



中銀香港(控股)有限公司
BOC HONG KONG (HOLDINGS) LIMITED

Stock Code: 2388

Annual Report 2018

Build a Top-class, Full-service and Internationalised Regional Bank



Our Strategic Goal is to

Build a Top-class, Full-service and Internationalised Regional Bank





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BOC Hong Kong (Holdings) Limited (“the Company”) was established by restructuring the businesses of Bank of China Group’s member banks in Hong Kong. The Company was incorporated in Hong Kong on 12 September 2001 to hold the entire equity interest of Bank of China (Hong Kong) Limited (“BOCHK”), its principal operating subsidiary. Bank of China Limited (“BOC”) holds approximately 66.06% of the equity interest in the Company through BOC Hong Kong (BVI) Limited, an indirect wholly-owned subsidiary of BOC. The Company began trading on the main board of the Stock Exchange of Hong Kong on 25 July 2002 and is one of the largest listed companies and commercial banking groups in Hong Kong, with stock code “2388” and ADR OTC Symbol: “BHKLY”.

With the goal to “Build a Top-class, Full-service and Internationalised Regional Bank”, BOCHK gives full play to its advantages as a major commercial banking group in Hong Kong to increase local market penetration and expand its business in the Southeast Asian region. We strive to provide customers with comprehensive, professional and high-quality services. As one of the three note-issuing banks and the sole clearing bank for Renminbi (“RMB”) business in Hong Kong, BOCHK has strong market positions in all major businesses. We have the most extensive local branch network and diverse service platforms in Hong Kong, including approximately 200 branches, 270 automated banking centres, over 1,000 self-service machines, and efficient e-channels such as Internet and Mobile Banking services. We offer a comprehensive range of financial, investment and wealth management services to personal, corporate and institutional customers. Our strong RMB franchise has made us the first choice for customers in RMB business.

In an effort to implement the overseas development strategy of BOC Group, we are actively pushing forward our regional development. Aiming to provide customers in Southeast Asian countries with professional and high-quality financial services, we have extended our branches and subsidiaries to Thailand, Malaysia, Vietnam, the Philippines, Indonesia, Cambodia, Laos and Brunei. Through deep collaboration with our parent bank BOC, BOCHK provides a full range of high-quality cross-border services to multinationals, cross-border customers, mainland enterprises going global, central banks and super-sovereign organisations.

As a leading commercial and internationalised regional bank with roots firmly planted in Hong Kong for over 100 years, we are committed to undertaking our corporate social responsibility, promoting long-term and balanced sustainable development, and delivering greater value for our stakeholders and the community.

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Financial Highlights

	2018	2017
For the year	HK\$'m	HK\$'m
Net operating income before impairment allowances ¹	54,411	49,006
Operating profit ¹	37,994	34,103
Profit before taxation ¹	38,988	35,375
Profit for the year ¹	32,584	29,307
Profit attributable to equity holders of the Company ¹	32,000	28,574
Per share	HK\$	HK\$
Basic earnings per share ¹	3.0266	2.7026
Dividend per share	1.468	1.398
At year-end	HK\$'m	HK\$'m
Total assets	2,952,903	2,651,086
Issued and fully paid up share capital	52,864	52,864
Capital and reserves attributable to equity holders of the Company	257,070	244,018
Financial ratios	%	%
Return on average total assets ²	1.16	1.24
Return on average shareholders' equity ³	12.83	13.15
Cost to income ratio ¹	27.90	28.26
Loan to deposit ratio ⁴	66.82	64.48
Average value of liquidity coverage ratio ⁵		
First quarter	134.33	121.41
Second quarter	146.39	123.88
Third quarter	141.44	121.12
Fourth quarter	160.23	135.64
Quarter-end value of net stable funding ratio ⁵		
First quarter	118.98	–
Second quarter	118.82	–
Third quarter	122.24	–
Fourth quarter	124.41	–
Total capital ratio ⁶	23.10	20.39

1. The financial information is from continuing operations.

2. Return on average total assets = $\frac{\text{Profit for the year}}{\text{Daily average balance of total assets}}$

3. Return on average shareholders' equity

= $\frac{\text{Profit attributable to equity holders of the Company}}{\text{Average of the beginning and ending balance of capital and reserves attributable to equity holders of the Company}}$

4. Loan to deposit ratio is calculated as at year end. Loan represents gross advances to customers. Deposit represents deposits from customers including structured deposits reported as "Financial liabilities at fair value through profit or loss".

5. Liquidity coverage ratio and net stable funding ratio are computed on the consolidated basis which comprises the positions of BOCHK and certain subsidiaries specified by the HKMA in accordance with the Banking (Liquidity) Rules.

6. Total capital ratio is computed on the consolidated basis for regulatory purposes that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA in accordance with the Banking (Capital) Rules.

7. The Group has applied the merger accounting method in the preparation of financial statements for the combination with entities under common control in 2018. The comparative information for the year 2017 has been restated accordingly.



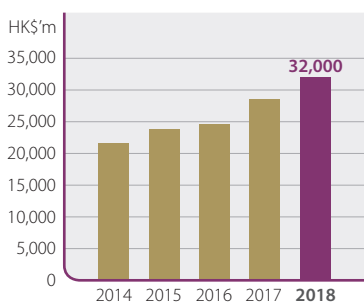
Five-Year Financial Summary

The financial information of the Group for the last five years commencing from 1 January 2014 is summarised below:

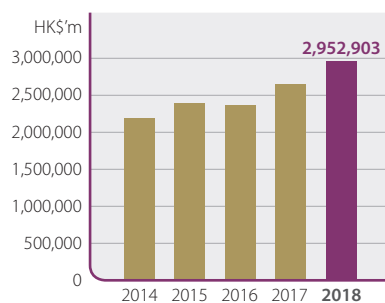
	2018	2017	2016	2015	2014
For the year	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net operating income before impairment allowances ¹	54,411	49,006	42,595	40,181	36,794
Operating profit ¹	37,994	34,103	29,482	27,815	26,261
Profit before taxation ¹	38,988	35,375	29,971	28,575	26,612
Profit for the year ¹	32,584	29,307	25,203	24,289	21,823
Profit attributable to equity holders of the Company ¹	32,000	28,574	24,574	23,757	21,482
Per share	HK\$	HK\$	HK\$	HK\$	HK\$
Basic earnings per share ¹	3.0266	2.7026	2.3243	2.2470	2.0318
At year-end	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances and other accounts	1,282,472	1,191,554	1,008,025	928,871	1,014,129
Total assets	2,952,903	2,651,086	2,354,740	2,382,815	2,189,367
Daily average balance of total assets	2,814,418	2,571,216	2,398,318	2,327,436	2,112,622
Deposits from customers ²	1,895,556	1,777,874	1,523,292	1,418,058	1,483,224
Total liabilities	2,667,996	2,402,463	2,120,186	2,182,650	2,007,895
Issued and fully paid up share capital	52,864	52,864	52,864	52,864	52,864
Capital and reserves attributable to equity holders of the Company	257,070	244,018	228,647	194,750	176,714
Financial ratios	%	%	%	%	%
Return on average total assets	1.16	1.24	2.36	1.19	1.19
Cost to income ratio ¹	27.90	28.26	29.37	28.90	28.21
Loan to deposit ratio	66.82	64.48	64.87	63.37	64.79

1. The financial information is from continuing operations.
2. Deposits from customers include structured deposits reported as "Financial liabilities at fair value through profit or loss".
3. The Group has applied the merger accounting method in the preparation of financial statements for the combination with entities under common control in 2018. The comparative information for the year 2017 has been restated accordingly. However, the financial information prior to year 2017 had not been restated as the difference before and after restatement is insignificant.

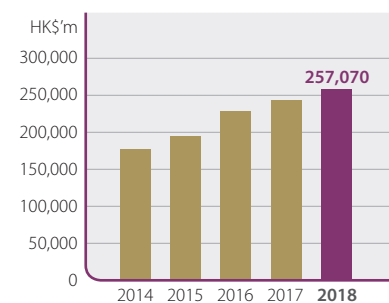
Profit attributable to equity holders of the Company



Total assets



Capital and reserves attributable to equity holders of the Company





Regional Development



Hong Kong



Message from the Chairman



In 2018, the global economy continued to recover despite increasingly divergent development trends across different regional economies. There arose various challenges to economic globalisation, multilateralism and global governance, implying larger downside risks for economic growth. The Chinese economy operated within a reasonable range and achieved positive progress amid overall stability. Despite a slight moderation, the Hong Kong economy achieved a commendable growth rate of 3% for the year. The economic fundamentals of the Southeast Asian region remained robust, notwithstanding pressure stemming from exchange rate and liquidity fluctuations. Hong Kong's banking industry continued its solid and prudent development, while the fusion of finance and technology accelerated and competition remained intense.

In 2018, BOCHK embarked on the implementation of its transformation strategy subordinate to BOC Group's new development strategy. Thanks to the wise leadership and well-formulated plans of its Board of Directors, BOCHK seized market opportunities, overcame difficulties and pursued innovation with a view to achieving its strategic goal of "building a top-class, full-service and internationalised regional bank".

We endeavoured to deepen our commitment to the Hong Kong market while enhancing our capabilities to provide all-round financial services globally and to fully support the local economy. We stepped up efforts to strengthen our business development and customer relationships, and strived to become the main bank for our major customer

groups. In order to cement our market share, we further sharpened the competitive edges of our products, sustaining market leadership in such business areas as syndicated loans, IPO receiving bank, cross-border cash pooling and residential mortgages. We fully consolidated our strengths in RMB business and leveraged our RMB franchise to promote RMB internationalisation. Through technological advances, we sped up the building of our smart channels and enhanced the efficiency of our online and offline omni-channels with a view to promoting channel upgrades and increasing branch network productivity. We supported the real economy by providing convenient banking services to local citizens through our branch network which is the most extensive in Hong Kong. Our branch outlets are fully dedicated to support corporate customers, providing a strong foundation for the development of our small-and-medium-sized corporate customer base.

The Guangdong-Hong Kong-Macao Greater Bay Area is a primary focus of our business development. We continued to enhance BOC Group's advantages in integrated development through technological means, while supporting Greater Bay Area development through financial services. On 18 February 2019, the *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* was promulgated, setting out the goal of building a first-class, globally recognised Bay Area. Hong Kong will play an irreplaceable role in the development of the Greater Bay Area and the formation of a new era of all-round opening-up for the nation, making positive contributions and unlocking further headroom



for growth. Remaining focused on livelihood finance, we will pursue innovation-driven development and win-win cooperation while striving to facilitate convenience of living and financial innovation in the Greater Bay Area. These objectives will be achieved by leveraging the advantages of BOC Group's globalisation and business integration. Our goal is to become the first-choice cross-border bank for Greater Bay Area residents by addressing customer difficulties and offering solutions in such areas as account opening, payment, credit extension and wealth management, specifically for northbound Hong Kong and Macao residents. During the year, BOCHK successfully hosted the Guangdong-Hong Kong-Macao Greater Bay Area Financial Summit Forum, and strengthened its capabilities in policy study and analysis to provide professional consultations for government organisations at various levels. We introduced new products and services such as BoC Dual Currency Card; BoC Pay mobile App, and BoC Bill integrated payment collection service. In order to gain first-mover advantage, we continuously launched signature financial products and services while fostering closer collaboration with our BOC Group sister institutions in the Greater Bay Area.

We made a solid contribution to the all-round opening-up strategy of the nation by proactively developing the Southeast Asian market based on a differentiated positioning strategy and a focus on enhancing regional management capabilities. Since the launch of its regional development strategy in 2015, BOCHK's business coverage in Southeast Asia has expanded to eight countries, including Thailand, Malaysia, Vietnam, the Philippines, Indonesia, Cambodia, Laos and Brunei. By now, BOCHK has fully assumed its role as BOC Group's Southeast Asian headquarters, and constantly refined its management model for regional expansion. Our Southeast Asian institutions have been ascribed a well-defined and differentiated development positioning, helping us to enhance our financial service capabilities along the Belt and Road. Leveraging its advantages in business, funding, products, management and talent, BOCHK has increased support to its Southeast Asian institutions and expedited the enhancement of their operational and risk management capabilities. These efforts were instrumental in fostering the

high-quality integrated development of our Southeast Asian businesses. Underpinned by steady growth in deposits and loans, a favourable risk profile and sustained leadership in RMB business, the positive synergistic effects of integration began to produce results in 2018, as the profitability of our Southeast Asian institutions continued to improve.

We enthusiastically sharpened our capabilities for driving technology-based development and digitalisation, thus helping to prepare Hong Kong for a "New Era of Smart Banking". In order to actively respond to the emerging competitive paradigm of the internet age, we drew on our customer-centric philosophy and adopted an innovative mechanism that aligns with internet trends. Technologies including blockchain, big data, cloud computing and biometric authentication were applied to the construction of our intelligent platform, data platform and open platform. Making mobile a top priority, we further optimised the products and services on our mobile platform so as to hone new competitive edges and enhance our intelligent operating and fintech service capabilities. During the year, we completed a number of initiatives including launching a new version of our mobile banking service and completing the simultaneous roll-out of FPS services in response to the HKMA's initiative. We also accelerated the building of smart counters and smart services so as to enhance our customer experience and push forward the digitalisation of the bank.

In support of the Group's strategic development plan, we dedicated ourselves to cultivating our bank culture, achieving absolute compliance with all applicable laws and regulations, and strengthening our risk management in all aspects. BOC Group has amassed rich cultural traditions and heritage throughout its century-long history. At BOCHK, the Board attaches strong importance to the nurturing of our culture, both as a vital component of our development strategy and as a strong foundation for achieving our strategic goals. Backed by the firm determination of senior management, we have adopted a top-down approach to developing and cascading a set of values and codes of conduct that align with our strategy and regulatory expectations. During the year, adhering to our people-oriented principle, we refined human resources

Message from the Chairman

management to ensure that we have available the talent needed to deliver on our strategy. In a bid to prevent and mitigate financial risks, we have further enhanced the standards of our risk management, compliance and internal controls, while also upgrading our regional risk management system so as to support our goal of becoming a full-service and internationalised regional bank.

We upheld the principle of caring for our community, focused on giving back to society and increased our support of charitable activities. Primarily focused on aiding the impoverished and minorities as well as assisting youth development, we sought to directly benefit grassroots communities and minority groups. In 2018, our donations helped more than 20 charitable projects. In terms of green finance, we proactively assisted Hong Kong in building an international green finance centre by facilitating the issuance of a number of corporate green bonds in USD, EUR and RMB, accounting for nearly 30% of the total amount of green bond issuance in the local market.

We held increasing shareholder value and fulfilling our social responsibilities to be our main corporate duty, while striving to maintain a robust and standardised mechanism for corporate governance. To protect the interests of our shareholders, customers and employees, BOCHK's top-tier corporate governance kept up with international and domestic best practices. In 2018, our Board further optimised the setup of its committees and maintained the diversity and independence of its board members, ensuring that its duties were fulfilled in compliance with relevant laws and regulations.

In 2018, Mr LIU Liange was appointed as Vice Chairman of

the Company. Mr LIU previously served in the People's Bank of China and Export-Import Bank of China for many years, and possesses strong experience in banking management. We believe his arrival will help bring the development of BOCHK to a new level. In August 2018, Mr LIN Jingzhen and Mr LIU Qiang were appointed as Non-executive Directors of the Company. Due to change of job, Mr REN Deqi and Mr LIU Qiang resigned as Non-executive Directors of the Company and Mr LI Jiuzhong resigned as Executive Director and Chief Risk Officer of the Company in June 2018, September 2018 and March 2019, respectively. In December 2018, Madam WANG Qi and Mr WANG Bing were appointed as Deputy Chief Executives of the Company. In March 2019, Mr LAW Yee Kwan Quinn was appointed as Independent Non-executive Director of the Company. On behalf of the Board, I would like to warmly welcome Mr LIU Liange, Mr LIN Jingzhen, Mr LAW Yee Kwan Quinn, Madam WANG Qi and Mr WANG Bing, and express our sincere gratitude to Mr REN Deqi, Mr LIU Qiang and Mr LI Jiuzhong for their contributions to BOCHK.

