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.

(a) Standards and amendments already mandatorily effective for accounting periods beginning on 1 January 2012

Standard	Content	Applicable for financial years beginning on/after	Currently relevant to the Group
HKAS 12 (Amendment)	Income Taxes	1 January 2012	Yes
HKFRS 1 (Amendment)	First-time Adoption of Hong Kong Financial Reporting Standards: Hyperinflation and Fixed Dates	1 July 2011	No
HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Transfer of Financial Assets	1 July 2011	Yes

- 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 has considered 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.

- 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 Group will disclose relevant information in the financial statements when the Group undertakes transfers of financial assets that fall within its scope.

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012

The following standards, amendments and interpretations have been issued and are mandatory for accounting periods beginning on or after 1 July 2012:

Standard/ Interpretation	Content	Applicable for financial years beginning on/after	Currently relevant to the Group
HKAS 1 (Revised)	Presentation of Financial Statements	1 July 2012	Yes
HKAS 19 (2011)	Employee Benefits	1 January 2013	Yes
HKAS 27 (2011)	Separate Financial Statements	1 January 2013	Yes
HKAS 28 (2011)	Investments in Associates and Joint Ventures	1 January 2013	Yes
HKAS 32 (Amendment)	Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities	1 January 2014	Yes
HKFRS 1 (Amendment)	First Time Adoption of Hong Kong Financial Reporting Standards – Government Loans	1 January 2013	No
HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities	1 January 2013	Yes
HKFRS 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 10, 11 and 12 (Amendment)	Transition Guidance	1 January 2013	Yes
HKFRS 10, 12 and HKAS 27 (Amendments)	Investment Entities	1 January 2014	No
HKFRS 13	Fair Value Measurement	1 January 2013	Yes
HK(IFRIC) – Int 20	Stripping Costs in the Production Phase of a Surface Mine	1 January 2013	No

NOTES TO THE FINANCIAL STATEMENTS

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012 (continued)

- 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.

- 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 – Offsetting Financial Assets and Financial Liabilities'. The amendments require new disclosures to include information that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position. 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, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012 (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, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012 (continued)

The mandatory effective date of HKFRS 9 is 1 January 2015 with earlier adoption permitted. 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.

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 adoption of these standards does not have a material impact on the Group's financial statements.

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretations issued that are not yet mandatorily effective and have not been early adopted by the Group in 2012 (continued)

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

- HKFRS 13, 'Fair Value Measurement'. The new standard which was issued in June 2011 replaces the fair value measurement guidance contained in individual HKFRSs by providing a revised definition of fair value and a single source of fair value measurement and disclosure requirements for use across HKFRSs. The requirements do not extend the use of fair value accounting, but provide guidance on how it should be applied when its use is already required or permitted by other standards within HKFRSs. The Group will apply HKFRS 13 prospectively from 1 January 2013.

(c) Improvements to HKFRSs

'Improvements to HKFRSs' contains numerous amendments to HKFRSs which the HKICPA considers not urgent but necessary. It comprises amendments that result in accounting changes for presentation, recognition or measurement purpose as well as terminology or editorial amendments related to a variety of individual HKFRSs. The amendments are effective for annual periods beginning on or after 1 January 2013. No material changes to accounting policies are expected as a result of these amendments.

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.

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

(1) Subsidiaries (continued)

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

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.

(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 equity. The effects of all transactions between the Group and the acquiree, whether occurring before or after the combination, are eliminated in preparing the consolidated financial statements of the Group. Comparative amounts are presented as if the acquiree had been combined at the end of the previous reporting period. The transaction costs for the combination will be expensed in the income statement.

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

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

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

(2) Transactions with non-controlling interests

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

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

(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.

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.

2.3 Segmental reporting

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

NOTES TO THE FINANCIAL STATEMENTS

2. Summary of significant accounting policies (continued)

2.4 Foreign currency translation

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

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

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

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

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

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

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

2. Summary of significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and through the use of valuation techniques, including discounted cash flow models and 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 the effective interest method. If the hedged item is derecognised, the unamortised carrying value adjustment is recognised immediately in the income statement.

(b) Cash flow hedge

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

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

(c) Net investment hedge

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

2.6 Offsetting financial instruments

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

2. Summary of significant accounting policies (continued)

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

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

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

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

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

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

2.8 Financial assets

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

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

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

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

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

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

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

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

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

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

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

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

(2) Loans and receivables

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

(3) Held-to-maturity

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

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

(4) Available-for-sale

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

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

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.

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. Summary of significant accounting policies (continued)

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

(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.

2. Summary of significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

(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.

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

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

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

2. Summary of significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

(2) Assets classified as available-for-sale

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

2.15 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.

2.16 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.

2. Summary of significant accounting policies (continued)

2.16 Investment properties (continued)

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

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

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

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

2. Summary of significant accounting policies (continued)

2.17 Properties, plant and equipment (continued)

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) Finance leases

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

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

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

2. Summary of significant accounting policies (continued)

2.19 Insurance contracts

(1) Insurance contracts classification, recognition and measurement

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

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

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

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

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

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

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

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

2. Summary of significant accounting policies (continued)

2.19 Insurance contracts (continued)

(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) 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.

NOTES TO THE FINANCIAL STATEMENTS

2. Summary of significant accounting policies (continued)

2.22 Employee benefits (continued)

(3) Bonus plans

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

2.23 Current and deferred income taxes

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

Income tax payable on profits, based on the applicable tax law enacted or substantially enacted at the end of the reporting period in each jurisdiction where the Company and the subsidiaries 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.

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. Summary of significant accounting policies (continued)

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.

NOTES TO THE FINANCIAL STATEMENTS

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

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 2012 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.

Carrying amounts of investment in securities as at 31 December 2012 are shown in Note 27 to the Financial Statements.

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 2012 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 2012 are shown in Note 27 to the Financial Statements.

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

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

Were the number of deaths in future years to differ by 10% from the Management's estimate, the long term business fund liability would increase by approximately HK$103 million (2011: approximately HK$91 million), which accounts for 0.2% (2011: 0.2%) 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.

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$1,410 million (2011: approximately HK$993 million). In this case, it is assumed there is no relief arising from reinsurance contracts held.

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

A resilience reserve was set up and included in long term business fund liabilities in accordance with the Insurance Companies (Determination of Long Term Liabilities) Regulation to provide a prudent provision against the effects of possible future changes to the value of the assets to meet the liabilities. The resilience reserve was set up based on the appointed actuary's advice of a 16 basis points (2011: 20 basis points) change in market yield of the underlying assets and valuation interest rates. The amount of resilience reserve set up depends on the degree of change in interest rate assumed.

NOTES TO THE FINANCIAL STATEMENTS

4. Financial risk management

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

Financial risk management framework

The Group's risk management governance structure is designed to cover 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.

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 clear lines of authority and responsibility for monitoring compliance with policies, procedures and limits. Proper reporting lines also provide sufficient independence of the control functions from the business areas, as well as adequate segregation of duties throughout the organisation which helps to promote an appropriate internal control environment.

4. Financial risk management (continued)

Product development

To ensure effective risk assessment and monitoring, the Group has 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 product management 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.

4.1 Credit Risk

Credit risk is the risk of loss arising from 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.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Credit risk management framework (continued)

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.

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 credit and other functions is responsible for making an independent assessment of all credit facilities which require the approval of Deputy Chief Executives ("DCE") or above. Credit applications for non-retail exposure are independently reviewed and objectively assessed by risk management units. Obligor ratings (in terms of PD) and facility ratings (in terms of LGD) are assigned to these portfolios to support credit approval. 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 and facility 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 non-retail exposures, more frequent rating review and closer monitoring are required for higher-risk customers. For retail exposures, monthly updated internal ratings and loss estimates are used for credit monitoring on a portfolio basis. More comprehensive review is required for obligors being identified under high-risk pools.

The Group 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 internal rating structure, and can be mapped to Standard & Poor's external ratings.

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.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Credit risk measurement and control (continued)

Loans and advances (continued)

As of 31 December 2012, the Group continues to adopt loan grading criteria which divide credit assets into 5 categories with reference to HKMA's guidelines, as below:

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

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

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

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

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

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.

4. Financial risk management (continued)

4.1 Credit Risk (continued)

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 2012 and 2011, the Group did not hold any collateral that it was permitted to sell or re-pledge in the absence of default by the borrower.

(A) Credit exposures

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

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

Balances and placements with banks and other financial institutions

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

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

Collateral is generally not sought on debt securities.

Derivative financial instruments

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(A) Credit exposures (continued)

Advances and other accounts, contingent liabilities and commitments

The general types of collateral are disclosed on page 140. 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 148 to 149. The components and nature of contingent liabilities and commitments are disclosed in Note 45. Regarding the commitments that are unconditionally cancellable without prior notice, the Group would assess the necessity to withdraw the credit line in case where the credit quality of a borrower deteriorates. For contingent liabilities and commitments, 11.4% (2011: 12.9%) is covered by collateral as at 31 December 2012.

