
	286,444	58,384	15,356	360,184

* Included available-for-sale securities of HK$20,746 million (2010: HK$15,973 million) and held-to-maturity securities of HK$832 million (2010: HK$822 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

As at 31 December 2011 and 2010, all of the available-for-sale securities held by the Company are issued by banks and other financial institutions.

27. Investment in securities (continued)

The movements in investment in securities are summarised as follows:

	2011		
	Available-for-sale securities HK$'m	**Held-to-maturity securities HK$'m**	**Loans and receivables HK$'m**
The Group			
At 1 January 2011	**286,444**	**58,384**	**15,356**
Additions	**547,949**	**44,116**	**18,861**
Disposals, redemptions and maturity	**(518,880)**	**(49,523)**	**(26,852)**
Amortisation	**(640)**	**218**	**127**
Change in fair value	**41**	**–**	**–**
Net charge of impairment allowances (Note 11)	**–**	**(124)**	**–**
Exchange difference	**1,484**	**856**	**(819)**
At 31 December 2011	**316,398**	**53,927**	**6,673**

	2010		
	Available-for-sale securities HK$'m	Held-to-maturity securities HK$'m	Loans and receivables HK$'m
The Group			
At 1 January 2010	228,613	72,439	12,703
Additions	347,376	36,909	16,530
Disposals, redemptions and maturity	(295,366)	(51,623)	(14,025)
Amortisation	66	(20)	134
Change in fair value	2,248	–	–
Net reversal of impairment allowances (Note 11)	–	46	–
Exchange difference	3,507	633	14
At 31 December 2010	286,444	58,384	15,356

27. Investment in securities (continued)

	Available-for-sale securities	
	2011 HK$'m	2010 HK$'m
The Company		
At 1 January	**2,775**	2,630
Change in fair value	**(269)**	145
At 31 December	**2,506**	2,775

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

	Available-for-sale securities		Held-to-maturity securities	
	2011 HK$'m	2010 HK$'m	**2011 HK$'m**	2010 HK$'m
The Group				
Treasury bills	**72,906**	23,847	**6,195**	5,037
Certificates of deposit held	**27,542**	23,629	**3,044**	4,600
Others	**215,950**	238,968	**44,688**	48,747
	316,398	286,444	**53,927**	58,384

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

	2011 HK$'m	2010 HK$'m
The Group		
At 1 January	**49**	112
Charged/(credited) to income statement (Note 11)	**124**	(46)
Disposals	**(148)**	(17)
At 31 December	**25**	49

28. Investment in subsidiaries

	2011 HK$'m	2010 HK$'m
Unlisted shares, at cost	**54,814**	54,814

The particulars of all direct and indirect subsidiaries of the Company are set out in the Appendix of this Annual Report, "Subsidiaries of the Company". The following is a list of principal subsidiaries as at 31 December 2011:

Name	Place of incorporation and 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	303,800,000 ordinary shares of HK$10 each	*51%	Life insurance business
Nanyang Commercial Bank, Limited	Hong Kong	7,000,000 ordinary shares of HK$100 each	100%	Banking business
Chiyu Banking Corporation Limited	Hong Kong	3,000,000 ordinary shares of HK$100 each	70.49%	Banking business
BOC Credit Card (International) Limited	Hong Kong	4,800,000 ordinary shares of HK$100 each	100%	Credit card services
Po Sang Futures Limited	Hong Kong	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

29. Interests in associates

	2011 HK$'m	2010 HK$'m
At 1 January	**212**	217
Share of result	**28**	–
Share of tax	**(5)**	(2)
Dividend received	**(1)**	(3)
At 31 December	**234**	212

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	Hong Kong		PRC		PRC	
Particulars of issued share capital/registered capital	100,238 ordinary shares of HK$100 each		Registered capital RMB50,000,000		Registered capital RMB450,000,000	
Principal activities	Operation of a private inter-bank message switching network in respect of ATM services		Credit card back-end service support		Prepay debit card services	
	2011 HK$'000	2010 HK$'000	**2011 HK$'000**	2010 HK$'000	**2011 HK$'000**	2010 HK$'000
Assets	**377,539**	362,078	**272,540**	318,851	**3,083,539**	1,569,615
Liabilities	**75,644**	77,299	**160,334**	234,424	**2,536,960**	1,073,916
Revenues	**70,075**	66,044	**827,296**	562,586	**36,220**	4,959
Profit/(loss) after taxation	**27,677**	28,823	**28,270**	9,285	**22,594**	(33,788)
	2011	2010	**2011**	2010	**2011**	2010
Interest held	**19.96%**	19.96%	**45.00%**	45.00%	**25.33%**	25.33%