In 2018, BOCHK steadily increased its asset size, made sustained improvements in its financial performance, enhanced its operating efficiency and maintained a sound risk profile, all of which heralded new contributions to Hong Kong's economic development and livelihood improvement. We were awarded "Strongest Bank in Asia Pacific and Hong Kong" by *The Asian Banker* for the fifth consecutive year, and "Best Bank for CSR in Hong Kong" by *Asiamoney*.

It is my great pleasure to announce that BOCHK's profitability hit a record high once again in 2018. Profits attributable to equity holders reached HK\$32,000 million, a growth of 12.0% compared with the profit of its continuing operations in the previous



year. The Board proposed the distribution of a final dividend of HK\$0.923 per share for 2018. Together with the interim dividend, our full-year total dividend is HK\$1.468 per share, representing an increase of HK\$0.07 per share year-on-year, and translating into a dividend payout ratio of 48.5%. I would like to take this opportunity to extend my heartfelt gratitude to all the directors for their remarkable contribution, to the entire staff for their dedication, to customers for their loyalty and trust, and to shareholders for their long-standing support.

Deep rooted in the city for over a century, BOCHK has always been committed to serving Hong Kong. In the last forty years, BOCHK has dedicated itself to the reform and opening-up of its mother country, as well as to Hong Kong's development. We have proactively fulfilled our role as a connector, functioning as a hub linking local corporates with investment opportunities in the Chinese mainland, and to act as a bridge for the development of their trade and economic activities. Our outlook can be summarised by the "four hopes" outlined by President Xi Jinping at the celebration of the 40th anniversary of national reform and opening-up, in which he highlighted to the Hong Kong and Macao delegations that their biggest advantage lies in "One Country, Two Systems", their biggest stage is national reform and opening-up, while their newest and most important opportunities will arise from the Belt and Road Initiative and the development of the Greater Bay Area.

Our world will embrace a once-in-a-century, epochal change in 2019, bringing with it great challenges to the global economy. China stands at a critical stage of strategic opportunity, and will remain so for a considerable period of time. The Hong Kong banking industry will face greater operational pressure amid a challenging environment, but we will also see many opportunities. On the one hand, China will maintain its stable

economic growth momentum and continue to produce policy dividends. On the other, Hong Kong will become more proactive and increasingly integrated in the nation's development, which is certain to add further impetus to Hong Kong's economy. The Southeast Asian economy will sustain strong economic vibrancy and offer promising prospects.

In the face of new and important strategic opportunities, BOCHK will firmly pursue its strategic goal of "building a top-class, full-service and internationalised regional bank". To achieve this goal, BOCHK will persist in its commitment to the local market, actively participate in the construction of the Greater Bay Area and proactively capture opportunities arising from the Belt and Road Initiative. Through innovation and unswerving determination, we will strive to deliver outstanding results to celebrate the 70th anniversary of the founding of the People's Republic of China, and to make a greater contribution to burnishing Hong Kong's status as an international financial centre and enhancing its prosperity and stability in the long term.

CHEN Siqing

Chairman

Hong Kong, 29 March 2019

Message from the Chief Executive



In 2018, BOCHK earnestly carried out the plans and decisions of the Board of Directors and continued to pursue our strategic goal of building a top-class, full-service and internationalised regional bank, amid challenging macroeconomic headwinds. We took full advantage of new opportunities, successfully implemented our strategies and carried out various new activities while strengthening our risk management and control. Together, these efforts translated into satisfactory operating results.

The Group recorded new heights in profitability with expanded business scale. In 2018, the Group's profit attributable to equity holders grew to HK\$32,000 million, up 12.0%, compared with profits from continuing operations of 2017. As of 31 December 2018, total assets increased to HK\$2,952,903 million, up 11.4% from the end of 2017. Deposits from customers and advances to customers increased by 6.6% and 10.5% from the prior year-end to HK\$1,895,556 million and HK\$1,266,705 million respectively, outpacing average market growth rates.

Our quality of growth steadily improved and financial indicators remained healthy. The Group's return on average shareholders' equity from continuing operations was 12.83%, up by 0.73 percentage points compared to last year. Net interest margin rose steadily. Fee and commission income from currency exchange, insurance, trust and custody services and securities brokerage rose by 36.3%, 16.6%, 14.1% and 5.5% respectively, while fee and commission income from credit card and payment services also increased. The classified or impaired loan ratio was 0.19% and the cost to income ratio was 27.90%, both well below the market average. During the year, the Bank successfully issued Additional Tier 1 (AT1) capital securities amounting to US\$3 billion and also completed the tender offer and redemption of its subordinated notes amounting to US\$877 million, further optimising its capital structure. This issuance outshone other investment-grade AT1 projects across Asia in terms of scale, and was recognised as "Best Hong Kong Deal" by *FinanceAsia* and "Best Bank Capital Bond" by *The Asset* in 2018.



The Group continued to enjoy distinct business advantages and reinforced its market position. We remained the top mandated arranger in the Hong Kong and Macao syndicated loans for the 14th consecutive year and maintained the largest market share in IPO receiving bank business for the eighth year in a row. Leveraging Hong Kong's inherent advantages and the opportunities brought about by the HKSAR Government's tax policy for corporate treasury centres, we retained our market leadership in cross-border cash pooling business by facilitating customers involved in the Belt and Road Initiative to establish their overseas fund management platforms through us. The Bank continued to serve as a major wholesaler of banknotes both in Hong Kong and the Chinese mainland. Our provision of wholesale foreign-currency banknotes contributed to about 90% of the total supply in Hong Kong. Our RMB business further strengthened, with RMB clearing transaction values processed via BOCHK accounting for approximately 75% of the total RMB clearing transaction values of the world's offshore markets. During the year, we assisted enterprises and institutions in issuing green bonds denominated in USD, EUR and RMB, accounting for nearly 30% of the total value of green bonds issued in Hong Kong in 2018. We maintained our leading market position in the residential mortgage market and topped the list in terms of market share in the reverse mortgage market.

The Group achieved solid progress and synergy in its regional development. During the year, we completed the acquisitions of BOCHK Ho Chi Minh City Branch and BOC Manila Branch. Together with the earlier acquisitions of businesses in Malaysia, Thailand, Indonesia, Cambodia, as well as the establishment of Brunei Branch, the integration of our Southeast Asian entities is in good progress. In addition, BOC Vientiane Branch was integrated with the Group on 21 January 2019. During the reporting period,

based on our entities' varied business characteristics, we adopted a differentiated management approach to drive integrated business development in the region. According to Hong Kong Financial Reporting Standards, our seven Southeast Asian entities recorded a total net operating income before impairment allowances of HK\$2,287 million, up 27.6% from 2017. Deposits from customers and advances to customers increased by 17.1% and 20.0% respectively compared with the end of last year. These increases in total net operating income, deposits and advances were above that of the Group as a whole. According to statistics compiled in line with local regulatory requirements, the non-performing loan ratio of the seven Southeast Asian entities stood at 1.14%, down by 0.04 percentage points as compared with the end of 2017. BOC Manila Branch set up the first self-governed financial organisation outside China which facilitates the trading of RMB and a local currency. This supported the launch of the RMB-Peso direct trade market in the Philippines. In addition, BOC Malaysia has been appointed as the RMB settlement bank for Labuan Island, the offshore financial centre of Malaysia.

We are actively involved in the development of the Guangdong-Hong Kong-Macao Greater Bay Area, and endeavour to facilitate the integration of Hong Kong into the nation's development plans. BOCHK chairs a committee within BOC to promote synergistic development among the operations in Guangdong, Hong Kong and Macao. Through our collaboration with BOC Group, the Integrated Financial Service Solution in the Guangdong-Hong Kong-Macao Greater Bay Area was introduced, covering three major product suites, namely Payment Connect, Financing Connect and Services Connect. We are dedicated to designing new systems and mechanisms as well as developing new products to promote cross-border flows. Over 200,000

Message from the Chief Executive

Pay as You Go – BOC Dual Currency Cards have been issued. BoC Pay, the mobile App that adopted international EMV standards, supports payments at 600,000 merchants and bill payments in the Greater Bay Area. We will continue to attend to the financial needs of northbound Hong Kong and Macao residents for account opening, payment, financing and wealth management. We strive to provide suitable financial services that support the building of the Guangdong-Hong Kong-Macao Greater Bay Area into a high-quality living zone for living, working and leisure travel.

Our commitment to foster innovation notched up a number of considerable achievements in new technological applications. During the year, we put into operation the Faster Payment System (“FPS”) and Phase II of the Cross-border Interbank Payment System (“CIPS”) for RMB. These have helped lay a stronger foundation for our future digital development. In the FPS market, we enjoyed a leading position in terms of the number of registered customers and transaction volumes. With the launch of our new mobile banking service, the number of active users increased by over 60% from the end of 2017 and in particular, the young customer segment (aged 18-35) jumped over 70%. The construction of a transaction banking platform is underway. In addition, continuous enhancements were made to our IT system functions. An Innovation and Optimisation Centre has been established to explore the operational model of agile project teams. We also took the lead in introducing finger vein authentication for ATM cash withdrawals and applying blockchain technology to property valuation. The Science Park Banking Services Centre, meanwhile, served as a pilot site equipped with a 24-hour Video Teller Machine.

We continued to diligently perform our duties in accordance with relevant laws and regulations while implementing measures to foster a sound bank culture. In an effort to

prevent and mitigate financial risks, as well as ensuring healthy business development, we continued to enhance our risk management standard and effectiveness by upgrading the management system for various types of risks, compliance, internal control and anti-money laundering (“AML”). To strengthen the management capabilities of our Southeast Asian entities as well as enhancing our regional risk management system, we formulated and implemented the *Guidelines on Risk Management, Compliance and Internal Control*. In addition, the *Implementation Plan on Cultural Development of BOCHK* was devised to promote a sound corporate culture, in compliance with the HKMA’s requirements for advancing bank culture reform. In this respect, we are dedicated to becoming a role model in the industry, meeting the expectations of regulatory authorities and being recognised by society.

The Group is committed to corporate social responsibility by serving society and caring for its employees. For the benefit of grassroots communities and to meet the genuine needs of the underprivileged, we stepped up our community investment and refined our mechanisms and strategies to focus on poverty alleviation, helping the disadvantaged, and youth development. In 2018, we made donations to more than 20 charity projects, and devised and adopted a number of measures to support youth development in Hong Kong. As part of our caring efforts, we reviewed a series of policies related to employee remuneration and benefits, and continued to improve the working environment. We strive to grow with our employees, and have put in place a rigorous talent selection process, a systematic training programme for nurturing talent and an effective incentive scheme to motivate staff, all in an effort to provide a stage for talented employees who aspire to pursue a career at BOCHK. We were named “Strongest Bank in Asia Pacific and Hong Kong”



for the fifth year in a row and the “Best Retail Bank in Hong Kong” for the third time by *The Asian Banker*, and “Best Bank for CSR in Hong Kong” by *Asiamoney*.

In 2019, Hong Kong banks will face greater difficulties and uncertainties amid a challenging external operating environment. At the same time, however, there are enormous opportunities arising from China’s continued opening-up and the acceleration of supply-side structural reform. The full development of the Guangdong-Hong Kong-Macao Greater Bay Area will add new impetus to Hong Kong’s economic growth and drive massive demand for cross-border finance, livelihood finance, industrial finance and fintech innovation. The Belt and Road Initiative will bring new business opportunities for the Southeast Asian market. The local market in Hong Kong also has great potential to grow. All of these will present BOCHK with unparalleled opportunities for further growth.

The year 2019 marks the 70th anniversary of the founding of the People’s Republic of China, the first year of the development of the Guangdong-Hong Kong-Macao Greater Bay Area, and a crucial year for evaluating the performance of BOCHK in its regional development. The Group will relentlessly pursue its strategic goals and execute its strategic plans. Our business transformation will be accelerated in order to tap the potential of different growth drivers. We will expedite BOCHK’s development into a top-class, full-service and internationalised regional bank by carrying out management reform, strengthening our foundation for future growth and bolstering our risk management.

Finally, I would like to take this opportunity to report on certain changes to the Group’s senior management. Due to reassignment, Mr LI Jiuzhong resigned as Executive Director and Chief Risk Officer of the Company in March 2019. On behalf of the staff, I would like to extend our gratitude for Mr LI’s outstanding contributions to the Group during his tenure of service. On 17 December 2018, the Group appointed Madam WANG Qi as Deputy Chief Executive overseeing legal and compliance and operational risk, as well as strategic planning, and Mr WANG Bing as Deputy Chief Executive (Corporate Banking), overseeing corporate banking business. We welcome Madam WANG Qi and Mr WANG Bing to the Group.

The time is now right for us to set sail and embark on our new journey. I believe that through the concerted efforts of our colleagues, who are diligent, committed, proactive, innovative and willing to rise to challenges, BOCHK will move forward and build itself into a top-class, full-service and internationalised regional bank, creating ever greater value for its stakeholders.

GAO Yingxin

Vice Chairman & Chief Executive
Hong Kong, 29 March 2019



FinTech Innovation

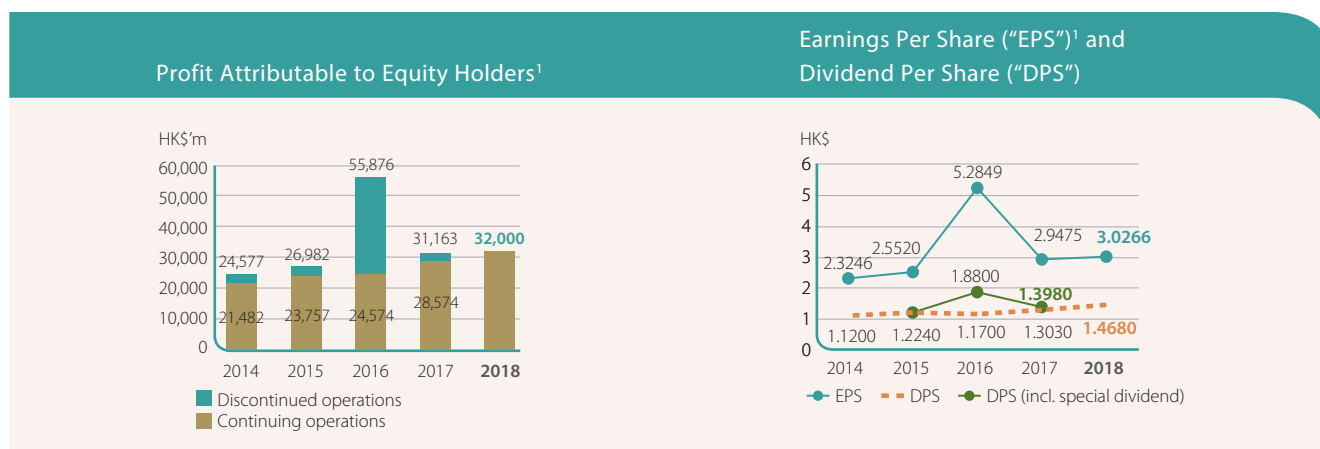


Management Discussion and Analysis

Following the completion of the acquisition of the Vietnam Business and Philippines Business of BOC on 29 January 2018, the Group has applied the merger accounting method for the combination of entities under common control in the preparation of its financial statements. The comparative information for 2017 has been restated accordingly. The above transactions are collectively referred as the “acquisitions” in this Management Discussion and Analysis.