(B) Gross advances and other accounts

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

	2012 HK$'m	2011 HK$'m
Advances to customers		
Personal		
– Mortgages	**202,386**	185,259
– Credit cards	**11,534**	9,655
– Others	**24,782**	20,801
Corporate		
– Commercial loans	**472,425**	424,156
– Trade finance	**67,137**	59,508
	778,264	699,379
Trade bills	**45,180**	56,506
Advances to banks and other financial institutions	**–**	2,174
Total	**823,444**	758,059

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

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

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

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 advances.

(a) Advances neither overdue nor impaired

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

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(a) Advances neither overdue nor impaired (continued)

	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

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(b) Advances overdue but not impaired

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

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

	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

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:

	2012		2011	
	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	**18**	**19**	9	5
– Credit cards	**28**	**–**	21	–
– Others	**31**	**6**	34	5
Corporate				
– Commercial loans	**1,544**	**1,315**	219	52
– Trade finance	**186**	**86**	156	97
Total	**1,807**	**1,426**	439	159
Loan impairment allowances made in respect of such advances	**768**		281	

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

As at 31 December 2012 and 2011, there were no impaired trade bills and advances to banks and other financial institutions.

	2012 HK$'m	2011 HK$'m
Current market value of collateral held against the covered portion of such advances to customers	**1,426**	159
Covered portion of such advances to customers	**1,177**	108
Uncovered portion of such advances to customers	**630**	331

NOTES TO THE FINANCIAL STATEMENTS

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(c) Impaired advances (continued)

Classified or impaired advances to customers are analysed as follows:

	2012 HK$'m	2011 HK$'m
Gross classified or impaired advances to customers	**2,054**	710
Gross classified or impaired advances to customers as a percentage of gross advances to customers	**0.26%**	0.10%
Individually assessed loan impairment allowances made in respect of such advances	**736**	259

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:

	2012		2011	
	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	**153**	**0.02%**	78	0.01%
– one year or less but over six months	**129**	**0.02%**	83	0.01%
– over one year	**323**	**0.04%**	227	0.04%
Advances overdue for over three months	**605**	**0.08%**	388	0.06%
Individually assessed loan impairment allowances made in respect of such advances	**303**		219	

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)

	2012 HK$'m	2011 HK$'m
Current market value of collateral held against the covered portion of such advances to customers	**1,115**	468
Covered portion of such advances to customers	**253**	116
Uncovered portion of such advances to customers	**352**	272

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 2012 and 2011, there were no trade bills and advances to banks and other financial institutions overdue for more than three months.

(e) Rescheduled advances

	2012		2011	
	Amount HK$'m	**% of gross advances to customers**	Amount HK$'m	% of gross advances to customers
Rescheduled advances to customers net of amounts included in "Advances overdue for more than three months"	**1,119**	**0.14%**	90	0.01%

As at 31 December 2012 and 2011, there were no rescheduled advances to banks and other financial institutions.

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers

(i) Sectoral analysis of gross advances to customers

The 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:

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

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(B) Gross advances and other accounts (continued)

(f) Concentration of advances to customers (continued)

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

	2011					
	Gross advances to customers HK$'m	% Covered by collateral or other security	Classified or impaired HK$'m	Overdue* HK$'m	Individually assessed impairment allowances HK$'m	Collectively assessed impairment allowances HK$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development	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

* 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:

	2012		2011	
	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	**3**	**–**	28	–
– Property investment	**34**	**1**	75	1
– Financial concerns	**11**	**–**	14	–
– Stockbrokers	**8**	**–**	1	–
– Wholesale and retail trade	**29**	**6**	62	6
– Manufacturing	**22**	**5**	48	6
– Transport and transport equipment	**365**	**–**	30	–
– Recreational activities	**9**	**–**	1	–
– Information technology	**16**	**–**	16	–
– Others	**31**	**6**	59	15
Individuals				
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**–**	**–**	1	–
– Loans for purchase of other residential properties	**11**	**–**	15	–
– Credit card advances	**149**	**141**	103	103
– Others	**79**	**72**	43	39
Total loans for use in Hong Kong	**767**	**231**	496	170
Trade finance	**94**	**3**	135	26
Loans for use outside Hong Kong	**311**	**4**	235	25
Gross advances to customers	**1,172**	**238**	866	221

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

	2012 HK$'m	2011 HK$'m
Hong Kong	**607,965**	540,862
Mainland China	**138,345**	121,207
Others	**31,954**	37,310
	778,264	699,379
Collectively assessed loan impairment allowances in respect of the gross advances to customers		
Hong Kong	**2,074**	1,855
Mainland China	**729**	550
Others	**166**	166
	2,969	2,571

Overdue advances

	2012 HK$'m	2011 HK$'m
Hong Kong	**3,937**	3,506
Mainland China	**639**	182
Others	**238**	104
	4,814	3,792
Individually assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**198**	187
Mainland China	**175**	28
Others	**33**	36
	406	251
Collectively assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**76**	57
Mainland China	**6**	5
Others	**3**	2
	85	64

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

	2012 HK$'m	2011 HK$'m
Hong Kong	**1,631**	574
Mainland China	**385**	79
Others	**38**	57
	2,054	710
Individually assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**526**	193
Mainland China	**177**	28
Others	**33**	38
	736	259
Collectively assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**29**	21
Mainland China	**3**	2
Others	**1**	1
	33	24

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:

	2012 **HK$'m**	2011 HK$'m
Commercial properties	**–**	1
Industrial properties	**5**	–
Residential properties	**12**	10
	17	11

The estimated market value of repossessed assets held by the Group as at 31 December 2012 amounted to HK$27 million (2011: HK$19 million). They comprise properties in respect of which the Group has acquired access or control (e.g. through court proceedings or voluntary actions by the proprietors concerned) for release in full or in part of the obligations of the borrowers.

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

- adjusting the selling prices
- selling the loans together with the assets
- arranging loan restructuring

NOTES TO THE FINANCIAL STATEMENTS

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.

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

	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

As at 31 December 2012 and 2011, 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 following tables present an analysis of the carrying value of debt securities by issue rating. In the absence of such issue ratings, the ratings designated for the issuers are reported.

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

	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	90,540	148,444	47,446	11,277	14,192	311,899
Held-to-maturity securities	15,637	26,991	8,973	1,815	511	53,927
Loans and receivables	–	4,797	1,876	–	–	6,673
Financial assets at fair value through profit or loss	3,306	22,730	15,706	1,498	3,263	46,503
Total	109,483	202,962	74,001	14,590	17,966	419,002

As at 31 December 2012, the Group's exposure to MBS/ABS amounted to HK$12,016 million (2011: HK$11,614 million), representing 2.3% (2011: 2.8%) of the total debt securities of the Group.

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 issue rating. In the absence of such issue ratings, the ratings designated for the issuers are reported.

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

	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	90,521	148,444	47,435	11,265	14,192	311,857
Held-to-maturity securities	15,508	26,957	8,885	1,815	511	53,676
Loans and receivables	–	4,797	1,876	–	–	6,673
Financial assets at fair value through profit or loss	3,306	22,730	15,706	1,498	3,263	46,503
Total	109,335	202,928	73,902	14,578	17,966	418,709

4. Financial risk management (continued)

4.1 Credit Risk (continued)

(E) Debt securities (continued)

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

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

	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	

As at 31 December 2012 and 2011, there were no overdue debt securities.

NOTES TO THE FINANCIAL STATEMENTS

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, commodity, 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 a robust market risk appetite to achieve a balance between risk and return. The Group's objective in managing market risk is to secure healthy growth of the treasury business, by effective management of potential market risk in the Group's business, according to the Group's overall risk appetite and strategy of treasury business on the basis of a well established risk management regime and related measures.

In accordance with the Group's corporate governance principles in respect of risk management, the Board and RC, senior management and functional departments/units perform their duties and responsibilities to manage the Group's market risk. The Market Risk Management Division of the RMD is mainly responsible for managing market risk, assisting senior management to perform their day-to-day duties, independently monitoring the market risk profile and compliance of management policies and limits of the Group and BOCHK, ensuring that the aggregate and individual market risks 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; meanwhile, the Group sets up the Group VAR and stress test limits, which are allocated and monitored across the Group, according to subsidiaries' business requirements and risk tolerance levels. In line with the requirements set in the Group policy, the subsidiaries may, subject to prior consent by BOCHK, formulate the detailed policies and procedures and are responsible for managing their daily market risk. The subsidiaries set up independent risk monitoring teams to monitor daily market risk and limit compliance, and submit management information and reports to BOCHK on a regular basis.