30. Investment properties

	2011 HK$'m	2010 HK$'m
At 1 January	**10,342**	9,364
Additions	**14**	2
Disposals	**(25)**	(171)
Fair value gains (Note 13)	**2,200**	1,511
Reclassification to properties, plant and equipment (Note 31)	**(92)**	(365)
Exchange difference	**2**	1
At 31 December	**12,441**	10,342

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

	2011 HK$'m	2010 HK$'m
Held in Hong Kong		
On long-term lease (over 50 years)	**2,261**	1,738
On medium-term lease (10 – 50 years)	**9,944**	8,398
Held outside Hong Kong		
On long-term lease (over 50 years)	**2**	6
On medium-term lease (10 – 50 years)	**234**	200
	12,441	10,342

As at 31 December 2011, investment properties are included in the consolidated balance sheet at valuation carried out at 31 December 2011 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited. The fair value represents the estimated amount at which the asset should be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

31. Properties, plant and equipment

	Premises HK$'m	Equipment, fixtures and fittings HK$'m	Total HK$'m
Net book value at 1 January 2011	**28,581**	**2,468**	**31,049**
Additions	**83**	**827**	**910**
Disposals	**(95)**	**(33)**	**(128)**
Revaluation	**8,989**	**–**	**8,989**
Depreciation for the year (Note 12)	**(610)**	**(667)**	**(1,277)**
Reclassification from investment properties (Note 30)	**92**	**–**	**92**
Exchange difference	**9**	**6**	**15**
Net book value at 31 December 2011	**37,049**	**2,601**	**39,650**
At 31 December 2011			
Cost or valuation	**37,049**	**7,414**	**44,463**
Accumulated depreciation and impairment	**–**	**(4,813)**	**(4,813)**
Net book value at 31 December 2011	**37,049**	**2,601**	**39,650**
Net book value at 1 January 2010	23,701	2,585	26,286
Additions	92	596	688
Disposals	(106)	(11)	(117)
Revaluation	4,946	–	4,946
Depreciation for the year (Note 12)	(484)	(647)	(1,131)
Reclassification from/(to) investment properties (Note 30)	378	(13)	365
Transfer	47	(47)	–
Exchange difference	7	5	12
Net book value at 31 December 2010	28,581	2,468	31,049
At 31 December 2010			
Cost or valuation	28,581	6,859	35,440
Accumulated depreciation and impairment	–	(4,391)	(4,391)
Net book value at 31 December 2010	28,581	2,468	31,049

31. Properties, plant and equipment (continued)

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

	Premises HK$'m	Equipment, fixtures and fittings HK$'m	Total HK$'m
At 31 December 2011			
At cost	**–**	**7,414**	**7,414**
At valuation	**37,049**	**–**	**37,049**
	37,049	**7,414**	**44,463**
At 31 December 2010			
At cost	–	6,859	6,859
At valuation	28,581	–	28,581
	28,581	6,859	35,440

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

	2011 HK$'m	2010 HK$'m
Held in Hong Kong		
On long-term lease (over 50 years)	**12,792**	9,869
On medium-term lease (10 – 50 years)	**23,819**	18,288
Held outside Hong Kong		
On long-term lease (over 50 years)	**102**	94
On medium-term lease (10 – 50 years)	**321**	299
On short-term lease (less than 10 years)	**15**	31
	37,049	28,581

As at 31 December 2011, premises are included in the consolidated balance sheet at valuation carried out at 31 December 2011 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited. The fair value represents the estimated amount at which the asset should be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

31. Properties, plant and equipment (continued)

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

	2011 HK$'m	2010 HK$'m
Increase in valuation credited to premises revaluation reserve	**8,918**	4,905
Increase in valuation credited to income statement (Note 14)	**–**	4
Increase in valuation credited to non-controlling interests	**71**	37
	8,989	4,946

As at 31 December 2011, 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$6,666 million (2010: HK$6,663 million).