Financial Performance and Conditions at a Glance

The following table is a summary of the Group’s key financial results for 2018 in comparison with the previous four years. The average value of liquidity coverage ratio and net stable funding ratio are reported on a quarterly basis.

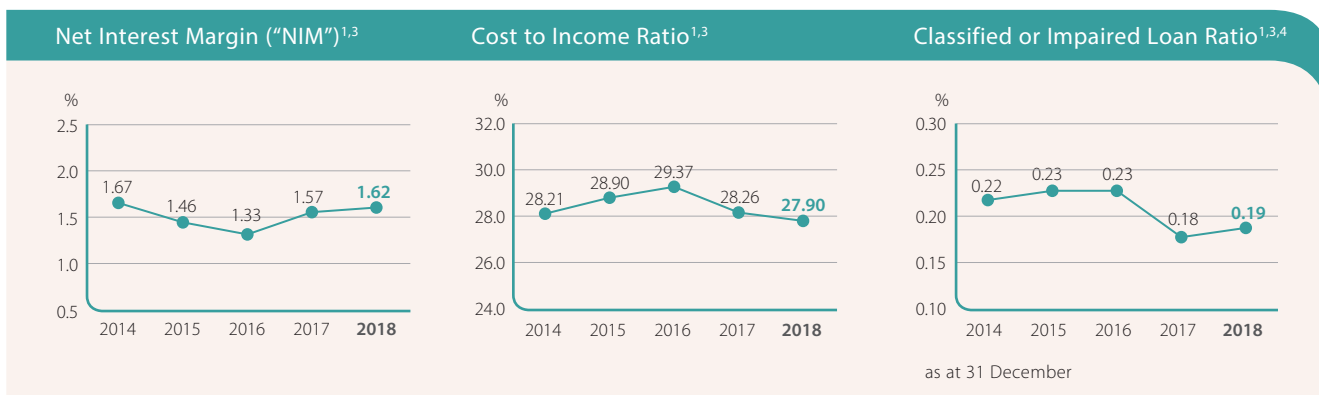


Profit attributable to equity holders

- The profit attributable to equity holders increased by 2.7% year-on-year to HK\$32,000 million, or a growth of 12.0% compared with the profit attributable to equity holders from continuing operations in 2017.

Solid returns to shareholders

- Return on average shareholders’ equity² (“ROE”) was 12.83%. On a continuing operations basis, it was up 0.73 percentage points year-on-year.
- Return on average total assets² (“ROA”) was 1.16%. On a continuing operations basis, it was up 0.01 percentage point year-on-year.
- EPS was HK\$3.0266. Dividend per share was HK\$1.4680.



Proactive assets and liabilities management, resulting in improvement to net interest margin ("NIM")

- NIM was 1.62%, up 5 basis points year-on-year. If the funding income or cost of foreign currency swap contracts⁵ were included, NIM would have been 1.63%, up 19 basis points, as a result of the Group's capturing of the opportunity from a rise in market interest rates and the proactive management of its assets and liabilities.

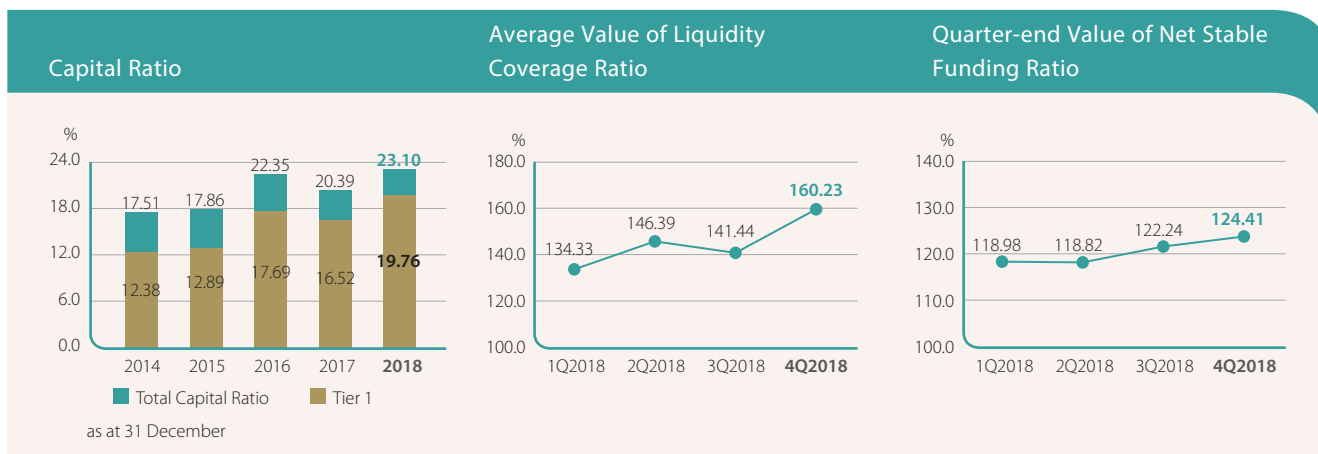
Flexible deployment of resources, leading to better operational efficiency

- The Group's cost to income ratio was 27.90%, down 0.36 percentage points year-on-year, maintaining cost efficiency at a solid level relative to industry peers.

Prudent risk management, maintaining benign asset quality

- The Group's classified or impaired loan ratio was 0.19%, well below the market average level.

Management Discussion and Analysis



Enhanced capital strength to support business growth

- The Group's total capital ratio stood at 23.10%. Tier 1 capital ratio was 19.76%, up 3.24 percentage points from that at the end of 2017. The Group's tier 1 capital was replenished via the issuance of additional tier 1 capital securities during the year.

Sound liquidity position

- The average value of liquidity coverage ratio and the quarter-end value of net stable funding ratio exceeded regulatory requirements in each of the four quarters of 2018.

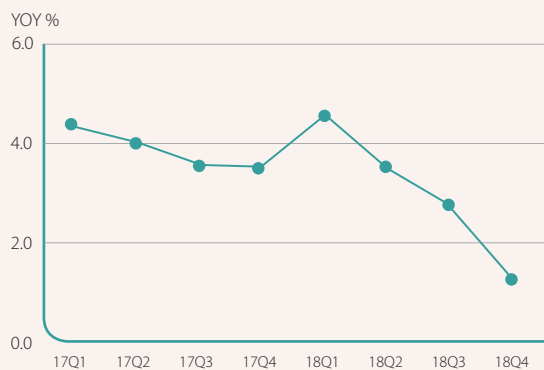
- The Group has applied the merger accounting method for the combination of entities under common control in the preparation of its financial statements in 2018. The comparative information for 2017 has been restated accordingly. However, financial information prior to 2017 has not been restated as the difference before and after restatement is insignificant.
- Return on average shareholders' equity and return on average total assets as defined in "Financial Highlights".
- Financial information is from continuing operations and excludes assets held for sale and liabilities associated with assets held for sale.
- Classified or impaired loans represent advances that are either classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or classified as Stage 3.
- Foreign exchange swap contracts are normally used for the Group's liquidity management and funding activities. In foreign exchange swap contracts, the Group exchanges one currency (original currency) for another (swapped currency) at the spot exchange rate (spot transaction) and commits to reverse the spot transaction by exchanging the same currency pair at a future maturity date at a predetermined rate (forward transaction). In this way, surplus funds in the original currency are swapped into another currency for liquidity and funding purposes with minimal foreign exchange risk. The exchange difference (funding income or cost) between the spot and forward contracts is recognised as a foreign exchange gain or loss (as included in "net trading gain"), while the corresponding interest differential between the surplus funds in the original currency and swapped currency is reflected in net interest income.



Economic Background and Operating Environment

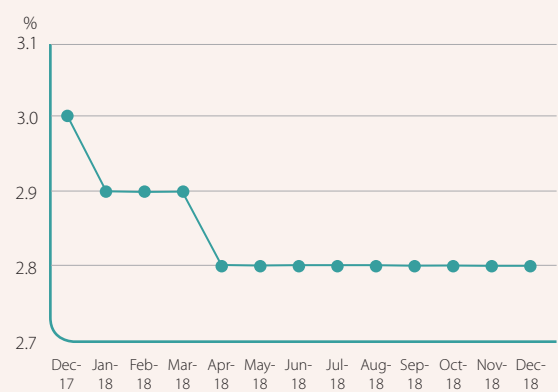
In 2018, the global economy maintained a growth trend, but the growth momentum slowed somewhat. There was increased uncertainty, including rising trade protectionism, repeated interest rate hikes by the US Federal Reserve and a reduction in its balance sheet, diverging growth among emerging economies and heightened political risks in certain countries. The US economy maintained relatively strong growth, supported by the implementation of tax reform and the relaxation of federal regulations. Eurozone economic growth slowed further, with the European Central Bank maintaining an ultra-loose monetary policy amid somewhat intensifying political disputes in some countries. In Southeast Asia, meanwhile, the regional economy maintained stable growth on the back of robust foreign and infrastructure investment and strong government spending and household consumption. The Chinese mainland economy continued to grow steadily, recording a growth rate of 6.6% for 2018.

Hong Kong Real GDP Growth Rate



Source: HKSAR Census and Statistics Department

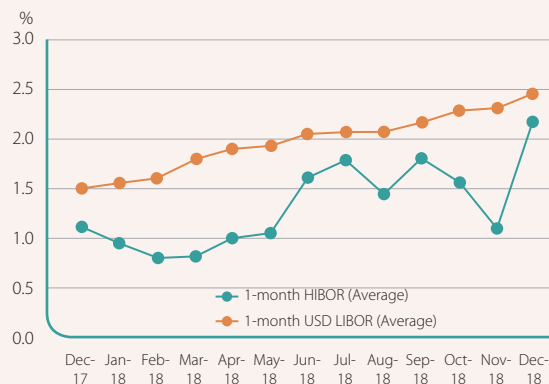
Hong Kong Unemployment Rate



Source: HKSAR Census and Statistics Department

The Hong Kong economy, after hitting its highest growth rate for six years in 2017, saw growth slowing down consecutively in each quarter of 2018. In general, however, it was supported by positive factors including moderate global economic growth, a recovering tourism sector, full employment and the HKSAR government’s expansionary fiscal policy. In 2018, Hong Kong achieved real GDP growth of 3.0%.

HIBOR and USD LIBOR



Source: Bloomberg

The average 1-month HIBOR and 1-month LIBOR rose from 0.55% and 1.11% respectively in 2017 to 1.34% and 2.02% respectively in 2018. The yield curve continued to flatten, as evidenced by the narrowing of the interest spread between the 2-year US Treasury yield and its 10-year counterpart from 52 basis points at the end of 2017 to 20 basis points at the end of 2018. In addition, banks in Hong Kong raised the prime lending rate in September, representing the first rate hike in 12 years.

Management Discussion and Analysis

Although global financial markets experienced heightened volatility in 2018, the average daily turnover of the Hong Kong stock market recorded a notable increase over the previous year and IPO activity remained robust. This was underpinned by positive stock market performance at the start of the year, a change in the Listing Rules by The Stock Exchange of Hong Kong Limited and strong capital inflows from the Chinese mainland. However, the Hong Kong stock market experienced a correction in the second half of the year amid intensifying trade conflict and the normalisation of monetary policies in advanced economies. The Hang Seng Index declined by 13.6% over the year.

Private residential property prices in Hong Kong reached a new high during the first seven months of 2018. However, the residential property market entered into a correction phase from August onwards, with transaction volumes decreasing because of growing uncertainty in economic prospects, the normalisation of HKD interest rates and volatility in financial markets. At the same time, the HKSAR government continued to implement demand management measures while the HKMA maintained prudent supervisory measures on mortgage loans, which helped banks to strengthen the risk management of their mortgage businesses.

Offshore RMB business in Hong Kong maintained steady growth in 2018. A series of measures was introduced by the PRC to promote capital account liberalisation and RMB internationalisation. These included the removal of limits on the foreign ownership of Chinese mainland banks and asset management companies, and the relaxation of the same with regard to securities houses, fund management firms, futures companies and life insurers. The scale of mutual connectivity was further expanded, with the daily quota of the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect increasing fourfold. At the same time, China's A shares was included in the MSCI index and Chinese bonds are to be included in the Bloomberg Barclays Global Aggregate Index. As a result of these measures, new business opportunities opened up for the financial industry in Hong Kong, further promoting the healthy development of offshore RMB markets.

In 2018, Hong Kong's banking industry faced a number of challenges in its operating environment, including looming trade protectionism, changes in global monetary policies, the normalisation of HKD interest rates, continuously diverging performance of emerging economies, rising geopolitical risks and intensifying market competition. However, banks in Hong Kong also gained fresh impetus from the enormous demand for financial services arising from the steady progress in the implementation of the Belt and Road Initiative and the building of Guangdong-Hong Kong-Macao Greater Bay Area, and the further development of two-way capital market access between the Chinese mainland and Hong Kong.



Consolidated Financial Review

The comparative information for 2017 has been restated following the Group's application of the merger accounting method in the preparation of its financial statements as a result of its acquisitions.

Financial Highlights

HK\$m, except percentages	2018	(Restated)	Change (%)
		2017	
FROM CONTINUING OPERATIONS			
Net operating income before impairment allowances	54,411	49,006	11.0
Operating expenses	(15,180)	(13,848)	9.6
Operating profit before impairment allowances	39,231	35,158	11.6
Operating profit after impairment allowances	37,994	34,103	11.4
Profit before taxation	38,988	35,375	10.2
Profit attributable to equity holders of the Company	32,000	31,163	2.7
– from continuing operations	32,000	28,574	12.0
– from discontinued operations	–	2,589	(100.0)

In 2018, the Group's profit attributable to equity holders amounted to HK\$32,000 million, an increase of HK\$837 million, or 2.7%, year-on-year. It increased by 12.0% compared with the profit attributable to equity holders from continuing operations in the previous year. Net operating income before impairment allowances was HK\$54,411 million, an increase of HK\$5,405 million, or 11.0%, year-on-year. Net interest income rose, benefitting from rising market interest rates and the positive results of the Group's proactive management of its assets and liabilities. The net trading gain of the banking business also increased, owing to rising foreign exchange income. Net fee and commission income decreased year-on-year, primarily due to lower loan commissions, which partially offset the above-mentioned income growth. Operating expenses increased as a result of the Group's ongoing investment in supporting its long-term business expansion. Net charge of impairment allowances increased year-on-year while the net gain from fair-value adjustments on investment properties decreased on a year-on-year basis.

Second Half Performance

In the second half of 2018, the Group's net operating income before impairment allowances decreased by HK\$703 million, or 2.6%, compared to the first half of 2018. A rise in net interest margin and growth in average interest-earning assets resulted in an increase in net interest income, which was offset by a decrease in net fee and commission income and in the net trading gain of the banking business. Moreover, operating expenses and net charge of impairment allowances increased from the first half of the year, while net gain from fair-value adjustments on investment properties decreased. As a result, the Group's profit attributable to equity holders decreased by HK\$3,056 million or 17.4%, on a half-on-half basis.

Management Discussion and Analysis

Income Statement Analysis

The following income statement analysis is based on the Group's continuing operations. The comparative information has been restated to conform to the current year's presentation.

Net Interest Income and Net Interest Margin

HK\$m, except percentages	(Restated)		Change (%)
	2018	2017	
Interest income	61,736	49,077	25.8
Interest expense	(22,342)	(14,259)	56.7
Net interest income	39,394	34,818	13.1
Average interest-earning assets	2,434,966	2,222,258	9.6
Net interest spread	1.44%	1.44%	
Net interest margin	1.62%	1.57%	
Net interest margin (adjusted)*	1.63%	1.44%	

* Including the funding income or cost of foreign currency swap contracts.