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

(A) VAR

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(A) VAR (continued)

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

	Year	At 31 December HK$'m	Minimum for the year HK$'m	Maximum for the year HK$'m	Average for the year HK$'m
VAR for all market risk	2012	14.6	14.6	35.1	25.4
	2011	15.5	6.8	20.7	12.2
VAR for foreign exchange risk	2012	9.2	9.2	25.7	16.7
	2011	11.2	2.1	19.1	9.7
VAR for interest rate risk	2012	9.9	8.9	29.5	17.7
	2011	10.4	4.9	10.9	7.8
VAR for equity risk	2012	0.0	0.0	2.3	0.4
	2011	1.0	0.0	1.3	0.1
VAR for commodity risk	2012	0.0	0.0	1.7	0.2
	2011	0.2	0.0	0.7	0.1

In 2012, the average daily revenue[2] of the Group earned from market risk-related trading activities was HK$7.2 million (2011: HK$8.3 million).

Notes:

1 Structural FX positions have been excluded. In 2012, all general market risk exposure are presented on the Group basis, comparative amounts are presented on the same basis accordingly.

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

Although a valuable guide to market 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 market risk includes sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis on historical events including the 1987 Equity Market Crash, 1994 Bond Market Crash, 1997 Asian Financial Crisis, 2001 9-11 event and 2008 Financial Tsunami, etc.

(B) Currency risk

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

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

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(B) Currency risk (continued)

	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

* 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 cash flows 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 Banking Book Interest Rate Risk Management Policy" approved by RC. Market Risk Management Division of RMD is responsible for interest rate risk management. With the cooperation of the Asset & Liability Management Division of Financial Management Department 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, repricing 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 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 debt securities with embedded options.

The Group is principally exposed to HK Dollar, US Dollar, onshore and offshore Renminbi in terms of interest rate risk. As at 31 December 2012, 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**	
	2012 HK$'m	2011 HK$'m	**2012 HK$'m**	2011 HK$'m
HK Dollar	**744**	896	**(402)**	(219)
US Dollar	**(834)**	(589)	**(5,390)**	(4,025)
Renminbi	**(529)**	(560)	**(1,128)**	(433)

The overall negative impact on net interest income of the above currencies has increased when compared with 2011 and is mainly because of the widened 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 2011 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, 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.

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

4. Financial risk management (continued)

4.2 Market Risk (continued)

(C) Interest rate risk (continued)

	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)

4.3 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 the 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 has established intragroup liquidity risk management guideline to manage the liquidity funding among different entities within the Group, to restrict their reliance of funding on each other. The Group also pays attention to manage liquidity risk created by off-balance sheet activities, such as loan commitments, derivatives, options and other complex structured products. The Group has overall liquidity risk management strategy to cover the liquidity management of foreign currency assets and liabilities, collaterals, intra-day liquidity, intra-group liquidity, the liquidity risk arising from other risks, etc., and has formulated corresponding contingency plan.

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 responsible for overseeing the Group's liquidity risk. It cooperates with the Asset and Liability Management Division of Financial Management Department, Investment Management, etc. to assist the ALCO to perform liquidity management functions according to their specific responsibilities.

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

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

In accordance with the requirements of Supervisory Policy Manual LM-2 "Sound Systems and controls for Liquidity Risk Management" issued by the HKMA in 2011, the Group has embarked to refine the behavior model and assumptions of existing cash flow analysis and stress test to enhance the Group's cash flow analysis under both normal and stressed conditions. In cash flow analysis under normal circumstances, assumptions applied to on-balance sheet items such as customer deposits and off-balance sheet items such as loan commitments are being modified. In liquidity stress test, a new combined scenario which is a combination of institution specific and world wide crisis is being set up to assess the Group's capability to withstand a more severe liquidity crisis, with a more stringent set of assumptions adopted. In addition, the Group has a policy in place to maintain an asset buffer portfolio which includes high quality marketable securities to ensure funding needs even under stressed scenarios. The contingency plan is being established which detailed the conditions to trigger the plan based on stress test results and early warning indicators, the action plans and relevant procedures and responsibility of various departments.

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

	2012	2011
Average liquidity ratio	**41.20%**	36.17%

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.

	2012							
	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	145,534	53,214	–	–	–	–	–	198,748
Placements with banks and other financial institutions maturing between one and twelve months	–	–	24,152	41,873	–	–	–	66,025
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held	–	67	64	14	–	–	–	145
– others	–	11,075	3,855	3,454	6,585	4,159	–	29,128
– debt securities designated at fair value through profit or loss								
– certificates of deposit held	–	–	509	310	378	–	–	1,197
– others	–	31	369	2,350	11,207	2,832	–	16,789
– fund and equity securities	–	–	–	–	–	–	2,073	2,073
Derivative financial instruments	17,690	2,535	2,032	3,421	1,600	4,061	–	31,339
Hong Kong SAR Government certificates of indebtedness	82,930	–	–	–	–	–	–	82,930
Advances and other accounts								
– advances to customers	60,076	19,055	53,963	138,157	288,680	213,106	1,522	774,559
– trade bills	76	10,150	15,765	19,189	–	–	–	45,180
– advances to banks and other financial institutions	–	–	–	–	–	–	–	–
Investment in securities								
– debt securities held for available-for-sale								
– certificates of deposit held	–	3,001	15,580	45,533	8,708	19	–	72,841
– others	–	49,064	76,254	40,775	143,730	68,424	9	378,256
– debt securities held for held-to-maturity								
– certificates of deposit held	–	465	–	332	77	–	–	874
– others	–	430	2,822	3,792	8,276	2,102	102	17,524
– debt securities held for loans and receivables	–	–	1,558	7,676	–	–	–	9,234
– equity securities	–	–	–	–	–	–	3,635	3,635
Interests in associates	–	–	–	–	–	–	259	259
Investment properties	–	–	–	–	–	–	14,364	14,364
Properties, plant and equipment	–	–	–	–	–	–	48,743	48,743
Other assets (including deferred tax assets)	10,563	13,904	73	47	8,857	3,452	24	36,920
Total assets	316,869	162,991	196,996	306,923	478,098	298,155	70,731	1,830,763
Liabilities								
Hong Kong SAR currency notes in circulation	82,930	–	–	–	–	–	–	82,930
Deposits and balances from banks and other financial institutions	140,245	37,270	1,483	208	–	–	–	179,206
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued	–	–	–	–	–	–	–	–
– others	–	10,017	6,287	3,475	254	139	–	20,172
Derivative financial instruments	13,022	668	865	1,766	3,602	1,291	–	21,214
Deposits from customers	701,678	276,068	129,269	111,327	7,910	38	–	1,226,290
Debt securities in issue at amortised cost	–	4	–	32	5,887	–	–	5,923
Other accounts and provisions (including current and deferred tax liabilities)	28,005	14,148	2,999	4,545	7,559	6	–	57,262
Insurance contract liabilities	3,281	493	3,068	1,070	24,655	21,370	–	53,937
Subordinated liabilities	–	–	418	–	–	28,337	–	28,755
Total liabilities	969,161	338,668	144,389	122,423	49,867	51,181	–	1,675,689
Net liquidity gap	(652,292)	(175,677)	52,607	184,500	428,231	246,974	70,731	155,074

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(B) Maturity analysis (continued)

	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)

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

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

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

(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.

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

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

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

(a) Non-derivative cash flows (continued)

	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

(b) Derivative cash flows

(i) Derivatives settled on a net basis

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

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

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.

	2012					
	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	**(12,527)**	**(33)**	**(84)**	**–**	**–**	**(12,644)**
Interest rate contracts	**(134)**	**(343)**	**(1,299)**	**(3,153)**	**(55)**	**(4,984)**
Commodity contracts	**(487)**	**–**	**–**	**–**	**–**	**(487)**
Equity contracts	**(3)**	**–**	**–**	**–**	**–**	**(3)**
	(13,151)	**(376)**	**(1,383)**	**(3,153)**	**(55)**	**(18,118)**

	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)
Commodity contracts	(717)	–	–	–	–	(717)
Equity contracts	–	(1)	–	–	–	(1)
	(13,901)	(581)	(1,808)	(3,700)	(192)	(20,182)

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.

	2012					
	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	**(284,426)**	**(180,744)**	**(292,998)**	**(37,187)**	**(1,200)**	**(796,555)**
– Inflow	**286,321**	**181,986**	**294,599**	**37,191**	**1,201**	**801,298**
Commodity contracts:						
– Outflow	**(4,024)**	**–**	**–**	**–**	**–**	**(4,024)**
– Inflow	**–**	**–**	**–**	**–**	**–**	**–**
Equity contracts:						
– Outflow	**–**	**–**	**–**	**–**	**–**	**–**
– Inflow	**2**	**–**	**–**	**–**	**–**	**2**
Total outflow	**(288,450)**	**(180,744)**	**(292,998)**	**(37,187)**	**(1,200)**	**(800,579)**
Total inflow	**286,323**	**181,986**	**294,599**	**37,191**	**1,201**	**801,300**

	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
Commodity 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

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 2012 that the Group commits to extend credit to customers and other facilities amounting to HK$392,508 million (2011: HK$319,768 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 2012 amounting to HK$71,261 million (2011: HK$70,417 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 arrangements.