32. Other assets

	2011 HK$'m	2010 HK$'m
Repossessed assets	**13**	81
Precious metals	**5,260**	3,664
Reinsurance assets	**9,022**	2,158
Accounts receivable and prepayments	**11,469**	11,738
	25,764	17,641

33. Hong Kong SAR currency notes in circulation

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

NOTES TO THE FINANCIAL STATEMENTS

34. Financial liabilities at fair value through profit or loss

	2011 HK$'m	2010 HK$'m
Trading liabilities		
– Short positions in Exchange Fund Bills and Notes	**2,598**	25,259
Financial liabilities designated at fair value through profit or loss		
– Structured deposits (Note 35)	**639**	234
	3,237	25,493

The carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2011 is more than the amount that the Group would be contractually required to pay at maturity to the holders by HK$1 million (2010: HK$2 million). The amount of change in the fair values of financial liabilities at fair value through profit or loss, during the year and cumulatively, attributable to changes in credit risk is insignificant.

35. Deposits from customers

	2011 HK$'m	2010 HK$'m
Current, savings and other deposit accounts (per consolidated balance sheet)	**1,145,951**	1,027,033
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 34)	**639**	234
	1,146,590	1,027,267
Analysed by:		
Demand deposits and current accounts		
– corporate	**62,847**	54,660
– personal	**14,593**	15,793
	77,440	70,453
Savings deposits		
– corporate	**162,672**	158,284
– personal	**342,196**	369,751
	504,868	528,035
Time, call and notice deposits		
– corporate	**334,581**	235,283
– personal	**229,701**	193,496
	564,282	428,779
	1,146,590	1,027,267

36. Debt securities in issue at amortised cost

	2011 HK$'m	2010 HK$'m
Senior notes under the Medium Term Note Programme	**5,856**	–
Other debt securities	**129**	–
	5,985	–

37. Other accounts and provisions

	2011 HK$'m	2010 HK$'m
Other accounts payable	**41,445**	35,284
Provisions	**366**	196
	41,811	35,480

38. Assets pledged as security

As at 31 December 2011, liabilities of the Group amounting to HK$4,614 million (2010: HK$23,832 million) were secured by assets deposited with central depositories to facilitate settlement operations. In addition, the liabilities of the Group amounting to HK$2,005 million (2010: HK$14,071 million) were secured by debt securities related to sale and repurchase arrangements. The amount of assets pledged by the Group to secure these liabilities was HK$6,643 million (2010: HK$37,932 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:

	2011					
	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 2011	**535**	**3,881**	**(124)**	**(333)**	**90**	**4,049**
Charged/(credited) to income statement (Note 15)	**12**	**(5)**	**(7)**	**(116)**	**(43)**	**(159)**
Charged/(credited) to other comprehensive income	**–**	**1,422**	**–**	**–**	**(156)**	**1,266**
Exchange difference	**–**	**1**	**–**	**(2)**	**–**	**(1)**
At 31 December 2011	**547**	**5,299**	**(131)**	**(451)**	**(109)**	**5,155**

	2010					
	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 2010	529	3,090	(139)	(274)	(44)	3,162
Charged/(credited) to income statement (Note 15)	6	1	15	(57)	5	(30)
Charged to other comprehensive income	–	788	–	–	129	917
Exchange difference	–	2	–	(2)	–	–
At 31 December 2010	535	3,881	(124)	(333)	90	4,049

39. Deferred taxation (continued)

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

	2011 HK$'m	2010 HK$'m
Deferred tax assets	**(210)**	(157)
Deferred tax liabilities	**5,365**	4,206
	5,155	4,049

	2011 HK$'m	2010 HK$'m
Deferred tax assets to be recovered after more than twelve months	**(141)**	(106)
Deferred tax liabilities to be settled after more than twelve months	**5,421**	4,085
	5,280	3,979

As at 31 December 2011, the Group has not recognised deferred tax assets in respect of tax losses amounting to HK$1,264 million (2010: HK$1,208 million) which is considered unlikely to be utilised. These tax losses do not expire under the current tax legislation.