Net interest income amounted to HK\$39,394 million in 2018, an increase of HK\$4,576 million, or 13.1%, year-on-year. This increase was driven by the improvement in net interest margin and growth in average interest-earning assets.

Average interest-earning assets expanded by HK\$212,708 million, or 9.6%, year-on-year. An increase in deposits from customers supported an increase in advances to customers and debt securities investments.

Net interest margin was 1.62%. If the funding income or cost of foreign currency swap contracts[#] were included, net interest margin would have been 1.63%, up 19 basis points year-on-year. Market interest rates rose and the Group proactively managed its assets and liabilities, which led to the widening of its loan and deposit spread. This, together with an improvement in the average yield of its debt securities investments and other debt instruments, resulted in a widening of the Group's net interest margin. However, the rise in market interest rates prompted customers in favour of time deposits, resulting in a lower proportion of current accounts and savings deposits, which partially offset the positive impact described above.

[#] Foreign exchange swap contracts are normally used for the Group's liquidity management and funding activities. In foreign exchange swap contracts, the Group exchanges one currency (original currency) for another (swapped currency) at the spot exchange rate (spot transaction) and commits to reverse the spot transaction by exchanging the same currency pair at a future maturity date at a predetermined rate (forward transaction). In this way, surplus funds in the original currency are swapped into another currency for liquidity and funding purposes with minimal foreign exchange risk. The exchange difference (funding income or cost) between the spot and forward contracts is recognised as a foreign exchange gain or loss (as included in "net trading gain"), while the corresponding interest differential between the surplus funds in the original currency and swapped currency is reflected in net interest income.



The table below summarises the average balances and average interest rates of individual categories of assets and liabilities:

	2018		(Restated) 2017	
	Average balance HK\$'m	Average yield %	Average balance HK\$'m	Average yield %
ASSETS				
Balances and placements with banks and other financial institutions	414,900	1.90	442,157	2.17
Debt securities investments and other debt instruments	783,128	2.39	669,950	1.98
Advances to customers	1,219,376	2.85	1,093,445	2.38
Other interest-earning assets	17,562	2.13	16,706	1.29
Total interest-earning assets	2,434,966	2.54	2,222,258	2.21
Non interest-earning assets ¹	379,452	–	348,958	–
Total assets	2,814,418	2.19	2,571,216	1.91

LIABILITIES	Average balance HK\$'m	Average rate %	Average balance HK\$'m	Average rate %
	Deposits and balances from banks and other financial institutions	226,141	1.10	226,067
Current, savings and time deposits	1,724,063	1.03	1,562,583	0.68
Subordinated liabilities	18,237	5.44	19,312	4.82
Other interest-bearing liabilities	55,080	1.95	47,781	1.41
Total interest-bearing liabilities	2,023,521	1.10	1,855,743	0.77
Shareholders' funds ² and other non interest-bearing deposits and liabilities ¹	790,897	–	715,473	–
Total liabilities	2,814,418	0.79	2,571,216	0.55

1. Including assets held for sale and liabilities associated with assets held for sale respectively.

2. Shareholders' funds represent capital and reserves attributable to equity holders of the Company.

Second Half Performance

In the second half of the year, net interest income recorded a half-on-half increase of HK\$2,414 million, or 13.1%. Net interest margin was 1.70%, up 17 basis points. If the funding income or cost of foreign currency swap contracts were included, net interest margin would have been up 14 basis points to 1.70%. This was mainly attributable to a rise in market interest rates, the widening of the Group's loan and deposit spread, and the improvement in the average yield of its debt securities investments and other debt instruments.

Management Discussion and Analysis

Net Fee and Commission Income

HK\$m, except percentages	(Restated)		Change (%)
	2018	2017	
Credit card business	3,441	3,202	7.5
Securities brokerage	2,769	2,625	5.5
Loan commissions	2,613	3,608	(27.6)
Insurance	1,546	1,326	16.6
Funds distribution	929	985	(5.7)
Bills commissions	738	816	(9.6)
Payment services	679	649	4.6
Trust and custody services	633	555	14.1
Currency exchange	590	433	36.3
Safe deposit box	285	291	(2.1)
Others	1,290	1,010	27.7
Fee and commission income	15,513	15,500	0.1
Fee and commission expense	(4,206)	(3,899)	7.9
Net fee and commission income	11,307	11,601	(2.5)

In 2018, the Group's net fee and commission income amounted to HK\$11,307 million, down HK\$294 million or 2.5%, year-on-year. This decrease was primarily due to a 27.6% year-on-year drop in loan commissions. The Group captured opportunities arising from improved investor sentiment in the market in the first half of the year by meeting customers' differentiated needs through enriched product and service offerings via various channels, and by focusing on delivering promotional campaigns to mid- to high-end and cross-border customers. As a result, commission income from the securities brokerage and insurance businesses grew by 5.5% and 16.6% respectively. The Group also leveraged its diversified business platforms to grasp market opportunities, recording satisfactory growth in a number of areas. Income from the Group's credit card business rose by 7.5%, with the business volumes of its cardholder spending and merchant acquiring businesses rising 9.8% and 10.5% year-on-year respectively, driven by recovery in local retail sales and addition in the number of new merchants acquired. The Group's currency exchange business achieved an increase in income of 36.3%, as the Group captured opportunities arising from demand for banknote services in the Chinese mainland, Hong Kong and Southeast Asia, growing its market share and business volume. The Group's trust and custody business continued to expand its assets under management ("AUM"), resulting in a year-on-year increase of 14.1% in related income. Commission income from payment services also rose by 4.6%. Meanwhile, commission income from bills, funds distribution and safe deposit box business decreased. Fee and commission expenses were up 7.9% year-on-year, mainly due to higher credit card related expenses.

Second Half Performance

In the second half of 2018, net fee and commission income decreased by HK\$1,641 million, or 25.3%, compared with the first half. This was attributable to lower fee and commission income from the Group's securities brokerage, insurance and funds distribution businesses amid subdued investor sentiment in the market during the second half of the year. Moreover, commission income from loans, bills, credit card business and safe deposit box business also fell. Meanwhile, currency exchange, payment services and trust and custody services maintained growth momentum, with a continuous rise in related income. The decrease in fee and commission expenses was due to lower securities brokerage, insurance and credit card related expenses.



Net Trading Gain

HK\$'m, except percentages	2018	(Restated)	Change (%)
		2017	
Foreign exchange and foreign exchange products	2,704	197	1272.6
Interest rate instruments and items under fair value hedge	50	741	(93.3)
Commodities	184	205	(10.2)
Equity and credit derivative instruments	140	225	(37.8)
Total net trading gain	3,078	1,368	125.0

Net trading gain amounted to HK\$3,078 million, an increase of HK\$1,710 million, or 125.0%, year-on-year. Net trading gain from foreign exchange and foreign exchange products increased by HK\$2,507 million, which was primarily attributable to a net gain from foreign currency swap contracts in 2018 (as compared with a net loss in the previous year), as well as an increase in currency exchange income from customer transactions. Net trading gain from interest rate instruments and items under fair value hedge decreased by HK\$691 million, primarily due to the lower mark-to-market gains of certain debt securities investments and interest rate instruments caused by interest rate movements. The decrease in net trading gain from equity and credit derivative instruments was mainly due to decreased income from equity-linked products. Net trading gain from commodities declined, due to a lower trading gain from bullion transactions. If the funding income or cost of foreign currency swap contracts were excluded, net trading gain would have decreased by 31.4% year-on-year.

Second Half Performance

In the second half of 2018, net trading gain decreased by HK\$1,010 million, or 49.4%, half-on-half. This was primarily due to a net loss from foreign currency swap contracts in the second half of 2018 (as compared with a net gain in the first half), lower currency exchange income from customer transactions, and a decrease in mark-to-market gains from certain debt securities investments and interest rate instruments caused by interest rate movements, all of which was partially offset by an increased gain from commodities. If the funding income or cost of foreign currency swap contracts were excluded, net trading gain would have decreased by 41.0%.

Net (Loss)/Gain on Other Financial Instruments at Fair Value through Profit or Loss

HK\$'m, except percentages	2018	(Restated)	Change (%)
		2017	
Net (loss)/gain on other financial instruments at fair value through profit or loss	(1,282)	2,181	N/A

The Group recorded a net loss of HK\$1,282 million on other financial instruments at fair value through profit or loss in 2018, compared to a net gain of HK\$2,181 million in 2017. This change was mainly attributable to a loss in the equity securities and bond fund investments of BOC Life, as well as the mark-to-market loss of debt securities investments caused by market interest rate movements. The mark-to-market changes of debt securities investments mentioned above were offset by changes in policy reserves, as reflected in changes in net insurance benefits and claims and movement in liabilities, which were also attributable to the movement of market interest rates.

Second Half Performance

A net loss of HK\$100 million was recorded in the second half of the year, which was HK\$1,082 million lower than the net loss recorded in the first half. This change was mainly attributable to the lower mark-to-market loss of the debt securities investments of BOC Life in the second half of the year.

Management Discussion and Analysis

Operating Expenses

HK\$m, except percentages	2018	(Restated)	Change (%)
		2017	
Staff costs	8,627	7,901	9.2
Premises and equipment expenses (excluding depreciation)	1,859	1,721	8.0
Depreciation	2,063	1,951	5.7
Other operating expenses	2,631	2,275	15.6
Total operating expenses	15,180	13,848	9.6

	At 31 December 2018	(Restated)	Change (%)
		At 31 December 2017	
Staff headcount measured in full-time equivalents*	14,046	13,212	6.3

* The comparative information of staff headcount measured in full-time equivalents as at 31 December 2017 has been restated to enable analysis on a comparable basis.

Total operating expenses increased by HK\$1,332 million, or 9.6%, year-on-year, as a result of the Group's ongoing investment in human resources, the optimisation of its business systems and platforms, the acceleration of fintech innovations and the promotion of digital development, all of which aim to enhance the Group's overall service capabilities and support long-term business growth. The cost to income ratio was 27.90%, down 0.36 percentage points year-on-year, with the Group maintaining cost efficiency at a solid level relative to industry peers.

Staff costs increased by 9.2% year-on-year, reflecting annual salary increment, increased headcount and higher performance-related remuneration.

Premises and equipment expenses were up 8.0%, due to higher rental costs for computer software and patent expenses from the enhancement of business systems and platforms, and an increase in rental costs for the operating network.

Depreciation rose by 5.7%, as depreciation charges on information technology infrastructure and premises increased year-on-year.

Other operating expenses rose by 15.6%, mainly due to a rise in communication expenses, which was in line with increased business volume, and donations. Meanwhile, there was a lower base for comparison resulting from the reversal of certain expenses in 2017.

Second Half Performance

Compared with the first half of 2018, total operating expenses increased by HK\$1,180 million, or 16.9%, half-on-half. The increase was due to higher staff costs, business promotional expenses, rental costs of the operating network and donations.



Net Charge of Impairment Allowances on Advances and Other Accounts

HK\$m, except percentages	(Restated)		Change (%)
	2018	2017	
Stage 1	167	N/A	N/A
Stage 2	(336)	N/A	N/A
Stage 3	(1,009)	N/A	N/A
Individually assessed	N/A	71	N/A
Collectively assessed	N/A	(1,117)	N/A
Total net charge of impairment allowances on advances and other accounts	(1,178)	(1,046)	12.6

Total Loan Impairment Allowance as a Percentage of Gross Advances to Customers

	(Restated)	
	At 31 December 2018	At 31 December 2017
Total loan impairment allowance as a percentage of gross advances to customers	0.43%	0.36%

From 1 January 2018 onwards, the Group has adopted Hong Kong Financial Reporting Standard 9 (“HKFRS 9”), “Financial Instruments”. Under this new standard, the recognition and measurement of impairment differs from that under Hong Kong Accounting Standard 39 (“HKAS 39”), “Financial Instruments: Recognition and Measurement”. Changes in the impairment of the Group’s financial assets in the comparative periods of 2017 remain in accordance with HKAS 39. Comparative information has not been restated.

Under HKFRS 9, the Group’s net charge of impairment allowances on advances and other accounts amounted to HK\$1,178 million in 2018. Impairment allowances at Stage 1 recorded a net reversal of HK\$167 million, mainly reflecting the impact from the upgrading of certain customers, which offset the impact of the net charge of impairment allowances arising from loan growth and the updating of parameter values in the expected credit losses assessment model to take into consideration changes in economic outlook during the year. Impairment allowances at Stage 2 recorded a net charge of HK\$336 million, as the result of the updating of parameter values in the expected credit losses assessment model. The net charge of impairment allowances at Stage 3 amounted to HK\$1,009 million, mainly relating to the downgrading of certain corporate advances and advances in the personal loan portfolio. As at 31 December 2018, total loan impairment allowance as a percentage of gross advances to customers was 0.43%, maintaining benign asset quality.

In 2017, the Group’s net charge of impairment allowances on advances and other accounts was HK\$1,046 million. There was a net reversal of individually assessed impairment allowances of HK\$71 million, mainly caused by the loan repayments of certain corporate customers. The net charge of collectively assessed impairment allowances amounted to HK\$1,117 million, which was attributable to a growth in advances to customers and to the Group’s prudent and stable approach to increasing impairment allowances for a certain loan portfolio. At the end of 2017, total loan impairment allowances as a percentage of gross advances to customers was 0.36%.

Second Half Performance

Compared with the first half of 2018, the Group’s net charge of impairment allowances on advances and other accounts increased by HK\$650 million, half-on-half, mainly reflecting the impact from the updating of parameter values in the expected credit losses assessment model to take into consideration changes in economic outlook.

Management Discussion and Analysis

Analysis on Assets and Liabilities

The table below summarises the Group's asset composition. The comparative figures as of 31 December 2017 have been restated to conform to the current year's presentation. Please refer to Note 24 to the Financial Statements for the contract/notional amounts and fair values of the Group's derivative financial instruments. Please refer to Note 43 to the Financial Statements for the contractual amounts of each significant class of contingent liability and commitment and the aggregate credit risk-weighted amounts of the Group.

Asset Composition

HK\$m, except percentages	At 31 December 2018		(Restated) At 31 December 2017		Change (%)
	Amount	% of total	Amount	% of total	
Cash and balances and placements with banks and other financial institutions	431,524	14.6	426,604	16.1	1.2
Hong Kong SAR Government certificates of indebtedness	156,300	5.3	146,200	5.5	6.9
Securities investments and other debt instruments ¹	899,176	30.5	711,385	26.8	26.4
Advances and other accounts	1,282,472	43.4	1,191,554	45.0	7.6
Fixed assets and investment properties	69,114	2.3	66,937	2.5	3.3
Other assets ²	114,317	3.9	108,406	4.1	5.5
Total assets	2,952,903	100.0	2,651,086	100.0	11.4

1. Securities investments and other debt instruments comprise investment in securities and financial assets at fair value through profit or loss.

2. Other assets comprise derivative financial instruments, interests in associates and joint ventures, current tax assets and deferred tax assets.

Adhering to the principle of stable, long-term and sustainable development, the Group continued to optimise the management of its assets and liabilities. The total assets of the Group amounted to HK\$2,952,903 million, an increase of HK\$301,817 million, or 11.4%, compared with the end of 2017. Key changes in the Group's total assets include the following:

- Securities investments and other debt instruments increased by HK\$187,791 million, or 26.4%, as the Group increased investments in high-quality corporate bonds and other debt instruments;
- Advances and other accounts rose by HK\$90,918 million, or 7.6%, with advances to customers growing by HK\$120,279 million, or 10.5%, and trade bills decreasing by HK\$25,614 million, or 59.6%.