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

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

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

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

4. Financial risk management (continued)

4.5 Capital Management

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

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

The Group has adopted the foundation internal ratings-based ("FIRB") approach to calculate the credit risk capital charge for 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 standardised (credit risk) ("STC") approach.

Since October 2012, the HKMA has approved the Group to adopt the internal models ("IMM") approach to calculate general market risk capital charge for foreign exchange and interest rate exposures and exclude its structural FX positions arising from Nanyang and Chiyu in the calculation of the market risk capital charge. The Group continues to adopt the standardised (market risk) ("STM") approach to calculate the market risk capital charge for remaining exposures.

The Group continues to adopt standardised (operational risk) ("STO") approach to calculate the minimum capital requirement for operational risk in year 2012.

In order to implement Basel II Enhancements, the Banking (Capital) (Amendment) Rules 2011 became effective on 1 January 2012. The amendments were mainly to revise the market risk framework and incorporate other enhancements to the Basel II framework. The Group has calculated the capital charge according to the related regulatory requirements.

The Group has continued to adopt an internal capital adequacy assessment process ("ICAAP") to comply with the HKMA's requirements in the Supervisory Policy Manual "Supervisory Review Process" in 2012. Based on the HKMA's guidelines on Pillar II, ICAAP has been initiated to assess the extra capital needed to cover the material risks not captured under Pillar I, and therefore minimum common equity CAR, minimum core CAR and the minimum CAR are determined. The Group considers this ICAAP process as an on-going process for capital management and periodically reviews and adjusts its capital structure where appropriate in relation to the overall risk profile.

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

NOTES TO THE FINANCIAL STATEMENTS

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

	2012	2011
Capital adequacy ratio	**16.80%**	16.90%
Core capital ratio	**12.31%**	12.51%

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 264.

(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:

	2012 HK$'m	2011 HK$'m
Core capital:		
Paid up ordinary share capital	**43,043**	43,043
Reserves	**38,987**	31,947
Profit and loss account	**5,820**	8,318
Non-controlling interests	**1,658**	1,605
Deductible item	**(25)**	–
	89,483	84,913
Deductions from core capital	**(387)**	(313)
Core capital	**89,096**	84,600
Supplementary capital:		
Fair value gains arising from holdings of available-for-sale securities	**2,067**	290
Fair value gains arising from holdings of securities designated at fair value through profit or loss	**35**	18
Collective loan impairment allowances	**192**	91
Regulatory reserve	**539**	253
Surplus provisions	**3,963**	3,354
Term subordinated debt	**26,043**	25,961
	32,839	29,967
Deductions from supplementary capital	**(387)**	(313)
Supplementary capital	**32,452**	29,654
Total capital base after deductions	**121,548**	114,254

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 261 to 264. 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. The carrying value and fair value of senior notes as at 31 December 2012 amounted to HK$5,919 million (2011: HK$5,856 million) and HK$6,317 million (2011: HK$6,007 million) respectively. The carrying value of other debt securities in issue 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 and their carrying value approximates fair value.

4. Financial risk management (continued)

4.6 Fair values of financial assets and liabilities (continued)

(B) Financial instruments measured at fair value

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

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 securitisation assets and re-securitisation assets, external prices are obtained from independent third parties. The valuation of security, depending on the nature of transaction, is estimated from market standard cash flow models with input parameter assumptions which include spreads to discount rates, default and recovery rates and prepayment rates that may be observable or unobservable.

For certain illiquid debt securities 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 2012 and 2011.

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

	2012			
	Level 1 HK$'m	Level 2 HK$'m	Level 3 HK$'m	Total HK$'m
Financial assets				
Financial assets at fair value through profit or loss				
– Trading securities				
– Debt securities	–	29,273	–	29,273
– Equity securities	13	212	–	225
– Financial assets designated at fair value through profit or loss				
– Debt securities	414	17,239	333	17,986
– Fund	636	–	–	636
– Equity securities	1,212	–	–	1,212
Derivative financial instruments	17,677	13,662	–	31,339
Available-for-sale securities				
– Debt securities	98,350	350,110	2,637	451,097
– Equity securities	2,592	838	205	3,635
Financial liabilities				
Financial liabilities at fair value through profit or loss				
– Trading liabilities	–	17,331	–	17,331
– Financial liabilities designated at fair value through profit or loss	–	2,070	771	2,841
Derivative financial instruments	13,004	8,210	–	21,214

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)

	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)

(ii) Reconciliation of level 3 items

	2012				
	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 2012	–	134	2,822	184	203
Gains/(losses)					
– Profit or loss	–	33	–	–	–
– Other comprehensive income	–	–	(10)	21	–
Purchases	–	–	1,860	–	–
Issues	–	–	–	–	771
Sales	–	(5)	(179)	–	–
Settlements	–	–	–	–	(203)
Transfers into/(out) of level 3	–	171	(1,856)	–	–
At 31 December 2012	–	333	2,637	205	771
Total gains for the year included in profit or loss for financial assets and liabilities held as at 31 December 2012	–	33	–	–	–

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 (continued)

	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 financial assets and liabilities held as at 31 December 2011	–	(10)	–	–	–

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

5. Net interest income

	2012 HK$'m	2011 HK$'m
Interest income		
Due from banks and other financial institutions	**8,168**	8,455
Advances to customers	**17,222**	13,386
Listed investments	**4,542**	4,470
Unlisted investments	**5,231**	5,387
Others	**250**	233
	35,413	31,931
Interest expense		
Due to banks and other financial institutions	**(971)**	(2,917)
Deposits from customers	**(9,013)**	(6,275)
Debt securities in issue	**(161)**	(26)
Subordinated liabilities	**(313)**	(562)
Others	**(247)**	(172)
	(10,705)	(9,952)
Net interest income	**24,708**	21,979

Included within interest income is HK$10 million (2011: HK$3 million) of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2012. Interest income accrued on impaired investment in securities amounted to HK$9 million (2011: HK$16 million).

Included within interest income and interest expense are HK$35,254 million (2011: HK$31,850 million) and HK$11,278 million (2011: HK$10,573 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

	2012 HK$'m	2011 HK$'m
Fee and commission income		
Credit card business	**3,307**	2,887
Securities brokerage	**2,114**	2,782
Loan commissions	**1,628**	1,160
Insurance	**965**	1,097
Bills commissions	**736**	854
Payment services	**667**	637
Funds distribution	**540**	337
Trust and custody services	**360**	379
Safe deposit box	**228**	211
Currency exchange	**156**	156
Others	**409**	358
	11,110	10,858
Fee and commission expense		
Credit card business	**(2,369)**	(2,106)
Securities brokerage	**(299)**	(431)
Payment services	**(92)**	(91)
Others	**(444)**	(397)
	(3,204)	(3,025)
Net fee and commission income	**7,906**	7,833
Of which arise from		
– financial assets or financial liabilities not at fair value through profit or loss		
– Fee and commission income	**1,770**	1,363
– Fee and commission expense	**(7)**	(5)
	1,763	1,358
– trust and other fiduciary activities		
– Fee and commission income	**550**	571
– Fee and commission expense	**(14)**	(6)
	536	565

7. Net trading gain

	2012 HK$'m	2011 HK$'m
Net gain from:		
– foreign exchange and foreign exchange products	**1,988**	1,430
– interest rate instruments and items under fair value hedge	**900**	12
– commodities	**121**	186
– equity instruments	**120**	82
	3,129	1,710

8. Net gain on other financial assets

	2012 HK$'m	2011 HK$'m
Net gain on available-for-sale securities	**644**	469
Net gain/(loss) on held-to-maturity securities	**108**	(19)
Others	**(2)**	(142)
	750	308

9. Other operating income

	2012 HK$'m	2011 HK$'m
Dividend income from investment in securities		
– listed investments	**88**	93
– unlisted investments	**29**	27
Gross rental income from investment properties	**436**	386
Less: Outgoings in respect of investment properties	**(56)**	(72)
Others	**92**	91
	589	525

Included in the "Outgoings in respect of investment properties" is HK$3 million (2011: HK$4 million) of direct operating expenses related to investment properties that were not let during the year.