40. Insurance contract liabilities

	2011 HK$'m	2010 HK$'m
At 1 January	**39,807**	33,408
Benefits paid	**(6,037)**	(3,366)
Claims incurred and movement in liabilities	**13,450**	9,765
At 31 December	**47,220**	39,807

The insurance contract liabilities that are covered by reinsurance arrangements amounted to HK$9,012 million (2010: HK$2,053 million) and the associated reinsurance assets of HK$9,022 million (2010: HK$2,158 million) are included in "Other assets" (Note 32).

41. Subordinated liabilities

	2011 HK$'m	2010 HK$'m
Subordinated loans, at amortised cost		
EUR660m*	**6,625**	6,848
Subordinated notes, at amortised cost with fair value hedge adjustment		
USD2,500m**	**22,031**	20,029
Total	**28,656**	26,877

In 2008, BOCHK obtained floating-rate subordinated loans from BOC, the intermediate holding company of the Group. The subordinated loans are repayable prior to maturity after the first 5-year tenure at the option of the borrower. In 2010, BOCHK issued listed subordinated notes with an aggregate amount of USD2,500 million.

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 5.55% per annum payable semi-annually, due February 2020.

42. Share capital

	2011 HK$'m	2010 HK$'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 107 to 108 of the financial statements.

44. Notes to consolidated cash flow statement

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

	2011 HK$'m	2010 HK$'m
Operating profit	**22,478**	18,239
Depreciation	**1,277**	1,131
Net charge/(reversal) of impairment allowances	**506**	(315)
Unwind of discount on impairment allowances	**(3)**	(6)
Advances written off net of recoveries	**132**	108
Change in subordinated liabilities	**2,409**	629
Change in balances with banks and other financial institutions with original maturity over three months	**(5,315)**	10,574
Change in placements with banks and other financial institutions with original maturity over three months	**(66,391)**	18,982
Change in financial assets at fair value through profit or loss	**11,924**	(22,892)
Change in derivative financial instruments	**(2,007)**	1,118
Change in advances and other accounts	**(110,324)**	(118,331)
Change in investment in securities	**25,445**	(47,541)
Change in other assets	**(8,133)**	(3,323)
Change in deposits and balances from banks and other financial institutions	**(77,090)**	214,137
Change in financial liabilities at fair value through profit or loss	**(22,256)**	9,205
Change in deposits from customers	**118,918**	184,712
Change in debt securities in issue at amortised cost	**5,985**	–
Change in other accounts and provisions	**6,331**	5,550
Change in insurance contract liabilities	**7,413**	6,399
Effect of changes in exchange rates	**(14,028)**	(10,149)
Operating cash (outflow)/inflow before taxation	**(102,729)**	268,227
Cash flows from operating activities included:		
– Interest received	**30,089**	22,635
– Interest paid	**8,404**	3,685
– Dividend received	**120**	97

Certain comparative figures have been revised to conform with the current year's presentation. The effect of exchange rate changes on cash and cash equivalents has also been separately presented on the consolidated cash flow statement.

44. Notes to consolidated cash flow statement (continued)

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

	2011 HK$'m	2010 HK$'m
Cash and balances with banks and other financial institutions with original maturity within three months	**267,152**	409,484
Placements with banks and other financial institutions with original maturity within three months	**15,571**	13,551
Treasury bills with original maturity within three months	**54,544**	23,644
Certificates of deposit held with original maturity within three months	**3,179**	–
	340,446	446,679

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:

	2011 HK$'m	2010 HK$'m
Direct credit substitutes	**8,124**	5,619
Transaction-related contingencies	**11,871**	7,262
Trade-related contingencies	**50,422**	42,691
Commitments that are unconditionally cancellable without prior notice	**263,246**	216,626
Other commitments with an original maturity of		
– up to one year	**11,506**	15,470
– over one year	**45,016**	49,042
	390,185	336,710
Credit risk weighted amount	**41,502**	38,282

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.

The Group adopted the FIRB approach in respect of banking operation to calculate credit risk exposures as at 31 December 2011, as opposed to the STC approach that was used as at 31 December 2010. As a result of the change in the basis used, the risk weighted amounts shown above are not directly comparable.