Advances to Customers

HK\$m, except percentages	At 31 December 2018		(Restated) At 31 December 2017		Change (%)
	Amount	% of total	Amount	% of total	
Loans for use in Hong Kong	841,720	66.4	759,038	66.2	10.9
Industrial, commercial and financial	492,712	38.9	436,754	38.1	12.8
Individuals	349,008	27.5	322,284	28.1	8.3
Trade finance	65,437	5.2	78,196	6.8	(16.3)
Loans for use outside Hong Kong	359,548	28.4	309,192	27.0	16.3
Total advances to customers	1,266,705	100.0	1,146,426	100.0	10.5

In 2018, the Group continued to implement BOC Group's development strategy and captured opportunities arising from the Belt and Road Initiative, enterprises' "Going Global" efforts, the development of the Guangdong-Hong Kong-Macao Greater Bay Area and in Southeast Asia. It strengthened its collaboration with BOC in order to provide a diversified range of financial services to mainland and Hong Kong "Going Global" enterprises as well as to corporates in Southeast Asia. At the same time, the Group also continued to improve its services to commercial customers in Hong Kong by helping them to establish a convenient and effective financial service platform. It remained the top mandated arranger in the Hong Kong and Macao syndicated loan market for the 14th consecutive year. It also maintained its leading market position in the residential mortgage and reverse mortgage businesses. The Group adhered to a prudent credit strategy in order to maintain benign asset quality. In 2018, advances to customers grew by HK\$120,279 million, or 10.5%, to HK\$1,266,705 million, outperforming market growth.

Loans for use in Hong Kong increased by HK\$82,682 million or 10.9%.

- Lending to the industrial, commercial and financial sectors increased by HK\$55,958 million or 12.8%, reflecting growth in property development, financial concerns, manufacturing, transport and transport equipment, as well as wholesale and retail trade.
- Lending to individuals increased by HK\$26,724 million or 8.3%. Residential mortgage loans (excluding those under government-sponsored home purchasing schemes) grew by 4.1% while other individuals loans increased by 23.6%, mainly driven by an increase in property refinancing and personal loans for investment purposes.

Trade finance decreased by HK\$12,759 million or 16.3%. Loans for use outside Hong Kong increased HK\$50,356 million or 16.3%, mainly driven by growth in loans for use in the Chinese mainland and Southeast Asia.

Management Discussion and Analysis

Loan Quality

HK\$'m, except percentages	At 31 December 2018	(Restated) At 31 December 2017
Advances to customers	1,266,705	1,146,426
Classified or impaired loan ratio	0.19%	0.18%
Total loan impairment allowance	5,411	4,106
Total loan impairment allowance as a percentage of gross advances to customers	0.43%	0.36%
Residential mortgage loans ¹ – delinquency and rescheduled loan ratio ²	0.01%	0.01%
Card advances – delinquency ratio ²	0.19%	0.21%

	2018	2017
Card advances – charge-off ratio ³	1.40%	1.51%

1. Residential mortgage loans exclude those under the Home Ownership Scheme and other government-sponsored home purchasing schemes.

2. The delinquency ratio is the ratio of the total amount of overdue advances (more than three months) to total outstanding advances.

3. The charge-off ratio is the ratio of total write-offs made during the year to average card receivables during the year.

The Group adhered to prudent risk management principles and maintained benign asset quality for the year. The classified or impaired loan ratio was 0.19% as at 31 December 2018, up 0.01 percentage point from the end of last year. This was attributable to an increase in classified or impaired advances to customers of HK\$304 million to HK\$2,383 million, following the downgrading of certain corporate advances.

The credit quality of the Group's residential mortgage loans and card advances remained robust. The combined delinquency and rescheduled loan ratio of residential mortgage loans was 0.01% as at 31 December 2018. The charge-off ratio of card advances was 1.40%, down 0.11 percentage points year-on-year.



Deposits from Customers*

HK\$'m, except percentages	At 31 December 2018		(Restated) At 31 December 2017		Change (%)
	Amount	% of total	Amount	% of total	
Demand deposits and current accounts	207,797	11.0	203,837	11.5	1.9
Savings deposits	852,339	45.0	913,192	51.3	(6.7)
Time, call and notice deposits	833,221	43.9	658,061	37.0	26.6
	1,893,357	99.9	1,775,090	99.8	6.7
Structured deposits	2,199	0.1	2,784	0.2	(21.0)
Total deposits from customers	1,895,556	100.0	1,777,874	100.0	6.6

* Including structured deposits

The Group continued to implement a number of strategic measures to grow deposits in 2018, including the launch of featured products to targeted customer groups and the maintenance of demand and savings deposits through payroll services, wealth management and integrated payment solutions to customers. Through its cash management, settlement and custody businesses, as well as its role serving as the main receiving bank for IPOs, it strengthened business relationships with large corporates, sovereign and institutional customers. At the end of 2018, total deposits from customers amounted to HK\$1,895,556 million, an increase of HK\$117,682 million or 6.6% from the end of last year. Demand deposits and current accounts increased by 1.9%. Savings deposits decreased by 6.7%. Time, call and notice deposits were up 26.6%.

Capital and Reserves Attributable to Equity Holders of the Company

HK\$'m, except percentages	At 31 December		Change (%)
	2018	(Restated) 2017	
Share capital	52,864	52,864	–
Premises revaluation reserve	38,527	36,689	5.0
Reserve for fair value changes/Reserve for fair value changes of available-for-sale securities	(4,116)	42	N/A
Reserve for own credit risk	5	–	N/A
Regulatory reserve	10,496	10,224	2.7
Translation reserve	(853)	(728)	(17.2)
Merger reserve	–	1,062	(100.0)
Retained earnings	160,147	143,865	11.3
Reserves	204,206	191,154	6.8
Capital and reserves attributable to equity holders of the Company	257,070	244,018	5.3

Capital and reserves attributable to equity holders of the Company amounted to HK\$257,070 million as at 31 December 2018, an increase of HK\$13,052 million, or 5.3%, from the end of 2017. Retained earnings rose by 11.3%, mainly reflecting the profit achieved in 2018 following the distribution of dividends. The premises revaluation reserve increased by 5.0%, following an increase in the valuation of the Group's premises in 2018. The reserve for fair value changes/reserve for fair value changes of available-for-sale securities recorded a deficit, as compared to a gain in the previous year, mainly due to a decline in the valuation of equity securities. The regulatory reserve rose by 2.7%, mainly driven by growth in advances to customers. The merger reserve arose owing to the Group's application of the merger accounting method in relation to its combination with BOC's Vietnam Business and Philippines Business.

Management Discussion and Analysis

Capital Ratio

HK\$m, except percentages	At 31 December 2018	At 31 December 2017
Consolidated capital after deductions		
Common Equity Tier 1 capital	180,202	170,012
Additional Tier 1 capital	23,476	–
Tier 1 capital	203,678	170,012
Tier 2 capital	34,393	39,816
Total capital	238,071	209,828
Total risk-weighted assets	1,030,815	1,029,152
Common Equity Tier 1 capital ratio	17.48%	16.52%
Tier 1 capital ratio	19.76%	16.52%
Total capital ratio	23.10%	20.39%

In the course of formulating its internal capital ratio targets, the Group not only takes into consideration regulatory requirements, but also adopts the internal capital adequacy assessment process and stress testing necessary to assess the Bank's capital requirement for Pillar II. This allows it to determine the most appropriate capital level to ensure that the Group has adequate capital strength to withstand any future unexpected loss arising from a drastic change in the economic environment. At the same time, the Group will also take into account its development strategy and risk appetite, as well as its short- and long-term capital requirements (including support from capital replenishment solutions), with the ultimate aim of ensuring the long-term stability of its capital level. During the year, the Group optimised its capital structure by completing the issuance of Additional Tier 1 ("AT1") capital securities amounting to US\$3 billion as well as a tender offer and redemption of its subordinated notes amounting to US\$877 million. The issuance of the AT1 capital securities was awarded Best Hong Kong Deal in *FinanceAsia's* Achievement Awards 2018, and 2018 Best Bank Capital Bond by *The Asset*. The Group attaches a high degree of importance to the need for capital accumulation and remains committed to strengthening internal capital generation to support its sustainable business development.

As at 31 December 2018, the common equity tier 1 ("CET1") capital ratio was 17.48% and tier 1 capital ratio was 19.76%, up 0.96 and 3.24 percentage points respectively from the end of 2017. Total capital ratio was 23.10%. Profits net of dividends for 2018 increased CET1 capital by 6.0%. Tier 1 capital increased by 19.8%, mainly as a result of replenishment from the issuance of AT1 capital securities during the year. The Group remains committed to balancing growth in risk-weighted assets ("RWAs") with enhancement in returns, with total RWAs rising only 0.2% in 2018.

The Group has established a long-term capital plan to optimise its capital structure and control the growth of its RWAs, so as to meet more stringent regulatory requirements and support better planning for the major strategic initiatives of the Group.



Liquidity Coverage Ratio and Net Stable Funding Ratio

	2018	2017
Average value of liquidity coverage ratio		
First quarter	134.33%	121.41%
Second quarter	146.39%	123.88%
Third quarter	141.44%	121.12%
Fourth quarter	160.23%	135.64%

	2018
Quarter-end value of net stable funding ratio	
First quarter	118.98%
Second quarter	118.82%
Third quarter	122.24%
Fourth quarter	124.41%

The Group's liquidity position remained sound, with the average value of liquidity coverage ratio and the quarter-end value of net stable funding ratio exceeding the regulatory requirement for all four quarters of 2018.

Management Discussion and Analysis

Business Review

In 2018, the Group adhered to its strategy of “Building a Top-class, Full-service and Internationalised Regional Bank”. It seized market opportunities for development, leveraged its competitive advantages and steadily pushed forward its key business priorities. Its core businesses realised satisfactory growth, with major financial indicators remaining at solid levels. During the year, the Group optimised its integrated regional business model and promoted the integration of its Southeast Asian entities, which led to increased regional synergies. It remained committed to developing the local market in Hong Kong, upgrading its product and service levels and strengthening the construction of its diversified business platforms, resulting in continuous refinement to its business structure. Through deepened collaboration with BOC Group, the Group actively expanded its cross-border businesses and pushed forward the development of the Guangdong-Hong Kong-Macao Greater Bay Area with the aim of becoming the first-choice bank in the Greater Bay Area. It also stepped up innovation in financial technology (“fintech”), strengthened O2O integration and upgraded the customer experience with intelligent products and services in order to become a customer-centric digital bank. It accelerated the pace of innovations and rapidly refined its systems and mechanisms so as to further enhance its innovative capacity.

Business Segment Performance

Profit before Taxation by Business Segment

HK\$'m, except percentages			(Restated)		Change (%)
	2018	% of total	2017	% of total	
FROM CONTINUING OPERATIONS					
Personal Banking	10,269	26.3	8,403	23.7	22.2
Corporate Banking	14,087	36.1	14,392	40.7	(2.1)
Treasury	11,884	30.5	9,525	26.9	24.8
Insurance	937	2.4	1,401	4.0	(33.1)
Others	1,811	4.7	1,654	4.7	9.5
Total profit before taxation	38,988	100.0	35,375	100.0	10.2

Note: For additional segmental information, see Note 47 to the Financial Statements.



Personal Banking

Financial Results

Personal Banking achieved a profit before tax of HK\$10,269 million in 2018, an increase of HK\$1,866 million or 22.2% year-on-year, mainly driven by an increase in net interest income and net fee and commission income, and a lower net charge of impairment allowances.

Net interest income increased by 17.3%. This was mainly driven by an increase in the average balance of deposits and loans along with an improvement in the deposit spread. Net fee and commission income increased by 8.0%, which was attributable to the Group achieving satisfactory performance in its insurance and securities brokerage business, including growth in commission income. Operating expenses rose by 10.2%, mainly due to an increase in staff costs and business-related expenses. The net charge of impairment allowances decreased, owing to the Group having taken a prudent approach on impairment allowances for a certain loan portfolio in 2017, thus resulting in a higher base for comparison.

Business operations

Providing exclusive and customised services to mid- to high-end customers

Striving to be customer-centric at all times, the Group catered for customers' various needs and behaviours by providing exclusive and customised services to mid- to high-end customers. As part of its efforts to enrich its services and customer experience across different channels, the Group strengthened the internet and mobile banking platforms for its securities, funds and other investment trading services during the year so as to enhance customer convenience. In addition, the Group provided customers with differentiated and privileged services at its high-end wealth management centre. The Group also enriched its value-added services, including hosting the Worldwide Wealth Management Expo 2018, in order to deepen customer relationships and enhance brand image. In 2018, the Group further refined its customer structure with the number of mid- to high-end customers growing by 17.5% from the end of 2017.

The Group's private banking business maintained satisfactory growth, acquiring high-net-worth clients from Hong Kong, the Chinese mainland and overseas. It optimised its open platform for private banking and enhanced the development of exclusive private banking products. It strengthened its private banking team and actively participated in the development of the private banking industry by supporting the Pilot Apprenticeship Programme for Private Wealth Management, that was held specifically for university students and was jointly organised by the HKMA and the Private Wealth Management Association, to provide training to wealth management talent. The number of private banking clients grew by 27.3% from the end of 2017 and the AUM also grew satisfactorily.

Management Discussion and Analysis

Addressing livelihood banking needs

With the largest retail branch network in Hong Kong, the Group stepped up the enhancement of its products and services so as to develop comprehensive financial service capabilities to facilitate general livelihood needs. To support the measures for improving people's livelihood promoted by the HKSAR government, the Group offered to receive applications relating to the retirement annuities scheme through more than a hundred of its branches. The Group continued to work alongside the Hong Kong Mortgage Corporation Limited in refining the Reverse Mortgage Programme with the launch of the Reverse Fixed-Rate Mortgage Scheme, thus making the Group the largest service provider of the Reverse Mortgage Programme in Hong Kong. It also introduced service packages for deposits, life insurance and payroll accounts with the theme of "My First hassle-free banking experience", in order to cultivate younger customers' awareness of the importance of sensible saving and consumption habits. It continued to support the Child Development Fund organised by Labour and Welfare Bureau of the HKSAR government by opening personal savings deposit accounts for participants of the fund with waiver on minimum deposit balance. The Group also actively promoted the development of inclusive finance with the launch of a free service, EPS EasyCash for Senior Citizens, which offers easy and convenient means of cash withdrawal to senior citizens. This service has been gradually expanded to major regions in Hong Kong. The Group also provided members of New Home Association with complimentary banking services, so as to meet the financial needs of new immigrants and facilitate their integration into the Hong Kong community.

Proactively supporting the development of local small enterprises

The Group strengthened its cooperation with foreign chambers of commerce and professional associations in order to proactively support the development of local small enterprises. It provided customers with BOC "Small Business Loans" unsecured loans, corporate tax loans, and one-stop business financial packages, coupled with Faster Payment System ("FPS"), WeChat Pay and other innovative mobile payment tools, thus fulfilling customers' full range of financial needs. Supporting the HKMA's call to encourage overseas enterprises to conduct business in Hong Kong, the Group provided targeted companies with services such as a 24-hour overseas company servicing hotline, an online chat service and various overseas company account opening packages, with the aim of solving account opening challenges. In addition, the Group launched BoC Bill, an integrated payment collection service for SMEs which covers various types of online and offline payment tools, in order to help merchants to cope better in their daily operations. The total number of business integrated accounts for small enterprises increased by 15.7%. During the year, BOCHK received the SME Partner Awards of Excellence 2018 in Retail and Business Integrated Services, organised by *Hong Kong Economic Journal*.