10. Gross insurance benefits and claims

	2012 HK$'m	2011 HK$'m
Claims, benefits and surrenders paid	**7,515**	6,437
Movement in liabilities	**6,632**	7,407
	14,147	13,844

11. Net charge of impairment allowances

	2012 HK$'m	2011 HK$'m
Advances to customers		
Individually assessed		
– new allowances	**(566)**	(146)
– releases	**54**	134
– recoveries	**234**	327
Net (charge)/reversal of individually assessed loan impairment allowances (Note 26)	**(278)**	315
Collectively assessed		
– new allowances	**(606)**	(720)
– releases	**–**	–
– recoveries	**30**	26
Net charge of collectively assessed loan impairment allowances (Note 26)	**(576)**	(694)
Net charge of loan impairment allowances	**(854)**	(379)
Available-for-sale securities		
Net reversal of impairment allowances on available-for-sale securities		
– Individually assessed	**2**	7
Held-to-maturity securities		
Net reversal/(charge) of impairment allowances on held-to-maturity securities		
– Individually assessed (Note 27)	**3**	(124)
Others	**(10)**	(10)
Net charge of impairment allowances	**(859)**	(506)

12. Operating expenses

	2012 HK$'m	2011 HK$'m
Staff costs (including directors' emoluments)		
– salaries and other costs	**5,932**	5,606
– pension cost	**474**	432
	6,406	6,038
Premises and equipment expenses (excluding depreciation)		
– rental of premises	**695**	613
– information technology	**398**	429
– others	**363**	348
	1,456	1,390
Depreciation (Note 31)	**1,493**	1,277
Auditor's remuneration		
– audit services	**33**	32
– non-audit services	**4**	6
Lehman Brothers related products*	**(96)**	(2,797)
Other operating expenses	**2,106**	1,916
	11,402	7,862

* The net amount of HK$97 million recovered by the Group in 2012 from the underlying collateral of the Lehman Brothers minibonds, was credited to operating expenses (2011: HK$2,854 million).

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

	2012 HK$'m	2011 HK$'m
Net gain from disposal of investment properties	**4**	13
Net gain from fair value adjustments on investment properties (Note 30)	**1,885**	2,200
	1,889	2,213

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

	2012 HK$'m	2011 HK$'m
Net gain/(loss) from disposal of premises	**118**	(2)
Net loss from disposal of other fixed assets	**(8)**	(32)
Net loss from revaluation of premises (Note 31)	**(4)**	–
	106	(34)

15. Taxation

Taxation in the consolidated income statement represents:

	2012 HK$'m	2011 HK$'m
Current tax		
Hong Kong profits tax		
– current year taxation	**3,762**	3,718
– (over)/under-provision in prior years	**(55)**	7
	3,707	3,725
Overseas taxation	**436**	301
	4,143	4,026
Deferred tax credit (Note 39)	**(169)**	(159)
	3,974	3,867

Hong Kong profits tax has been provided at the rate of 16.5% (2011: 16.5%) on the estimated assessable profits arising in Hong Kong during the year. Taxation on overseas profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the countries in which the Group operates.

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

	2012 HK$'m	2011 HK$'m
Profit before taxation	**25,521**	24,680
Calculated at a taxation rate of 16.5% (2011: 16.5%)	**4,211**	4,072
Effect of different taxation rates in other countries	**45**	37
Income not subject to taxation	**(501)**	(432)
Expenses not deductible for taxation purposes	**105**	104
Tax losses not recognised	**–**	24
Utilisation of previously unrecognised tax losses	**(91)**	(2)
(Over)/under-provision in prior years	**(55)**	7
Foreign withholding tax	**260**	57
Taxation charge	**3,974**	3,867
Effective tax rate	**15.6%**	15.7%

16. Profit attributable to the equity holders of the Company

The profit of the Company for the year ended 31 December 2012 attributable to the equity holders of the Company and dealt with in the financial statements of the Company amounted to HK$12,820 million (2011: HK$12,823 million).

17. Dividends

	2012		2011	
	Per share HK$	**Total HK$'m**	Per share HK$	Total HK$'m
Interim dividend paid	**0.545**	**5,762**	0.630	6,661
Proposed final dividend	**0.693**	**7,327**	0.558	5,899
	1.238	**13,089**	1.188	12,560

At a meeting held on 23 August 2012, the Board declared an interim dividend of HK$0.545 per ordinary share for the first half of 2012 amounting to approximately HK$5,762 million.

At a meeting held on 26 March 2013, the Board proposed to recommend to the Annual General Meeting on 28 May 2013 a final dividend of HK$0.693 per ordinary share for the year ended 31 December 2012 amounting to approximately HK$7,327 million. This proposed final dividend is not reflected as a dividend payable in these financial statements, but will be reflected as an appropriation of retained earnings for the year ending 31 December 2013.

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 2012 of approximately HK$20,930 million (2011: HK$20,430 million) and on the ordinary shares in issue of 10,572,780,266 shares (2011: 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 2012 (2011: 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.

19. Retirement benefit costs (continued)

The Group's total contributions made to the ORSO schemes for the year ended 31 December 2012 amounted to approximately HK$343 million (2011: approximately HK$327 million), after a deduction of forfeited contributions of approximately HK$3 million (2011: approximately HK$4 million). For the MPF Scheme, the Group contributed approximately HK$59 million (2011: approximately HK$51 million) for the year ended 31 December 2012.

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.

No options were granted pursuant to the Share Option Scheme or the Sharesave Plan during the year 2012 (2011: Nil). Both the Share Option Scheme and the Sharesave Plan expired in July 2012.

(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.

20. Share option schemes (continued)

(b) Pre-Listing Share Option Scheme (continued)

Details of the share options outstanding as at 31 December 2012 and 2011 are disclosed as follows:

	Directors	Senior management	Others*	Total number of share options	Average exercise price (HK$ per share)
At 1 January 2012	**2,530,500**	**247,300**	**1,446,000**	**4,223,800**	**8.50**
Less: Share options exercised during the year	**–**	**(247,300)**	**–**	**(247,300)**	**8.50**
Less: Share options lapsed during the year	**(2,530,500)**	**–**	**(1,446,000)**	**(3,976,500)**	**8.50**
At 31 December 2012	**–**	**–**	**–**	**–**	**–**
Exercisable at 31 December 2012	**–**	**–**	**–**	**–**	**–**
At 1 January 2011	3,976,500	247,300	–	4,223,800	8.50
Transfer	(1,446,000)	–	1,446,000	–	8.50
At 31 December 2011	2,530,500	247,300	1,446,000	4,223,800	8.50
Exercisable at 31 December 2011	2,530,500	247,300	1,446,000	4,223,800	8.50

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

Share options were exercised on a regular basis throughout the year and its weighted average share price was HK$23.70. No share options were exercised during the year of 2011.

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. The valid exercise period of Pre-Listing Share Option Scheme ended on 4 July 2012 and all the non-exercised share options under this scheme have lapsed.

NOTES TO THE FINANCIAL STATEMENTS

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

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

(i) Directors' emoluments

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

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

Mr. XIAO Gang resigned as Chairman and Non-executive Director of the Company with effect from 17 March 2013; and Mr. NING Gaoning was appointed as an Independent Non-executive Director of the Company with effect from 24 August 2012.

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

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

(i) Directors' emoluments (continued)

	2011			
	Directors' fee HK$'000	Basic salaries, allowances and benefits in kind HK$'000	Bonus HK$'000	Total HK$'000
Executive Directors				
HE Guangbei (Chief Executive)	100	7,265	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

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 (2011: Nil).

For the year ended 31 December 2012, certain directors waived emoluments of HK$2 million (2011: HK$2 million), which include directors' fee from subsidiaries.

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

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

(ii) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include two (2011: two) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining three (2011: three) individuals during the year are as follows:

	2012 **HK$'m**	2011 HK$'m
Basic salaries and allowances	**15**	14
Bonus	**7**	7
Directors' fee from subsidiaries	**1**	1
	23	22

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

	Number of individuals	
	2012	2011
HK$5,000,001 – HK$5,500,000	**–**	1
HK$5,500,001 – HK$6,000,000	**2**	1
HK$11,000,001 – HK$11,500,000	**–**	1
HK$11,500,001 – HK$12,000,000	**1**	–

(iii) Senior management's emoluments

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

	Number of individuals	
	2012	2011
HK$1,500,001 – HK$2,000,000	**–**	1
HK$4,500,001 – HK$5,000,000	**1**	1
HK$5,000,001 – HK$5,500,000	**2**	3
HK$5,500,001 – HK$6,000,000	**2**	1
HK$7,500,001 – HK$8,000,000	**1**	–
HK$8,000,001 – HK$8,500,000	**–**	1
HK$11,000,001 – HK$11,500,000	**–**	1
HK$11,500,001 – HK$12,000,000	**2**	–
HK$12,000,001 – HK$12,500,000	**–**	1

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

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

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

(i) Remuneration awarded during the year

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

	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

The remuneration above includes 10 (2011: 11) members of Senior Management and 22 (2011: 21) members of Key Personnel.