46. Capital commitments

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

	2011 HK$'m	2010 HK$'m
Authorised and contracted for but not provided for	**244**	169
Authorised but not contracted for	**8**	12
	252	181

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:

	2011 HK$'m	2010 HK$'m
Land and buildings		
– not later than one year	**598**	474
– later than one year but not later than five years	**1,050**	547
– later than five years	**299**	22
	1,947	1,043

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

(b) The Group as lessor

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

	2011 HK$'m	2010 HK$'m
Land and buildings		
– not later than one year	**377**	309
– later than one year but not later than five years	**441**	594
	818	903

The Group leases its investment properties (Note 30) under operating lease arrangements, with leases typically for a period from one to three years. The terms of the leases generally require the tenants to pay security deposits and provide for periodic rent adjustments according to the prevailing market conditions. None of the leases include 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 manages the business mainly from a business segment perspective and over 90% of the Group's revenues, profits before tax and assets are derived from Hong Kong. Currently, four business segments are identified which are Personal Banking, Corporate Banking, Treasury and Insurance. The classification of the Group's operating segments is based on customer segment and product type, which is aligned with the RPC (relationship, product and channel) management model of the Group.

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

As the Group's major revenue is derived from interest and the senior management relies primarily on net interest revenue to assess the performance of the segment, the total interest income and expense for all reportable segments will be presented on a net basis. The senior management also relies primarily on net insurance premium income and benefits and claims to assess the performance of the Insurance segment.

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

In 2011, a more comprehensive cost allocation mechanism was adopted. No revision has been made to the comparative figures of last year. However, if the same mechanism is applied last year, it is estimated that the operating expenses of Personal Banking, Corporate Banking, Treasury and Others would be HK$5,497 million, HK$2,763 million, HK$802 million, and HK$1,273 million respectively.

49. Segmental reporting (continued)

	2011							
	Personal Banking HK$'m	Corporate Banking HK$'m	Treasury HK$'m	Insurance HK$'m	Others HK$'m	Subtotal HK$'m	Eliminations HK$'m	Consolidated HK$'m
Net interest income/(expense)								
– external	1,386	6,901	11,991	1,697	4	21,979	–	21,979
– inter-segment	4,378	1,757	(5,978)	–	(157)	–	–	–
	5,764	8,658	6,013	1,697	(153)	21,979	–	21,979
Net fee and commission income	4,485	3,015	205	78	143	7,926	(93)	7,833
Net insurance premium income	–	–	–	5,696	–	5,696	(13)	5,683
Net trading gain/(loss)	583	298	724	136	(31)	1,710	–	1,710
Net loss on financial instruments designated at fair value through profit or loss	–	–	(4)	(339)	–	(343)	3	(340)
Net (loss)/gain on other financial assets	(2)	(29)	437	(22)	(76)	308	–	308
Other operating income	36	1	1	15	1,341	1,394	(869)	525
Total operating income	10,866	11,943	7,376	7,261	1,224	38,670	(972)	37,698
Net insurance benefits and claims	–	–	–	(6,852)	–	(6,852)	–	(6,852)
Net operating income before impairment allowances	10,866	11,943	7,376	409	1,224	31,818	(972)	30,846
Net (charge)/reversal of impairment allowances	(176)	(213)	50	(167)	–	(506)	–	(506)
Net operating income	10,690	11,730	7,426	242	1,224	31,312	(972)	30,340
Operating expenses	(5,787)	(3,085)	(911)	(209)	1,158	(8,834)	972	(7,862)
Operating profit	4,903	8,645	6,515	33	2,382	22,478	–	22,478
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	2,213	2,213	–	2,213
Net loss from disposal/revaluation of properties, plant and equipment	(7)	(9)	–	–	(18)	(34)	–	(34)
Share of profits less losses after tax of associates	–	–	–	–	23	23	–	23
Profit before taxation	4,896	8,636	6,515	33	4,600	24,680	–	24,680
Assets								
Segment assets	241,275	536,091	860,848	57,299	61,099	1,756,612	(18,336)	1,738,276
Interests in associates	–	–	–	–	234	234	–	234
	241,275	536,091	860,848	57,299	61,333	1,756,846	(18,336)	1,738,510
Liabilities								
Segment liabilities	676,928	507,852	368,709	54,282	15,892	1,623,663	(18,336)	1,605,327
Other information								
Capital expenditure	26	4	–	20	874	924	–	924
Depreciation	317	153	59	5	743	1,277	–	1,277
Amortisation of securities	–	–	(294)	(1)	–	(295)	–	(295)