Promoting integrated development and collaboration in the Greater Bay Area to expand featured cross-border services

The Group actively participated in the building and development of the Belt and Road and the Guangdong-Hong Kong-Macao Greater Bay Area. To assist in building the Greater Bay Area into a high-quality lifestyle destination, it enhanced self-services by providing branch network in Hong Kong International Airport, Hong Kong West Kowloon Rail Station (the terminus of the Guangdong-Shenzhen-Hong Kong Express Rail Link) and the Hong Kong-Zhuhai-Macao Bridge. To address the needs of residents in Guangdong, Hong Kong and Macao for financial services, including payment, wealth management and financing, the Group accelerated the development of cross-border banking products and services through mutual brand recognition, BOC Dual Currency Card, BoC Pay mobile App and an RMB cross-border direct remittance service. All of these initiatives were made to promote the Greater Bay Area as a high-quality lifestyle destination that is ideal for living, working and travelling. The total number of BOC Dual Currency Card in issue reached 208,000 and number of cross-border customers increased by 22.6%. During the year, the Group was honoured with the Sing Tao Excellent Services Brand Award – Cross-border Banking Services Award by *Sing Tao Daily*.



Steady growth in deposit and loan business with an increase in fee and commission income

In line with trends in market interest rates, the Group devoted efforts to acquiring deposits in different currencies and optimising deposit tenors. At the same time, the Group grew its current account and savings deposit businesses via payroll services, wealth management and integrated payment solutions through collaboration between the personal and corporate banking segments. As at the end of 2018, total personal deposits grew by 8.9% compared to the end of the previous year. Regarding its loan business, the Group further uplifted the brand image of BOCHK Mortgage Expert and set up seven mortgage centres with experienced mortgage specialists to provide one-stop professional mortgage services. It maintained second position in the market in terms of the total number of new residential mortgage loans and captured the largest market share in the reverse mortgage market. To cope with market volatility and uncertainty, the Group enriched its range of investment and insurance products by providing annuity plans and integrating the concepts of retirement planning and wealth inheritance into its life insurance business, thus providing all-round protection solutions to customers. To cater for the rapid growth in customers' demand for online transactions, the Group accelerated the development and application of digital services with the launch of a securities trading platform for US stocks and fund distribution service in mobile banking. These initiatives, coupled with the full coverage of an integrated insurance mechanism in all branches, helped enhance customers' investment experience and further expanded the Group's source for fee and commission income.

Promoting digital innovation to foster the advancement of green banking

Embracing the "New Era of Smart Banking" advocated by the HKMA, the Group stepped up innovation in fintech and dedicated efforts to enhancing the financial ecosystem in Hong Kong. During the year, it pushed forward digital applications in its branches and enhanced its iService offering by providing an all-weather video banking service to customers. It steadily pushed forward the development of its next-generation smart branches by setting up the Science Park Banking Services Centre, featuring a new process of customer service. In line with the FPS introduced by the HKMA, the Group offered customers with 24/7 real-time interbank and payment services. To enhance banking service experience, it launched finger-vein authentication to provide high security authentication without the need for password login. The Group also encouraged the development of green banking through the digitalisation of business processes and the increased promotion of paperless operations, leading to larger-scale implementation of the green banking concept.

Advancing regional development in Southeast Asia

The Group continued to enhance the regional development of its Southeast Asian entities. Based on the characteristics of different countries, the Group implemented matrix management and differentiated development strategies. Segment by segment, it deployed its business development strategy to its Southeast Asian entities and continued to refine its business organisation structure. It pushed forward its regional product management in an orderly manner and enhanced regional risk management. During the year, the Group also enhanced its capability for serving mid- to high-end customers with the setup of a wealth management model in BOC Malaysia to offer exclusive and all-round financial services solutions, including a variety of funds, insurance, bonds and other wealth management products. The Group successfully expanded its personal banking service network to Thailand, Malaysia, Vietnam, the Philippines, Indonesia, Cambodia and Brunei and further accelerated the integration progress of its Southeast Asian entities.

Innovation in credit card business

Although Hong Kong retail consumption growth slowed down in the second half of 2018, new impetus for retail spending emerged from the development of the Guangdong-Hong Kong-Macao Greater Bay Area, the penetration of mobile payment and e-wallet services, which boosted the Group's cross-border business development, popularity of mobile payments and expansion of the younger customer segment. The Group continuously optimised the BOC Dual Currency Card to meet customer needs in transportation and payments in the Greater Bay Area. In August 2018, the Group launched BoC Pay, the first mobile App introduced by a Hong Kong bank to meet EMV international standards. BoC Bill, an integrated collection service for merchants, was launched in December 2018, making it the first integrated collection platform in Hong Kong that enables merchants to handle QR code payments. During the year, the Group maintained its leadership in the UnionPay card issuing and cardholder spending business in Hong Kong.

Management Discussion and Analysis

Corporate Banking

Financial Results

Corporate Banking achieved a profit before tax of HK\$14,087 million, a decrease of HK\$305 million or 2.1% year-on-year. Net interest income and net trading gain increased. The increase was, however, offset by a drop in net fee and commission income and a rise in the net charge of impairment allowances.

Net interest income increased by 11.4%, owing to an increase in the average balance of loans and deposits, coupled with improvement in the deposit spread. Net fee and commission income decreased by 21.1%, mainly due to a decrease in loan commissions, which was partially offset by an increase in commission income from trust and payment services. Net trading gain increased by 13.2%, owing to growth in currency exchange income from customer transactions. The net charge of impairment allowances amounted to HK\$784 million, as compared to a net charge of HK\$73 million in 2017, mainly reflecting the impact from loan growth and the downgrading of certain corporate advances.

Business operations

Continuous expansion of customer base and enhancement of integrated service capabilities

The Group remained committed to expanding its customer base and deepening relationship with its corporate clients. For targeted customer groups, including BOC's global strategic clients and large corporates from Hong Kong, Southeast Asia and other overseas countries, it provided exclusive, customised and integrated financial solutions to meet client demand for sophisticated financial services. By providing comprehensive services, the Group was able to attract more potential customers from different industries, thus enhancing its synergistic service capabilities and creating an excellent customer experience. The Group reinforced its competitive edge and promoted the development of its commercial banking and investment banking business. It remained the top mandated arranger in the Hong Kong and Macao syndicated loan market for the 14th consecutive year with a total loan arrangement volume of US\$9.6 billion, representing a market share of 8.0%, and successfully underwrote a number of bond issues with significant market influence. Moreover, the total amount of funds raised from IPOs in which the Group served as the main receiving bank reached HK\$235.5 billion, representing a market share of 82.9% and retaining its market leadership for the eighth consecutive year. At the same time, it entered into a number of service contracts with the HKSAR government through bidding process, and continued to establish relationships with a number of major central banks, national treasuries and sovereign wealth funds.

Proactive development of commercial and SME customer base

The Group continued to improve its services to commercial customers in Hong Kong by deepening relationships with family-owned businesses, chambers of commerce and listed companies and helping them by establishing a convenient and effective financial service platform. Its service capabilities for local corporate clients were also enhanced through its integrated payment and settlement product and service package, which offers a superior customer experience. To cater for SME customers' demands for financial services, the Group provided convenient services through its branch network, the largest in Hong Kong, and actively promoted the SME Financing Guarantee Scheme to support the development of Hong Kong's SMEs. BOCHK won the Best SME's Partner Gold Award 2018 for the second consecutive year from the Hong Kong General Chamber of Small and Medium Business. It also received the SME Partner Awards of Excellence 2018 – Guangdong-Hong Kong-Macao Greater Bay Area Commercial Banking Services from *Hong Kong Economic Journal*, in recognition of its support of the development of the SME business community in the Greater Bay Area and its continuous optimisation in cross-border commercial banking services.



Promoting business development in Southeast Asia and the Greater Bay Area

The Group accelerated the improvement of its regional management capabilities and continued to optimise its management model and mechanism. It strengthened collaborative marketing with its Southeast Asian entities so as to acquire high-quality and influential local clients, and successfully participated in a number of major projects in Southeast Asia. It further integrated competitive products and services from Hong Kong into its Southeast Asian entities' local franchises, to help them expand into local mainstream markets. During the year, the Group enhanced BOCHK's brand image and business development in Southeast Asia by actively participating in relevant investment-related promotional activities organised by the HKSAR government and the governments of Southeast Asian countries. In order to capture the enormous business opportunities arising from the development of the Guangdong-Hong Kong-Macao Greater Bay Area, the Group strengthened its collaboration with BOC Group's entities in the Greater Bay Area via four major aspects in cross-border activities, including people flow, commodities flow, fund flow and information flow and established an integrated marketing and services system, with a view to providing a full range of financial services in support of the mutual access of infrastructures within the Greater Bay Area and boosting the development of corporates within the area's technological innovation industry. At the same time, the Group joined hands with the Hong Kong Chinese Enterprises Association and the Chinese Banking Association of Hong Kong to host the Guangdong-Hong Kong-Macao Greater Bay Area Financial Summit Forum, with an aim to strengthening financial cooperation within the Greater Bay Area and driving the synergistic development of Guangdong, Hong Kong and Macao.

Constantly enhancing the competitiveness of corporate banking products and services

The Group continuously upgraded its service capabilities. Following the live launch of the FPS introduced by the HKMA, it remained customer-centric and enhanced the comprehensive and scenario-based applications of its products and services. By accelerating the regional development of its key businesses including cash pooling and treasury centre, and upgrading the competitiveness of its products and services, the Group was able to fully serve customers in Hong Kong, the Chinese mainland and Southeast Asia. In recognition of its excellent and highly professional services, the Group was named Hong Kong Domestic Cash Management Bank of the Year for the fifth consecutive year by *Asian Banking & Finance* and received the Achievement Award for Best Trade Finance Bank in Hong Kong as well as Best Corporate Trade Finance Deal in Hong Kong for the second year from *The Asian Banker*.

Continuous expansion in custody business

In 2018, global investment markets experienced a persistent downward trend amid heightened volatility, which posed challenges to the asset servicing industry. The Group continued to capture opportunities arising from various market links to connect with more local and overseas institutions through Bond Connect. Its market share continued to eclipse its peers, with the value of the Group's assets under custody relating to Bond Connect at one point exceeding RMB16.8 billion. BOCHK was awarded the Bond Connect Best Custodian by Bond Connect Company in recognition of its satisfactory overall services. Meanwhile, the Group's insurance and pension-type client segments exhibited steady expansion, while sovereign-type clients grew and demand for escrow services on assets was robust. This, coupled with active business collaboration within the Group, meant that the Group's custody business achieved substantial growth in its key performance indicators compared to last year. At the same time, risk control standards were further enhanced. In recognition of its professional service, the Group was awarded Best Custodian – QDII (China) and Best QDII Mandate in *The Asset's Triple A Asset Servicing, Institutional Investor and Insurance Awards 2018*. The Group also proactively contributed to the preparation of Chinese Depository Receipts as well as to the service requirements of the Greater Bay Area. As of the end of 2018, the Group's total assets under custody amounted to HK\$1,098.4 billion.

Management Discussion and Analysis

Treasury

Financial Results

Treasury recorded a profit before tax of HK\$11,884 million, an increase of HK\$2,359 million or 24.8% year-on-year. The growth was driven by an increase in net interest income, net trading gain and net gain on other financial instruments at fair value through profit or loss.

Net interest income increased by 4.7%, which was mainly attributable to an increase in the average balance of debt securities investments and an increase in the average yield of related assets caused by a rise in market interest rates. The treasury business recorded a net trading gain in 2018, as compared to a net loss last year. This was due to a net gain from foreign currency swap contracts in 2018, as compared to a net loss last year. There was also a net gain on other financial instruments at fair value through profit or loss, as compared to a net loss last year. These positive developments were, however, partially offset by a lower net gain on other financial assets.

Business Operations

Constant enhancement of trading and service capabilities

The Group continued to strengthen its market research capabilities and actively responded to market changes. It made its best efforts to promote business diversification and conducted stringent risk control measures. It steadily improved its pricing and trading capabilities by strengthening its trading system infrastructure and continuously refining its electronic trading platform. Adhering to a customer-oriented principle, the Group advanced the development of innovative products and further enriched product lines to meet client needs. By leveraging its expertise, capitalising on market opportunities, expanding its customer base and elevating service quality, the Group achieved rapid growth in customer trading business. It also actively promoted its regional development, making continuous efforts to enhance the development framework for its treasury business in Southeast Asia. In recognition of its treasury business performance, BOCHK was named the Best Overseas Member of Interbank FX Market in 2017 by the China Foreign Exchange Trade System. It received the Best Local Currency Bond Award from *Global Capital*, Gold and Precious Metals Bank of the year – Hong Kong from *Asian Banking & Finance*, and the 2017 Outstanding International Member Award from the Shanghai Gold Exchange. BOCHK also won the Key Business Partner in FIC Market award at the 5th Annual RMB Fixed Income and Currency Conference, organised by HKEX.

Proactive expansion in banknotes business

Drawing on its expertise in the wholesale banknotes business, the Group captured market opportunities and strengthened the development of its banknotes business in the Asia Pacific region, becoming a major bank to provide foreign currency banknotes in Hong Kong and further reinforcing its market leadership in the local banknotes business. By establishing a flexible and efficient cash banknote operating mechanism in the Chinese mainland market, the Group successfully won bids for a number of foreign currency banknote tenders from its mainland peers. As a result, it maintained steady growth of its market share in the Chinese mainland. In addition, it actively and firmly pushed forward its regional development strategy to gradually increase its business scale in overseas markets, including Southeast Asia.



Consolidating competitive advantages in RMB clearing business

The Group leveraged its strong franchise in RMB business to reinforce its leading market position. BOCHK was appointed by China Securities Depository and Clearing Corporation Limited as the sole clearing bank in Hong Kong to support H-share full convertibility. In line with the Phase II construction of the CIPS by the People's Bank of China, BOCHK successfully launched its CIPS Phase II project. This provides a longer operation window through the CIPS channel and connects with the new Deferred Net Settlement ("DNS") mechanism, further enhancing the capability and efficiency of the Clearing Bank in terms of RMB cross-border fund clearing and thus reinforcing BOCHK's leadership in the offshore RMB market. In addition, in order to meet the demand from the local market in Hong Kong for highly efficient payment services, BOCHK launched a 24/7 round-the-clock RMB FPS clearing service, making RMB the only currency other than HKD to support FPS.

A proactive but risk-aware investment strategy

The Group continued to take a cautious approach to managing its banking book investments by closely monitoring market changes and seeking investment opportunities to enhance return while remaining alert to risk. During the year, the Group adjusted its investment portfolio to respond to changes in interest rates and to achieve solid returns.

Steady growth in asset management business

BOCHK Asset Management Limited ("BOCHK AM") actively captured development opportunities and achieved steady growth in many areas. Despite major fluctuations in investment markets, its AUM at the end of 2018 grew steadily compared to the end of 2017, with AUM growth of private funds exceeding 60%. During the year, the Group's major bond portfolios outperformed the market. The performance of its bond funds, such as the BOCHK All Weather China High Yield Bond Fund, was better than that of most market peers. As part of its efforts to proactively promote innovation in fund products, BOCHK AM launched two new public funds and four new private funds to meet the investment needs of different client segments. In addition, BOCHK AM gained new clients and deepened business relationships with existing clients. New discretionary managed accounts were established during the year, with a number of institutional clients increasing their investments in BOCHK AM's funds. Meanwhile, it continued to lay the foundation for growth in cross-border funds distribution. The BOCHK All Weather Hong Kong Equity Fund was approved for distribution in the Chinese mainland, becoming the second northbound fund under the Mainland-Hong Kong Mutual Recognition of Funds scheme ("MRF"). This new fund will be launched for public distribution in the Chinese mainland in due course. In recognition of its market and industry expertise, BOCHK AM was awarded Best China Fund House in Hong Kong and Best Offshore RMB Bond Performance (3 years) in the 2019 Best of the Best Awards organised by *Asia Asset Management*.