NOTES TO THE FINANCIAL STATEMENTS

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

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

(ii) Deferred remuneration outstanding

	2012		2011	
	Senior Management HK$'m	**Key Personnel HK$'m**	Senior Management HK$'m	Key Personnel HK$'m
Deferred remuneration				
Vested	**3**	**3**	1	1
Unvested	**12**	**11**	9	8
	15	**14**	10	9
At 1 January	**9**	**8**	3	1
Awarded	**6**	**6**	7	8
Paid out	**(3)**	**(3)**	(1)	(1)
Reduced through performance adjustments	**–**	**–**	–	–
At 31 December	**12**	**11**	9	8

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 heads of material business lines, heads of major subsidiaries, Head of Trading and Chief Dealer, as well as heads of risk control functions.

22. Cash and balances with banks and other financial institutions

	2012 HK$'m	2011 HK$'m
Cash	**6,688**	6,425
Balances with central banks	**84,387**	158,950
Balances with banks and other financial institutions	**64,735**	48,412
Placements with banks and other financial institutions maturing within one month	**42,938**	65,008
	198,748	278,795

23. Financial assets at fair value through profit or loss

	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	2012 HK$'m	2011 HK$'m	**2012 HK$'m**	2011 HK$'m	**2012 HK$'m**	2011 HK$'m
At fair value						
Debt securities						
– Listed in Hong Kong	**5,378**	3,628	**959**	776	**6,337**	4,404
– Listed outside Hong Kong	**4,982**	4,732	**7,119**	5,376	**12,101**	10,108
	10,360	8,360	**8,078**	6,152	**18,438**	14,512
– Unlisted	**18,913**	16,673	**9,908**	15,318	**28,821**	31,991
	29,273	25,033	**17,986**	21,470	**47,259**	46,503
Fund						
– Unlisted	**–**	–	**636**	1,103	**636**	1,103
Equity securities						
– Listed in Hong Kong	**13**	12	**1,126**	823	**1,139**	835
– Listed outside Hong Kong	**–**	–	**86**	–	**86**	–
	13	12	**1,212**	823	**1,225**	835
– Unlisted	**212**	161	**–**	–	**212**	161
	225	173	**1,212**	823	**1,437**	996
Total	**29,498**	25,206	**19,834**	23,396	**49,332**	48,602

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

	2012 HK$'m	2011 HK$'m
Sovereigns	**22,729**	19,524
Public sector entities*	**267**	285
Banks and other financial institutions	**15,006**	17,731
Corporate entities	**11,330**	11,062
	49,332	48,602

* Included financial assets at fair value through profit or loss of HK$168 million (2011: HK$263 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

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

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

	2012 HK$'m	2011 HK$'m
Treasury bills	**17,210**	14,691
Certificates of deposit held	**1,342**	1,515
Other financial assets at fair value through profit or loss	**30,780**	32,396
	49,332	48,602

24. Derivative financial instruments and hedge accounting

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

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

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

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

The contract/notional amounts and fair values of derivative financial instruments held by the Group are set out in the following tables. The contract/notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet dates and certain of them provide a basis for comparison with fair value instruments recognised on the 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.

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments

The Group trades derivative products (both exchange-traded or OTC) mainly for customer business. The Group strictly follows risk management policies 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:

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

Not qualified for hedge accounting: 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)

	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
Commodity contracts	13,010	–	–	13,010
Equity contracts	372	–	–	372
Other contracts	82	–	–	82
Total	1,071,975	38,821	54,540	1,165,336

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:

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

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

	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)
Commodity 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)*

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

	2012 HK$'m	2011 HK$'m
Exchange rate contracts		
Forwards	**462**	1,487
Swaps	**3,746**	1,325
Foreign currency options		
– Options purchased	**10**	2
Interest rate contracts		
Swaps	**913**	1,733
Commodity contracts	**6**	14
Equity contracts	**38**	5
	5,175	4,566

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

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

(b) *Hedge accounting*

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

	2012		2011	
	Assets HK$'m	Liabilities HK$'m	Assets HK$'m	Liabilities HK$'m
Fair value hedges	**3,338**	**(1,693)**	2,946	(1,110)
Cash flow hedges	**42**	**(55)**	59	(100)
	3,380	**(1,748)**	3,005	(1,210)

24. Derivative financial instruments and hedge accounting (continued)

(b) Hedge accounting (continued)

(i) Fair value hedges

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

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

	2012		2011	
	Hedged assets HK$'m	**Hedged liabilities HK$'m**	Hedged assets HK$'m	Hedged liabilities HK$'m
Net (loss)/gain				
– hedging instruments	**(110)**	**590**	(634)	2,064
– hedged items	**86**	**(426)**	589	(2,066)
	(24)	**164**	(45)	(2)

(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 (2011: Nil).

(iii) Hedges of net investments in foreign operations

As at 31 December 2012, a proportion of the Group's RMB-denominated deposits from customers of HK$1,834 million (2011: HK$2,642 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 (2011: Nil).

25. Advances and other accounts

	2012 HK$'m	2011 HK$'m
Personal loans and advances	**238,702**	215,715
Corporate loans and advances	**539,562**	483,664
Advances to customers*	**778,264**	699,379
Loan impairment allowances		
– Individually assessed	**(736)**	(259)
– Collectively assessed	**(2,969)**	(2,571)
	774,559	696,549
Trade bills	**45,180**	56,506
Advances to banks and other financial institutions	**–**	2,174
Total	**819,739**	755,229

As at 31 December 2012, advances to customers included accrued interest of HK$1,434 million (2011: HK$1,305 million).

As at 31 December 2012 and 2011, 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$520,638 million (2011: HK$470,898 million) and US dollars equivalent to HK$177,027 million (2011: HK$179,888 million).

26. Loan impairment allowances

	2012		
	Individual assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2012	**28**	**231**	**259**
(Credited)/charged to income statement (Note 11)	**(16)**	**294**	**278**
Loans written off during the year as uncollectible	**(3)**	**(23)**	**(26)**
Recoveries	**17**	**217**	**234**
Unwind of discount on impairment allowances	**–**	**(10)**	**(10)**
Exchange difference	**–**	**1**	**1**
At 31 December 2012	**26**	**710**	**736**

26. Loan impairment allowances (continued)

	2012		
	Collective assessment		
	Personal HK$'m	Corporate HK$'m	Total HK$'m
At 1 January 2012	**237**	**2,334**	**2,571**
Charged to income statement (Note 11)	**213**	**363**	**576**
Loans written off during the year as uncollectible	**(211)**	**(1)**	**(212)**
Recoveries	**30**	**–**	**30**
Exchange difference	**–**	**4**	**4**
At 31 December 2012	**269**	**2,700**	**2,969**

	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

27. Investment in securities

	2012 HK$'m	2011 HK$'m
The Group		
(a) Available-for-sale securities		
Debt securities, at fair value		
– Listed in Hong Kong	**20,252**	9,614
– Listed outside Hong Kong	**111,969**	102,098
	132,221	111,712
– Unlisted	**318,876**	200,187
	451,097	311,899
Equity securities, at fair value		
– Listed in Hong Kong	**2,592**	3,660
– Listed outside Hong Kong	**–**	92
	2,592	3,752
– Unlisted	**1,043**	747
	3,635	4,499
	454,732	316,398
(b) Held-to-maturity securities		
Listed, at amortised cost		
– in Hong Kong	**948**	1,164
– outside Hong Kong	**7,807**	14,125
	8,755	15,289
Unlisted, at amortised cost	**9,652**	38,663
	18,407	53,952
Impairment allowances	**(9)**	(25)
	18,398	53,927
(c) Loans and receivables		
Unlisted, at amortised cost	**9,234**	6,673
Total	**482,364**	376,998
Market value of listed held-to-maturity securities	**8,983**	15,288

	2012 HK$'m	2011 HK$'m
The Company		
Available-for-sale securities		
Equity securities, at fair value		
– Listed in Hong Kong	**2,528**	2,506

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27. Investment in securities (continued)

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

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

	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

* Included available-for-sale securities of HK$20,974 million (2011: HK$20,746 million) and held-to-maturity securities of HK$248 million (2011: HK$832 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

As at 31 December 2012 and 2011, 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:

	2012		
	Available-for-sale securities HK$'m	**Held-to-maturity securities HK$'m**	**Loans and receivables HK$'m**
The Group			
At 1 January 2012	**316,398**	**53,927**	**6,673**
Additions	**865,481**	**12,687**	**16,446**
Disposals, redemptions and maturity	**(728,314)**	**(47,895)**	**(14,146)**
Amortisation	**380**	**(215)**	**90**
Change in fair value	**5,484**	**–**	**–**
Net reversal of impairment allowances (Note 11)	**–**	**3**	**–**
Exchange difference	**(4,697)**	**(109)**	**171**
At 31 December 2012	**454,732**	**18,398**	**9,234**