49. Segmental reporting (continued)

	2010							
	Personal Banking HK$'m	Corporate Banking HK$'m	Treasury HK$'m	Insurance HK$'m	Others HK$'m	Subtotal HK$'m	Eliminations HK$'m	Consolidated HK$'m
Net interest income/(expense)								
– external	2,377	6,738	8,130	1,491	(2)	18,734	–	18,734
– inter-segment	3,608	(104)	(3,423)	–	(81)	–	–	–
	5,985	6,634	4,707	1,491	(83)	18,734	–	18,734
Net fee and commission income/(expense)	4,626	2,568	46	(227)	143	7,156	(112)	7,044
Net insurance premium income	–	–	–	6,490	–	6,490	(6)	6,484
Net trading gain/(loss)	495	163	611	171	(70)	1,370	(1)	1,369
Net gain on financial instruments designated at fair value through profit or loss	–	–	44	698	–	742	–	742
Net gain on other financial assets	–	–	533	123	–	656	–	656
Other operating income	35	(5)	–	13	1,956	1,999	(1,532)	467
Total operating income	11,141	9,360	5,941	8,759	1,946	37,147	(1,651)	35,496
Net insurance benefits and claims	–	–	–	(7,988)	–	(7,988)	–	(7,988)
Net operating income before impairment allowances	11,141	9,360	5,941	771	1,946	29,159	(1,651)	27,508
Net (charge)/reversal of impairment allowances	(108)	169	307	(53)	–	315	–	315
Net operating income	11,033	9,529	6,248	718	1,946	29,474	(1,651)	27,823
Operating expenses	(6,369)	(2,568)	(785)	(213)	(1,300)	(11,235)	1,651	(9,584)
Operating profit	4,664	6,961	5,463	505	646	18,239	–	18,239
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	1,511	1,511	–	1,511
Net (loss)/gain from disposal/revaluation of properties, plant and equipment	(8)	–	–	–	2	(6)	–	(6)
Share of profits less losses after tax of associates	–	–	–	–	(2)	(2)	–	(2)
Profit before taxation	4,656	6,961	5,463	505	2,157	19,742	–	19,742
Assets								
Segment assets	210,978	458,928	910,772	48,195	50,650	1,679,523	(18,695)	1,660,828
Interests in associates	–	–	–	–	212	212	–	212
	210,978	458,928	910,772	48,195	50,862	1,679,735	(18,695)	1,661,040
Liabilities								
Segment liabilities	657,605	407,328	437,174	45,149	14,190	1,561,446	(18,695)	1,542,751
Other information								
Capital expenditure	11	4	–	7	668	690	–	690
Depreciation	298	149	85	4	595	1,131	–	1,131
Amortisation of securities	–	–	106	74	–	180	–	180

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:

	2011 HK$'m	2010 HK$'m
Aggregate amount of relevant transactions outstanding at year end	**4,015**	3,492
Maximum aggregate amount of relevant transactions outstanding during the year	**4,572**	3,878

51. Significant related party transactions

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

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

General information of the parent companies:

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

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

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

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

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

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

– lending, provision of credits and guarantees, and deposit taking;

– inter-bank balance taking and placing;

– sales, purchase, underwriting and redemption of bonds issued by other state controlled entities;

– rendering of foreign exchange, remittance and investment related services;

– provision of fiduciary activities; and

– purchase of utilities, transport, telecommunication and postage services.

51. Significant related party transactions (continued)

(c) *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:

	2011		2010	
	Associates HK$'m	**Other related parties HK$'m**	Associates HK$'m	Other related parties HK$'m
Income statement items:				
Administrative services fees received/receivable	**–**	**8**	–	8
Balance sheet items:				
Deposits from customers	**173**	**–**	157	–
Off-balance sheet items:				
Contingent liabilities and commitments	**20**	**–**	20	–

(d) *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 is detailed as follows:

	2011 HK$'m	2010 HK$'m
Salaries and other short-term employee benefits	**66**	59
Post-employment benefits	**1**	1
	67	60

52. Currency concentrations

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

	2011							
	Equivalent in million of HK$							
	US Dollars	**Japanese Yen**	**Euro**	**Australian Dollars**	**Pound Sterling**	**Renminbi**	**Other foreign currencies**	**Total foreign currencies**
Spot assets	**451,222**	**51,268**	**18,271**	**32,826**	**6,108**	**449,786**	**16,695**	**1,026,176**
Spot liabilities	**(339,118)**	**(2,921)**	**(21,407)**	**(26,183)**	**(15,738)**	**(436,987)**	**(25,490)**	**(867,844)**
Forward purchases	**331,290**	**30,300**	**30,439**	**28,440**	**23,152**	**126,276**	**35,522**	**605,419**
Forward sales	**(438,296)**	**(78,706)**	**(27,604)**	**(35,125)**	**(13,500)**	**(132,354)**	**(26,524)**	**(752,109)**
Net options position	**441**	**–**	**(1)**	**(15)**	**(11)**	**(2)**	**(14)**	**398**
Net long/(short) position	**5,539**	**(59)**	**(302)**	**(57)**	**11**	**6,719**	**189**	**12,040**
Net structural position	**315**	**–**	**–**	**–**	**–**	**5,261**	**–**	**5,576**

	2010							
	Equivalent in million of HK$							
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi	Other foreign currencies	Total foreign currencies
Spot assets	454,733	8,486	33,414	46,818	4,366	434,077	15,517	997,411
Spot liabilities	(281,774)	(2,250)	(23,881)	(37,113)	(17,865)	(412,948)	(22,109)	(797,940)
Forward purchases	250,546	28,083	20,996	22,732	32,637	91,295	34,530	480,819
Forward sales	(417,632)	(34,375)	(30,466)	(32,549)	(19,273)	(109,072)	(27,925)	(671,292)
Net options position	262	1	3	(19)	(7)	–	15	255
Net long/(short) position	6,135	(55)	66	(131)	(142)	3,352	28	9,253
Net structural position	296	–	–	–	–	3,309	–	3,605

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:

	2011			
	Banks HK$'m	**Public sector entities* HK$'m**	**Others HK$'m**	**Total HK$'m**
Asia, other than Hong Kong				
– Mainland China	**246,133**	**171,336**	**111,932**	**529,401**
– Others	**58,475**	**52,622**	**24,026**	**135,123**
	304,608	**223,958**	**135,958**	**664,524**
North America				
– United States	**10,389**	**42,037**	**29,949**	**82,375**
– Others	**13,590**	**1,739**	**245**	**15,574**
	23,979	**43,776**	**30,194**	**97,949**
Western Europe				
– United Kingdom	**19,533**	**2,043**	**2,390**	**23,966**
– Others	**31,341**	**15,567**	**4,773**	**51,681**
	50,874	**17,610**	**7,163**	**75,647**
Total	**379,461**	**285,344**	**173,315**	**838,120**

	2010			
	Banks HK$'m	Public sector entities* HK$'m	Others HK$'m	Total HK$'m
Asia, other than Hong Kong				
– Mainland China	155,935	347,683	87,066	590,684
– Others	51,481	12,405	27,333	91,219
	207,416	360,088	114,399	681,903
North America				
– United States	5,653	51,303	30,968	87,924
– Others	8,761	3,438	125	12,324
	14,414	54,741	31,093	100,248
Western Europe				
– United Kingdom	29,834	2,722	1,246	33,802
– Others	56,616	14,083	4,989	75,688
	86,450	16,805	6,235	109,490
Total	308,280	431,634	151,727	891,641

* Included United States of HK$8,937 million (2010: HK$7,334 million), other countries in North America of HK$1,704 million (2010: HK$3,405 million) and other countries in Western Europe of HK$10,140 million (2010: HK$5,026 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

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 are summarised as follows:

	2011			
	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	234,738	56,381	291,119	34
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	40,038	17,964	58,002	14
Other non-bank Mainland China exposures	27,294	2,542	29,836	44
	302,070	76,887	378,957	92

	2010			
	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	185,309	48,278	233,587	59
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	25,600	11,827	37,427	18
Other non-bank Mainland China exposures	25,545	3,907	29,452	43
	236,454	64,012	300,466	120

During the year, the basis of the above analyses has been refined and the comparative amounts have been reclassified accordingly.

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. Comparative amounts

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

57. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 29 March 2012.