Steady growth in trustee business and technological upgrades to services

The Group provides trustee and fund administration services for occupational retirement schemes and Mandatory Provident Fund schemes, as well as trustee and custodian services for unit trusts, through its subsidiary, BOCI-Prudential Trustee Limited ("BOCI-Prudential Trustee"). In 2018, BOCI-Prudential Trustee made technological improvements and upgrades to its MPF services by launching the BOCHK ORSO App, revamping the MPF website to provide a better customer experience, designing and developing a chatbot, and reprogramming the MPF App with the aim of establishing MPF straight-through processing. The AUM of MPF maintained steady growth, with the monthly average value in 2018 increasing by 11.6% from that of 2017. In 2018, BOCI-Prudential Trustee was recognised on its outstanding fund performance and innovative technological strength. BOCI-Prudential Trustee's My Choice MPF Scheme and BOC-Prudential Easy-Choice MPF Scheme received multiple accolades at the MPF Awards 2018, organised by MPF Ratings. It also received the Best Group Over 3 Years – Overall and multiple fund awards at the 2018 Lipper Hong Kong Fund Awards, organised by Thomson Reuters, as well as a number of fund awards at events such as the Top Fund Awards 2018 organised by *Bloomberg Businessweek* and the Fund of the Year Awards 2018 organised by *Benchmark*.

Management Discussion and Analysis

Insurance

Financial Results

In 2018, the standard new insurance premium of the Group's insurance segment was HK\$9,240 million, up 8.2% year-on-year. The value of new business was HK\$1,161 million, an increase of 36.4% year-on-year. Profit before tax was HK\$937 million, down 33.1% year-on-year. This decrease was mainly attributable to losses recorded in equity securities and bond fund investments amid the downturn in investment markets. The loss was, however, partially offset by higher net interest income and reinsurance income.

Business Operations

Proactive application of insurtech to improve customer experience

In 2018, an innovative artificial intelligence chatbot service, Easy Chat, was launched to answer customers' enquiries on claims and certain policy-related matters. This helped to develop and activate the younger customer segment, and enhance the Group's corporate image and operational efficiency. The Group also promoted interaction with customers using social media platforms, including the launch of the brand new BOC Life WeChat Official Account and two Facebook pages (BOC Life and BOC Life Wealth Management Team). During the year, the Group launched eClaims to allow customers to enjoy easy and rapid claims services. In line with the FPS introduced by the HKMA, BOC Life was among the first cohort of companies to adopt the instant transfer function for both premium collection and claims payment.

Maintaining a leading position in RMB insurance business, recognised for service quality and financial strength

In November 2018, Moody's Investor Service upgraded the insurance financial strength rating of BOC Life from A2 to A1, reflecting BOC Life's track record of good profitability, a stable solvency ratio, solid capitalisation and well-diversified distribution channels, leading to an increase in the value of new business. In 2018, the Group maintained its leading position in Hong Kong's life insurance market and remained the market leader in RMB insurance business. In recognition of its service quality and professional image, BOC Life received a number of local and regional awards in 2018, including the Cross Border Insurance Services – Excellence, Annuity Plan – Outstanding, Customer Service – Outstanding and Claims Management – Excellence awards in *Bloomberg Businessweek's* Financial Institution Awards 2018; and the Outstanding Insurance Business – Customer Service Award (Hong Kong China) and Annuity Award (Hong Kong China) in the 2018 RMB Business Outstanding Awards, jointly organised by Metro Finance and Hong Kong Ta Kung Wen Wei Media Group.

Enhancement and innovation of product and service packages

In 2018, the Group launched new products in line with market trends. Based on the success of the SmartUp Whole Life Insurance Plan series, the Group introduced an enhanced version of SmartUp Plus Whole Life Insurance Plan as well as a new SmartGuard Critical Illness Plan in order to increase the value of the new business. A new annuity product, Smart Immediate Annuity Plan, was also launched to cater for customers' needs for annuity products and retirement protection. The Group joined up with new sales channels by launching its first product for critical illness protection, AlongPro Critical Illness Plan, on the WeChat Pay HK and AlipayHK electronic payment platforms. This product was also launched on BOC Life's online platform, in order to attract customers using mobile devices. To strengthen its service packages, the Group relaxed the underwriting limits of Forever Glorious ULife Plan (Simplified Underwriting) and expanded the appointed hospital list in the hospitalisation plan, so as to fully meet customers' needs.

BOC Life's 20th anniversary brand promotions

The year 2018 marked the 20th anniversary of BOC Life. The Group title-sponsored a number of TV programmes and launched a series of promotional initiatives to raise awareness of the Group's life insurance business and to further strengthen its brand image.



Regional Business

Improving Southeast Asia development strategy with the aim of building mainstream foreign banks in the region

Southeast Asia has remarkable development potential, both as a core focus of China's Belt and Road Initiative, as a market for RMB internationalisation and as a target region for Chinese enterprises' "Going Global" efforts. The Group attached great importance to the opportunities that lies in advancing its asset restructuring in Southeast Asia and accelerating its self-development, in line with its steadfast commitment to building a top-class, full-service and internationalised regional bank. The Group has developed a strong franchise and deep, market-oriented management experience through a century of service in Hong Kong. Now acting as the regional hub for Southeast Asia, the Group fully leveraged these advantages and introduced its competitive products and services, advanced technology and management, and professional talent teams from Hong Kong to Southeast Asia. BOCHK also invested in its Southeast Asian entities by providing capital, subordinated loans and working capital to support their long-term development. The Group actively developed an advanced and efficient regional management model and, on the basis of integrated operations, fully leveraged its competitive advantages in capital funding, products, management and talents in order to upgrade its competitiveness and development quality in the Southeast Asian region.

Accelerating logical integration and continuously refining regional management model

The Group successfully completed the acquisition of the Philippines Business and Vietnam Business of BOC on 29 January 2018. On 4 December 2018, it entered into agreement with BOC in relation to the acquisition of BOC Vientiane Branch and subsequently completed the acquisition on 21 January 2019. BOCHK has developed into a regional bank with initial operating entities in eight Southeast Asian countries, including Thailand, Malaysia, Vietnam, the Philippines, Indonesia, Cambodia, Laos and Brunei. The Group continued to push forward logical integration and stepped up its efforts to promote the integration of the business mechanisms, systems, personnel and culture of its Southeast Asian entities. It adopted an integrated regional management model according to the business characteristics of the front, middle and back offices. Differentiated arrangements were made regarding approval authorisation, resource allocation, personnel management, performance appraisal and daily operations. The frontline units further refined their differentiated regional business positioning and management models, so as to implement integrated operational and management objectives. The middle office units strengthened the internal risk and compliance control of the Southeast Asian entities, in order to effectively improve their overall internal risk control and anti-money laundering capabilities. The back offices enhanced regional administration and resource support in order to improve the operational capacity and technological strength of back office operations across Southeast Asia.

Promoting solid Southeast Asian business development and achieving continuous growth in operating results

The development of the Group's Southeast Asia business achieved satisfactory results in 2018. Net operating income before impairment allowances of its Southeast Asian entities* was HK\$2,287 million, a growth of 27.6% year-on-year. At the end of 2018, deposits from customers and advances to customers amounted to HK\$45,398 million and HK\$39,198 million, up 17.1% and 20.0% respectively from the end of 2017. The non-performing loan ratio was 1.14%, down 0.04 percentage points from the end of 2017.

* Referring to the seven Southeast Asian entities, including BOC Thailand, BOC Malaysia, Ho Chi Minh City Branch, Manila Branch, Jakarta Branch, Phnom Penh Branch and Brunei Branch. Net operating income before impairment allowances, the balance of deposits from customers and advances to customers represented the consolidated data which were prepared in accordance with Hong Kong Financial Reporting Standards. Non-performing loan ratio was calculated in accordance with local regulatory requirements.

Management Discussion and Analysis

In the corporate banking business, the Group actively promoted the marketing and expansion of its Belt and Road related projects, including those relating to road and bridge development infrastructure, telecommunications equipment, energy and petroleum, and aviation facilities. It also established a regional relationship manager system and continued to promote the integrated management of customer development and project marketing by analysing the distribution of “Going Global” enterprises in Southeast Asia and the trend of industrial transfers in the Asia-Pacific region, so as to capture development opportunities from these customers and key projects. The Group also actively expanded its business with institutional clients, promoting RMB products and treasury operations. BOC Malaysia was officially designated as the RMB settlement bank for Labuan Island, the offshore international financial centre of Malaysia. The Manila Branch, meanwhile, supported the Central Bank of the Philippines in successfully issuing its first sovereign Panda bonds, amounting to RMB1.46 billion, in China’s interbank bond market. It also initiated the establishment of the Philippine Association of Renminbi Traders, the first self-governed financial organisation outside China to deal in RMB and local currencies, and completed the first direct exchange of RMB against the Philippines Peso in the Philippines market on 20 November 2018.

In the personal banking business, the Group continued to build up its product and service capabilities in Southeast Asia by enhancing its infrastructure and implemented differentiated management approaches. It also strengthened customer positioning and management by allocating suitable products and personnel to support business development and increase revenues. During the year, BOC Malaysia obtained a fund business license and launched two housing loan insurance products. The Jakarta Branch launched a cross-border RMB direct remittance product and set up a personal banking wealth management centre. The Phnom Penh Branch launched money collection services on POS and WeChat Pay.

Promoting regional risk management using the Three Lines of Defense and Take-the-Most-Stringent-Approach principle to achieve healthy and sustainable development

The Group promoted regional risk management on the basis of the Three Lines of Defense and the Take-the-Most-Stringent-Approach principle, actively pushing forward the full implementation of its risk management framework and stepping up the construction of the management structure and personnel deployment of its Southeast Asian entities. It comprehensively strengthened its Southeast Asian entities’ management of credit risk, internal control and compliance. By closely monitoring market and liquidity risk in the Southeast Asian market, these entities were able to enhance their emergency handling capabilities and conduct anti-money laundering measures under the most stringent regulatory requirements. By comprehensively enhancing their risk compliance and control capabilities, the Southeast Asian entities will lay a solid foundation for high-quality development, operate in accordance with the standards stipulated by the Group, and ensure compliance with the regulatory requirements of the HKMA and local regulatory bodies.

In conjunction with the Group’s implementation of the Southeast Asian Institutional Risk Management Framework, the Group promoted anti-money laundering management in Southeast Asia through related policies and systems, organisational structures, professional staffing and technological systems, with a special focus on system application. The Group also adopted effective measures to gradually improve the credit policies, credit models, loan approval processes, loan time and post-lending management of its Southeast Asian entities, and to continuously strengthen the Group’s capabilities in regional credit risk management.



Fintech and Innovations

Adhering to the concept of “navigated by technology, driven by innovation”, the Group strived to enhance the competitiveness of its fintech to support business growth. It actively participated in and encouraged the development of innovative technologies, and continued to increase the application of artificial intelligence, big data, blockchain and open API to provide customers with more comprehensive, more efficient and more intelligent banking services. At the same time, the Group accelerated its pace for innovation and refined mechanism to further enhance its innovative capacity.

In line with BOC Group’s global strategic IT deployment, the Group completed BOC Group’s system integration project on 1 April. Putting customers first, the Group completed the system upgrade within the expected timeframe and operation ran smoothly afterwards.

The Group made proactive efforts to promote the enhanced version of its mobile banking service. In March, the enhanced version of Mobile Banking 3.0 was officially launched, with an optimised user interface and design and upgraded intelligent functions. It offers more than 200 mobile banking service functions with over 110 customer experience enhancements, including Hong Kong and US stocks trading, online investment account opening, mobile token and FPS. The Group also became the first bank in Hong Kong to launch a mobile fund investment service. Moreover, it met customer needs in fund transfer, investment, foreign exchange, payment and security. The number of mobile banking customers and active customers grew by 41.7% and 63.5% respectively from the end of 2017, with a 70.6% increase in the young customer segment (aged 18-35) acting as a key driver.

The Group successfully rolled out its FPS project according to requirements of the HKMA, with an official launch in September. This offers personal and corporate customers a brand new experience for HKD and RMB real-time interbank transfer and cross-platform collection and payment solutions, catering to individuals’ payment needs in daily life. It successfully cooperated with a number of major clients in the household, retail and telecommunication industries and led the market in terms of customer acquisition rate and transaction volume.

The Group officially launched the BoC Pay in August, the first mobile App in Hong Kong to provide local and cross-border retail and bill payment, and support local interbank transfer. BoC Pay enables customers to make QR code payments to 9.5 million merchants in the Chinese mainland, 600,000 merchants in the Greater Bay Area and more than a thousand merchants in Hong Kong.

The Group introduced BoC Bill, an integrated collection platform that provides merchants with integrated collection services by supporting different payment channels. The first platform in Hong Kong to enable merchants to handle QR code payments, it caters more than 3,000 retail outlets in Hong Kong, covering different areas including daily living and leisure activities. BoC Bill addresses merchants’ business needs and caters for consumers’ preferred payment methods, which effectively helps to enhance merchants’ competitive edge.

During the year, the Group established the Innovation and Optimisation Centre to promote innovative development of products, services and business models that better satisfy customer needs and meet the changing requirements of the competitive environment. Adopting an internet-first mindset to enhancing the improvement and development of fintech and banking products, the Group completed pioneering prototypes and feasibility analysis of new technologies, business models, products and services, thus advancing innovative projects in an orderly manner and improving overall resilience. The Group deepened communications with venture companies, strengthened cooperation in innovation projects and proactively participated in BOC’s product and technological innovations. It helped to create an innovative atmosphere and culture by sponsoring the first Hong Kong B2B eCommerce Youth Festival and hosting the BOCHK Fintech Hackathon, which fostered fintech talent and enhanced the Group’s influence among the younger customer segment.

Management Discussion and Analysis

The Group also continuously improved its technology risk and cybersecurity capabilities by implementing multi-dimensional cybersecurity measures and enhancing its protection on information security and cybersecurity control in order to provide itself and its clients with safer and more stable operations and services.

In recognition of its innovation achievements in technology and IT development, BOCHK received the Service Innovation of the Year – Hong Kong award for the first time, the Mobile Banking Initiative of the Year – Hong Kong award for the fourth consecutive year and the Digital Banking Initiative of the Year – Hong Kong award for the third consecutive year in the 13th Retail Banking Awards organised by *Asian Banking & Finance*.

Outlook and Business Focus for 2019

The global economy will face a number of challenges in 2019, including rising trade protectionism, a contraction in liquidity and financial market volatility. According to the forecasts of International Monetary Fund, global economic growth for the year is projected to slow to 3.5%. The US economy is expected to maintain positive growth, albeit at a slower pace. The Chinese mainland economy is expected to continue its growth trend within a reasonable range, in line with the state's guidance for promoting high-quality development, steady growth, active reform, structural adjustment, improvement in people's livelihood and risk prevention. In Southeast Asia, the regional economy is gradually entering into a peak period for the construction of infrastructure projects, which will help foster strong economic growth momentum.

Banks in Hong Kong will face challenges in their operating environment, with Hong Kong's economic outlook expected to be affected by China-US trade friction, the normalisation of Hong Kong dollar interest rates and asset market adjustments. Nevertheless, Hong Kong possesses unique advantages and will continue to play a vital role in the reform and opening-up of the new era in the Chinese mainland. Major national strategies, including the implementation of the Belt and Road Initiative, the steady progress in the development plan for the Guangdong-Hong Kong-Macao Greater Bay Area, and RMB internationalisation will provide more development opportunities for the banking industry in Hong Kong. In 2018, the HKSAR government's Policy Address put forward more than 200 specific measures, which will create a solid foundation for the long-term development of Hong Kong and provide long-term business opportunities for the banking industry.

In view of the opportunities and challenges ahead, the Group remains committed to "Building a Top-class, Full-service and Internationalised Regional Bank" by actively responding to market changes, strengthening its core business development, accelerating its regional development and business transformation, and enhancing product and service innovations while adhering to a high level of risk management, so as to achieve stable, long-term and sustainable development in each of its businesses.