	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

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27. Investment in securities (continued)

	Available-for-sale securities	
	2012 HK$'m	2011 HK$'m
The Company		
At 1 January	**2,506**	2,775
Change in fair value	**22**	(269)
At 31 December	**2,528**	2,506

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

	Available-for-sale securities		Held-to-maturity securities	
	2012 HK$'m	2011 HK$'m	**2012 HK$'m**	2011 HK$'m
The Group				
Treasury bills	**115,637**	72,906	**885**	6,195
Certificates of deposit held	**72,841**	27,542	**874**	3,044
Others	**266,254**	215,950	**16,639**	44,688
	454,732	316,398	**18,398**	53,927

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

	2012 HK$'m	2011 HK$'m
The Group		
At 1 January	**25**	49
(Credited)/charged to income statement (Note 11)	**(3)**	124
Disposals	**(13)**	(148)
At 31 December	**9**	25

28. Investment in subsidiaries

	2012 HK$'m	2011 HK$'m
The Company		
Unlisted shares, at cost	**54,834**	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 2012:

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	950,000 ordinary shares of HK$100 each	100%	Securities and futures brokerage
Nanyang Commercial Bank (China), Limited	PRC	Registered capital RMB6,500,000,000	100%	Banking business

* Shares held directly by the Company

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29. Interests in associates

	2012 HK$'m	2011 HK$'m
At 1 January	**234**	212
Share of result	**35**	28
Share of tax	**(8)**	(5)
Dividend received	**(2)**	(1)
At 31 December	**259**	234

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$100 each**		**Registered capital RMB50,000,000**		**Registered capital RMB450,000,000**	
Principal activities	**Operation of a private inter-bank message switching network in respect of ATM services**		**Credit card back-end service support**		**Prepay debit card services**	
	2012 HK$'000	2011 HK$'000	**2012 HK$'000**	2011 HK$'000	**2012 HK$'000**	2011 HK$'000
Assets	**375,120**	377,539	**347,288**	272,540	**1,775,491**	3,083,539
Liabilities	**74,411**	75,644	**192,258**	160,334	**1,210,013**	2,536,960
Revenues	**73,040**	70,075	**858,809**	827,296	**64,194**	36,220
Profit after taxation	**26,833**	27,677	**44,650**	28,270	**19,134**	22,594
	2012	2011	**2012**	2011	**2012**	2011
Interest held	**19.96%**	19.96%	**45.00%**	45.00%	**25.33%**	25.33%

30. Investment properties

	2012 HK$'m	2011 HK$'m
At 1 January	**12,441**	10,342
Additions	**2**	14
Disposals	**(62)**	(25)
Fair value gains (Note 13)	**1,885**	2,200
Reclassification from/(to) properties, plant and equipment (Note 31)	**98**	(92)
Exchange difference	**–**	2
At 31 December	**14,364**	12,441

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

	2012 HK$'m	2011 HK$'m
Held in Hong Kong		
On long-term lease (over 50 years)	**2,754**	2,261
On medium-term lease (10 – 50 years)	**11,361**	9,944
Held outside Hong Kong		
On long-term lease (over 50 years)	**–**	2
On medium-term lease (10 – 50 years)	**249**	234
	14,364	12,441

As at 31 December 2012, investment properties are included in the consolidated balance sheet at valuation carried out at 31 December 2012 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 2012	**37,049**	**2,601**	**39,650**
Additions	**358**	**687**	**1,045**
Disposals	**(147)**	**(9)**	**(156)**
Revaluation	**9,792**	**–**	**9,792**
Depreciation for the year (Note 12)	**(778)**	**(715)**	**(1,493)**
Reclassification to investment properties (Note 30)	**(98)**	**–**	**(98)**
Exchange difference	**2**	**1**	**3**
Net book value at 31 December 2012	**46,178**	**2,565**	**48,743**
At 31 December 2012			
Cost or valuation	**46,178**	**7,793**	**53,971**
Accumulated depreciation and impairment	**–**	**(5,228)**	**(5,228)**
Net book value at 31 December 2012	**46,178**	**2,565**	**48,743**
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

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 2012			
At cost	**–**	**7,793**	**7,793**
At valuation	**46,178**	**–**	**46,178**
	46,178	**7,793**	**53,971**
At 31 December 2011			
At cost	–	7,414	7,414
At valuation	37,049	–	37,049
	37,049	7,414	44,463

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

	2012 HK$'m	2011 HK$'m
Held in Hong Kong		
On long-term lease (over 50 years)	**16,913**	12,792
On medium-term lease (10 – 50 years)	**28,547**	23,819
Held outside Hong Kong		
On long-term lease (over 50 years)	**65**	102
On medium-term lease (10 – 50 years)	**632**	321
On short-term lease (less than 10 years)	**21**	15
	46,178	37,049

As at 31 December 2012, premises are included in the consolidated balance sheet at valuation carried out at 31 December 2012 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.

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:

	2012 HK$'m	2011 HK$'m
Increase in valuation credited to premises revaluation reserve	**9,718**	8,918
Decrease in valuation charged to income statement (Note 14)	**(4)**	–
Increase in valuation credited to non-controlling interests	**78**	71
	9,792	8,989

As at 31 December 2012, 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$6,904 million (2011: HK$6,666 million).

32. Other assets

	2012 HK$'m	2011 HK$'m
Repossessed assets	**18**	13
Precious metals	**6,610**	5,260
Reinsurance assets	**14,671**	9,022
Accounts receivable and prepayments	**15,532**	11,469
	36,831	25,764

33. Hong Kong SAR currency notes in circulation

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

34. Financial liabilities at fair value through profit or loss

	2012 HK$'m	2011 HK$'m
Trading liabilities		
– Short positions in Exchange Fund Bills and Notes	**17,331**	2,598
Financial liabilities designated at fair value through profit or loss		
– Structured deposits (Note 35)	**2,841**	639
	20,172	3,237

The carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2012 is more than the amount that the Group would be contractually required to pay at maturity to the holders by HK$1 million (2011: HK$1 million). The amount of change in the fair values of financial liabilities at fair value through profit or loss, during the year and cumulatively, attributable to changes in own credit risk is insignificant.

35. Deposits from customers

	2012 HK$'m	2011 HK$'m
Current, savings and other deposit accounts (per consolidated balance sheet)	**1,226,290**	1,145,951
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 34)	**2,841**	639
	1,229,131	1,146,590
Analysed by:		
Demand deposits and current accounts		
– corporate	**76,742**	62,847
– personal	**20,553**	14,593
	97,295	77,440
Savings deposits		
– corporate	**202,846**	162,672
– personal	**400,719**	342,196
	603,565	504,868
Time, call and notice deposits		
– corporate	**298,902**	334,581
– personal	**229,369**	229,701
	528,271	564,282
	1,229,131	1,146,590

36. Debt securities in issue at amortised cost

	2012 HK$'m	2011 HK$'m
Senior notes under the Medium Term Note Programme	**5,919**	5,856
Other debt securities	**4**	129
	5,923	5,985

37. Other accounts and provisions

	2012 HK$'m	2011 HK$'m
Other accounts payable	**47,639**	41,445
Provisions	**344**	366
	47,983	41,811

38. Assets pledged as security

As at 31 December 2012, liabilities of the Group amounting to HK$18,029 million (2011: HK$4,614 million) were secured by assets deposited with central depositories to facilitate settlement operations. In addition, the liabilities of the Group amounting to HK$438 million (2011: HK$2,005 million) were secured by debt securities and bills related to sale and repurchase arrangements. The amount of assets pledged by the Group to secure these liabilities was HK$18,596 million (2011: HK$6,643 million) included in "Trading securities", "Available-for-sale securities" and "Trade bills".

39. Deferred taxation

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

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

	2012					
	Accelerated tax depreciation HK$'m	**Property revaluation HK$'m**	**Losses HK$'m**	**Impairment allowance HK$'m**	**Other temporary differences HK$'m**	**Total HK$'m**
At 1 January 2012	**547**	**5,299**	**(131)**	**(451)**	**(109)**	**5,155**
Charged/(credited) to income statement (Note 15)	**17**	**(128)**	**(13)**	**(41)**	**(4)**	**(169)**
Charged to other comprehensive income	**–**	**1,601**	**–**	**–**	**730**	**2,331**
At 31 December 2012	**564**	**6,772**	**(144)**	**(492)**	**617**	**7,317**

	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

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:

	2012 HK$'m	2011 HK$'m
Deferred tax assets	**(89)**	(210)
Deferred tax liabilities	**7,406**	5,365
	7,317	5,155

	2012 HK$'m	2011 HK$'m
Deferred tax assets to be recovered after more than twelve months	**(154)**	(141)
Deferred tax liabilities to be settled after more than twelve months	**6,847**	5,421
	6,693	5,280

As at 31 December 2012, the Group has not recognised deferred tax assets in respect of tax losses amounting to HK$718 million (2011: HK$1,264 million). These tax losses do not expire under the current tax legislation.

40. Insurance contract liabilities

	2012 HK$'m	2011 HK$'m
At 1 January	**47,220**	39,807
Benefits paid	**(7,169)**	(6,037)
Claims incurred and movement in liabilities	**13,886**	13,450
At 31 December	**53,937**	47,220

The insurance contract liabilities that are covered by reinsurance arrangements amounted to HK$14,644 million (2011: HK$9,012 million) and the associated reinsurance assets of HK$14,671 million (2011: HK$9,022 million) are included in "Other assets" (Note 32).

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41. Subordinated liabilities

	2012 HK$'m	2011 HK$'m
Subordinated loans, at amortised cost		
EUR660m*	**6,749**	6,625
Subordinated notes, at amortised cost with fair value hedge adjustment		
USD2,500m**	**22,006**	22,031
Total	**28,755**	28,656

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

	2012 HK$'m	2011 HK$'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 before taxation

	2012 HK$'m	2011 HK$'m
Operating profit	**23,499**	22,478
Depreciation	**1,493**	1,277
Net charge of impairment allowances	**859**	506
Unwind of discount on impairment allowances	**(10)**	(3)
Advances written off net of recoveries	**26**	132
Change in subordinated liabilities	**703**	2,409
Change in balances with banks and other financial institutions with original maturity over three months	**(7,794)**	(5,315)
Change in placements with banks and other financial institutions with original maturity over three months	**34,466**	(66,391)
Change in financial assets at fair value through profit or loss	**568**	11,924
Change in derivative financial instruments	**(5,619)**	(2,007)
Change in advances and other accounts	**(65,385)**	(110,324)
Change in investment in securities	**(104,150)**	25,445
Change in other assets	**(11,077)**	(8,133)
Change in deposits and balances from banks and other financial institutions	**(57,488)**	(77,090)
Change in financial liabilities at fair value through profit or loss	**16,935**	(22,256)
Change in deposits from customers	**80,339**	118,918
Change in debt securities in issue at amortised cost	**(62)**	5,985
Change in other accounts and provisions	**6,172**	6,331
Change in insurance contract liabilities	**6,717**	7,413
Effect of changes in exchange rates	**3,862**	(14,028)
Operating cash outflow before taxation	**(75,946)**	(102,729)
Cash flows from operating activities included:		
– Interest received	**35,297**	30,089
– Interest paid	**9,704**	8,404
– Dividend received	**117**	120

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44. Notes to consolidated cash flow statement (continued)

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

	2012 **HK$'m**	2011 HK$'m
Cash and balances with banks and other financial institutions with original maturity within three months	**179,311**	267,152
Placements with banks and other financial institutions with original maturity within three months	**8,152**	15,571
Treasury bills with original maturity within three months	**53,912**	54,544
Certificates of deposit held with original maturity within three months	**1,580**	3,179
	242,955	340,446

45. Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment and the aggregate credit risk weighted amount:

	2012 **HK$'m**	2011 HK$'m
Direct credit substitutes	**14,168**	8,124
Transaction-related contingencies	**11,681**	11,871
Trade-related contingencies	**45,412**	50,422
Commitments that are unconditionally cancellable without prior notice	**320,777**	263,246
Other commitments with an original maturity of		
– up to one year	**18,988**	11,506
– over one year	**52,743**	45,016
	463,769	390,185
Credit risk weighted amount	**59,008**	41,502

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

46. Capital commitments

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

	2012 HK$'m	2011 HK$'m
Authorised and contracted for but not provided for	**325**	244
Authorised but not contracted for	**1**	8
	326	252

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:

	2012 HK$'m	2011 HK$'m
Land and buildings		
– not later than one year	**697**	598
– later than one year but not later than five years	**1,209**	1,050
– later than five years	**446**	299
	2,352	1,947

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

(b) The Group as lessor

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

	2012 HK$'m	2011 HK$'m
Land and buildings		
– not later than one year	**410**	377
– later than one year but not later than five years	**272**	441
	682	818

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

48. Litigation

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

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

49. Segmental reporting

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

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

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

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.

49. Segmental reporting (continued)

	2012							
	Personal Banking HK$'m	Corporate Banking HK$'m	Treasury HK$'m	Insurance HK$'m	Others HK$'m	Subtotal HK$'m	Eliminations HK$'m	Consolidated HK$'m
Net interest income/(expense)								
– external	932	8,784	13,229	1,757	6	24,708	–	24,708
– inter-segment	5,725	1,085	(6,288)	–	(522)	–	–	–
	6,657	9,869	6,941	1,757	(516)	24,708	–	24,708
Net fee and commission income/(expense)	4,377	3,420	138	(67)	247	8,115	(209)	7,906
Net insurance premium income	–	–	–	6,466	–	6,466	(15)	6,451
Net trading gain/(loss)	559	364	1,873	359	(34)	3,121	8	3,129
Net gain on financial instruments designated at fair value through profit or loss	–	–	42	705	–	747	–	747
Net (loss)/gain on other financial assets	–	(2)	623	129	–	750	–	750
Other operating income	50	3	8	14	1,429	1,504	(915)	589
Total operating income	11,643	13,654	9,625	9,363	1,126	45,411	(1,131)	44,280
Net insurance benefits and claims	–	–	–	(8,520)	–	(8,520)	–	(8,520)
Net operating income before impairment allowances	11,643	13,654	9,625	843	1,126	36,891	(1,131)	35,760
Net (charge)/reversal of impairment allowances	(214)	(650)	16	(11)	–	(859)	–	(859)
Net operating income	11,429	13,004	9,641	832	1,126	36,032	(1,131)	34,901
Operating expenses	(5,913)	(3,278)	(1,259)	(223)	(1,860)	(12,533)	1,131	(11,402)
Operating profit/(loss)	5,516	9,726	8,382	609	(734)	23,499	–	23,499
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	1,889	1,889	–	1,889
Net (loss)/gain from disposal/revaluation of properties, plant and equipment	(3)	(1)	–	–	110	106	–	106
Share of profits less losses after tax of associates	–	–	–	–	27	27	–	27
Profit before taxation	5,513	9,725	8,382	609	1,292	25,521	–	25,521
Assets								
Segment assets	266,839	573,803	870,488	66,150	65,760	1,843,040	(12,536)	1,830,504
Interests in associates	–	–	–	–	259	259	–	259
	266,839	573,803	870,488	66,150	66,019	1,843,299	(12,536)	1,830,763
Liabilities								
Segment liabilities	716,696	551,508	346,561	61,904	11,556	1,688,225	(12,536)	1,675,689
Other information								
Capital expenditure	27	8	–	15	997	1,047	–	1,047
Depreciation	324	169	90	6	904	1,493	–	1,493
Amortisation of securities	–	–	190	65	–	255	–	255

NOTES TO THE FINANCIAL STATEMENTS

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)

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:

	2012 HK$'m	2011 HK$'m
Aggregate amount of relevant transactions outstanding at year end	**5,865**	4,015
Maximum aggregate amount of relevant transactions outstanding during the year	**7,316**	4,572

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/expenses and balances arising from related party transactions with associates and other related parties of the Group are summarised as follows:

	2012		2011	
	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	**34**	**–**	173	–
Other accounts and provisions	**5**	**–**	–	–
Off-balance sheet items:				
Contingent liabilities and commitments	**–**	**–**	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, senior management and company secretary. The Group accepts deposits from and grants loans and credit facilities to key management personnel in the ordinary course of business. During both the current and prior years, no material transaction was conducted with key management personnel of BOCHK, its holding companies and parties related to them.

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

	2012 HK$'m	2011 HK$'m
Salaries and other short-term employee benefits	**66**	66
Post-employment benefits	**1**	1
	67	67

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.

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

	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

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:

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

	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
– Japan	14,630	47,527	537	62,694
– Others	43,845	5,095	23,489	72,429
	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
Total	328,587	267,734	166,152	762,473

* Included United States of HK$10,442 million (2011: HK$8,937 million) and other countries in North America of HK$1,355 million (2011: HK$1,704 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

54. Non-bank Mainland China exposures

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

	2012			
	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	**317,910**	**70,998**	**388,908**	**142**
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	**44,283**	**16,191**	**60,474**	**16**
Other non-bank Mainland China exposures	**23,213**	**2,600**	**25,813**	**67**
	385,406	**89,789**	**475,195**	**225**

	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	254,105	65,129	319,234	34
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	34,440	11,941	46,381	14
Other non-bank Mainland China exposures	21,746	2,060	23,806	44
	310,291	79,130	389,421	92

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. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 26 March 2013.