The Group will remain committed to developing the local market and promoting operational and business transformation while adhering to its customer-centric philosophy. The personal banking business will revolutionise its operations by gradually transforming into a RC+P (relationship, channel + product) business model, which is in line with the Group's three goals of transformation, that is, customer-centric, data-driven and agile cooperation. The corporate banking business will focus on improving its comprehensive financial services capabilities. The Group will lend its weight to Hong Kong's economic development, support major projects in Hong Kong, actively expand its customer base and deepen business cooperation with the government and public entities as well as develop financial inclusion so as to fully enhance customers' experience and satisfaction.



Advancement in technology and acceleration in fintech development is another important task of the Group. It will actively promote innovative technology projects, reshape business models and improve innovation mechanisms in order to become a leading digital bank. It will fully embrace the HKMA's seven initiatives for preparing Hong Kong for a "New Era of Smart Banking" and introduce a diversified range of distinctive services.

The Group will seize opportunities arising from the development of the Guangdong-Hong Kong-Macao Greater Bay Area by focusing on the facilitation of people's livelihood and cross-border financial needs and enhancing the competitiveness of its products and services. Based on BOC's *Guangdong, Hong Kong and Macao Greater Bay Area Integrated Financial Services Plan*, it will deepen its collaboration with BOC's entities in the Chinese mainland and overseas countries in order to enhance the quality of its one-stop products and services and its regional service capabilities. The Group will also provide comprehensive support for the mutual connectivity of regional infrastructure projects, industrial transformation and upgrading, technological innovation and international cooperation, with the goal of becoming the first-choice bank for customers in the Greater Bay Area.

The Group will continue to refine its regional management model to promote business development in Southeast Asia. To achieve sustainable and balanced development, the Group will continue to improve its regional management capabilities, reinforce support to its Southeast Asian entities, tailor their business development to local conditions and enrich their product offering with a view to expanding their customer base by attracting customers in countries along the Belt and Road, "Going Global" enterprises, local leading enterprises and high-net-worth clients. The Group will also accelerate the promotion of innovative cross-border RMB products and improve and expand its RMB clearing bank network in Southeast Asia in order to further enhance its leading edge in RMB business. Moreover, it will improve the overall risk management systems of its Southeast Asian entities to ensure that they comply with regulatory requirements.

Credit Ratings

As at 31 December 2018	Long-term	Short-term
Standard & Poor's	A+	A-1
Moody's	Aa3	P-1
Fitch	A	F1

Management Discussion and Analysis

Risk Management

Banking Group

Overview

The Group believes that sound risk management is crucial to the success of any organisation. In its daily operation, the Group attaches a high degree of importance to risk management and emphasises that a balance must be struck between risk control and business development. The principal types of risk inherent in the Group's businesses are credit risk, interest rate risk, market risk, liquidity risk, operational risk, reputation risk, legal and compliance risk, and strategic risk. The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. The Group has a defined risk appetite statement approved by the Board, which is an expression of the types and level of risk that the Group is willing to take in a controllable way in order to achieve its business goals and to meet the expectations of its stakeholders. For details of the Group's risk management governance structure, please refer to Note 4 to the Financial Statements.

Credit risk management

Credit risk is the risk of loss that a customer or counterparty is unable to or unwilling to meet its contractual obligations. Credit risk exists in the trading book and banking book, as well as from on- and off-balance sheet transactions of the Group. It arises principally from lending, trade finance and treasury businesses. For details of the Group's Credit Risk Management, please refer to Note 4.1 to the Financial Statements.

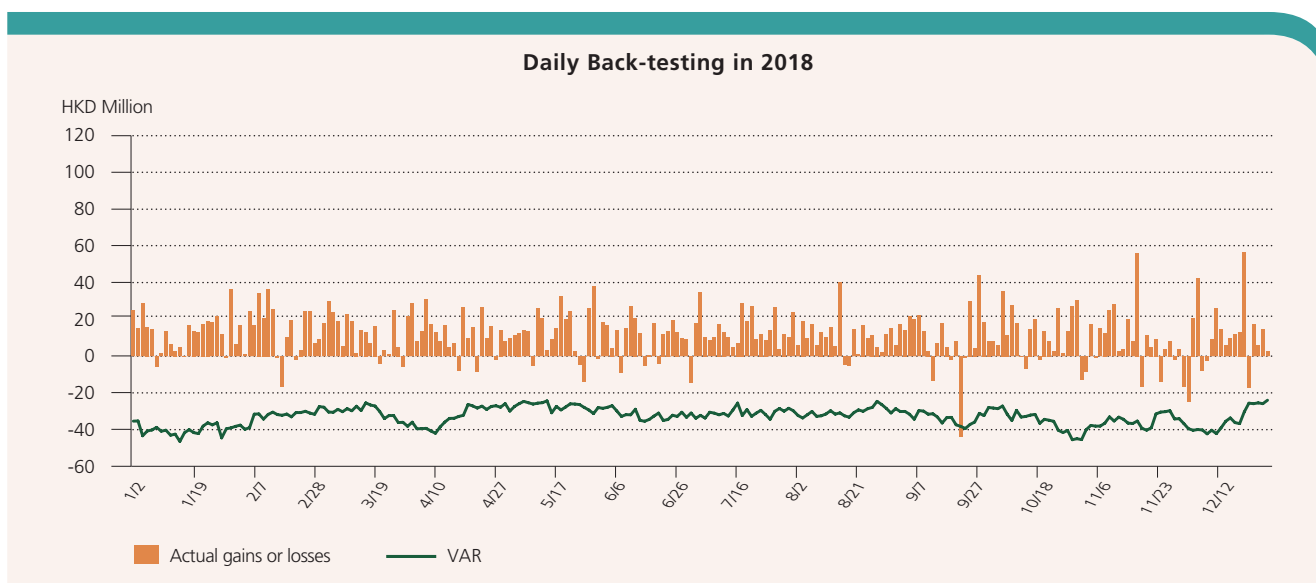
Market risk management

Market risk refers to the risk of loss arising from movements in the value of foreign exchange, interest rate, equity and commodity positions held by the Group due to the volatility of financial market price (foreign exchange rate, interest rate, equity price, commodity price). The Group adopts a moderate market risk appetite to achieve a balance between risk and return. For details of the Group's Market Risk Management, please refer to Note 4.2 to the Financial Statements.

The Group uses the VAR to measure and report general market risks to the Risk Committee ("RMC") and senior management on a periodic basis. The Group adopts a uniformed VAR calculation model, using a historical simulation approach and two years of historical market data, to calculate the VAR of the Group and subsidiaries over a one-day holding period with a 99% confidence level, and sets up the VAR limit of the Group and subsidiaries.



The Group adopts back-testing to measure the accuracy of VAR model results. The back-testing compares the calculated VAR figure of market risk positions of each business day with the actual and hypothetical gains or losses arising from those positions on the next business day. Generally speaking, the number of back-testing exceptions in a rolling 12-month period will not exceed four times, given a 99% confidence level. The graph below shows the back-testing result of the VAR against actual gains or losses of the Group.



There was one actual loss exceeding the VAR for the Group in 2018 as shown in the back-testing results.

Interest rate risk management

Interest rate risk means the risks to a bank's earnings and economic value arising from movements in interest rate and term structures of the bank's asset and liability positions. The Group's interest rate risk exposures are mainly structural. The major types of interest rate risk from structural positions are repricing risk, basis risk, yield curve risk and option risk. For details of the Group's Interest Rate Risk Management, please refer to Note 4.2 to the Financial Statements.

Liquidity risk management

Liquidity risk is the risk that banks may not be able to obtain sufficient and timely funding at reasonable cost to meet their obligations as they fall due. The Group maintains sound liquidity risk appetite to provide stable, reliable and adequate sources of cash to meet liquidity needs under normal circumstances or stressed scenarios; and to survive with net positive cumulative cash flow in extreme scenarios, without requesting the HKMA to act as the lender of last resort. For details of the Group's Liquidity Risk Management, please refer to Note 4.3 to the Financial Statements.

Management Discussion and Analysis

Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal process, people and system, or from external events. The risk is inherent in every aspect of business operations and confronted by the Group in its day-to-day operational activities.

The Group has implemented the “Three Lines of Defence” for its operational risk management. All departments or functional units as the first line of defence are the first parties responsible for operational risk management, and carry out the duties and functions of self risk control in the process of business operation through self assessment and self enhancement. The Legal & Compliance and Operational Risk Management Department (“LCO”), together with certain specialist functional units in relation to operational risk management within the Group, including the Human Resources Department, Information Technology Department, Corporate Services Department, Financial Crime Compliance Department, Financial Management Department, Treasury and General Accounting & Accounting Policy Department (collectively known as “specialist functional units”), are the second line of defence. They are responsible for assessing and monitoring the operational risk conditions in the first line of defence, and providing them with guidance. The LCO, being independent from the business units, is responsible for assisting the Management in managing the Group’s operational risk, including the establishment and review of the operational risk management policy and framework, designing the operational risk management tools and reporting mechanism, and assessing and reporting the overall operational risk position to the Management and RMC. Specialist functional units are required to carry out their managerial duties of the second line of defence with respect to some specific aspects of operational risk and its related issues. Besides taking charge of operational risk management in their own units, these units are also required to provide other units with professional advice/training in respect of certain operational risk categories and to lead the group-wide operational risk management. Group Audit is the third line of defence which provides independent assessment to the effectiveness and adequacy of the operational risk management framework and is required to conduct periodic audit of the operational risk management activities of various departments or functional units within the Group regarding their compliance and effectiveness and to put forward recommendations for remedial actions.

The Group has put in place an effective internal control process which requires the establishment of policies and control procedures for all the key activities. The Group adheres to the fundamental principle of proper segregation of duties and authorisation. The Group adopts various operational risk management tools or methodologies such as key risk indicators, self-assessment, operational risk events reporting and review to identify, assess, monitor and control the risks inherent in business activities and products, as well as purchase of insurance to mitigate unforeseeable operational risks. Business continuity plans are established to support business operations in the event of an emergency or disaster. Adequate backup facilities are maintained and periodic drills are conducted.

Reputation risk management

Reputation risk is the risk that negative publicity about the Group’s business practices, whether genuine or not, will cause a potential decline in the customer base, or lead to costly litigation or revenue decrease. Reputation risk is inherent in other types of risk and every aspect of business operation and covers a wide spectrum of issues.

In order to mitigate reputation risk, the Group has formulated and duly followed its Reputation Risk Management Policy. The policy aims to identify and prevent reputation risk proactively at an early stage when an incident occurs. Since reputation risk is often caused by various types of operational and strategic issues that negatively impact the trust and perception of the Group, all operational and key risks identified are assessed through the established Key Control Self-Assessment framework, including risk assessment tools, to evaluate the severity of their impact on the Group, including the damage to reputation.



In addition, the Group has put in place a comprehensive framework to continuously monitor reputation risk incidents in the financial industry. This continuous monitoring enables the Group to effectively manage, control and mitigate any potential adverse impact from an incident. The Group also adopts robust disclosure practices to keep our stakeholders informed at all times, which helps build confidence in the Group and establish a strong public image.

Legal and compliance risk management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operations or financial conditions of the Group. Compliance risk is the risk of legal or regulatory sanctions, financial losses or losses in reputation the Group may suffer as a result of its failure to comply with applicable laws and regulations. Legal and compliance risks are managed by the LCO, while the risks related to money laundering, terrorist financing and financial crimes including bribery and corruption are independently managed and monitored by the Financial Crime Compliance Department ("FCC"). Both LCO and FCC report directly to the CRO. As part of the Group's corporate governance framework, the policies for the management of legal and compliance risks, and money laundering, terrorist financing and financial crime compliance risks are approved by the RMC as delegated by the Board.

Strategic risk management

Strategic risk generally refers to the risks that may cause current or future negative impacts on the earnings, or capital or reputation or market position of the Group because of poor business decisions, improper implementation of strategies and inadequacies in the response to the changing market condition. The Board reviews and approves the strategic risk management policy. Key strategic issues have to be fully evaluated and properly endorsed by the senior management and the Board.

The Group regularly reviews its business strategies to cope with the latest market situation and developments.

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 Asset and Liability Management Committee ("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.

To comply with the HKMA's requirements as stated in the Supervisory Policy Manual "Supervisory Review Process", the Group adopts the internal capital adequacy assessment process ("ICAAP") and reviews it annually. Based on the HKMA's guidelines on Pillar II, ICAAP has been initiated to assess the extra capital needed to cover the material risks not captured or not adequately captured under Pillar I, and therefore minimum Common Equity Tier 1 capital ratio, minimum Tier 1 capital ratio and minimum Total capital ratio are determined. Meanwhile, operating ranges for the aforementioned capital ratios have also been established which enable the flexibility for future business growth and efficiency of capital utilisation.

Stress testing

The Group supplements the analysis of various types of risks with stress testing. Stress testing is a risk management tool for estimating risk exposures under stressed conditions arising from extreme but plausible market or macroeconomic movements. These tests are conducted on a regular basis by the Group's various risk management units in accordance with the principles stated in the Supervisory Policy Manual "Stress-testing" published by the HKMA. The ALCO monitors the results against the key risk limits approved by the RMC. The Financial Management Department reports the combined stress test results of the Group to the Board and RMC regularly.

Management Discussion and Analysis

BOC Life

BOC Life's principal business underwrites long-term insurance business in life and annuity (Class A), linked long term business (Class C), permanent health (Class D), retirement scheme management category I (Class G) and retirement scheme management category III (Class I) in Hong Kong. Major types of risk arising from BOC Life's insurance business are insurance risk, interest rate risk, liquidity risk, credit risk, equity price risk and currency risk. BOC Life closely monitors these risks and reports to its Risk Management Committee on a regular basis. Furthermore, BOC Life has regular communication with the Group to ensure consistency with the Group's risk management strategy. The key risks of its insurance business and related risk control process are as follows:

Insurance risk management

BOC Life is in the business of insuring against the risk of mortality, morbidity, disability, critical illness, accidents and related risks. These risks are managed through the application of underwriting strategy 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 and BOC Life's underwriting procedures include the screening processes, such as the review of health condition and family medical history, to ensure alignment with the underwriting strategy.

The reinsurance arrangement transfers the insurance risk associated with the insurance contracts to the third party. It does not, however, discharge BOC Life's liability as the primary insurer. If a reinsurer fails to pay a claim for any reasons, BOC Life remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered by reviewing the reinsurers' financial strength prior to finalisation of any reinsurance contract. BOC Life directs its reinsurance placement policy and assesses the creditworthiness of all reinsurers and intermediaries by reviewing credit grades provided by rating agencies and other publicly available financial information. BOC Life also monitors the reinsurance counterparty risk exposure on an ongoing basis.

For details of the Group's Insurance Risk Management, please refer to Note 4.4 to the Financial Statements.

Interest rate risk management

An increase in interest rates may result in the depreciation of the value of BOC Life's investment assets. A decrease in interest rates may result in an increase in insurance liability and customer dissatisfaction due to decrease in returns. BOC Life manages the matching of assets and liabilities of its portfolios within an asset liability management framework that has been developed to achieve investment returns that match its obligations under insurance contracts; and to manage the adverse impact due to interest rate movement.

**Liquidity risk management**

BOC Life's liquidity risk is the risk of not being able to meet obligations as they fall due. BOC Life's asset and liability management framework includes cash flow management to preserve liquidity to match policy payout from time to time.

Credit risk management

BOC Life has exposure to credit risk that a customer, debtor or counterparty will be unable to or unwilling to meet a commitment that they have entered into. Key areas to which BOC Life's insurance business is exposed include:

- Default risk associated with bonds, notes and counterparties
- Credit spread widening as a result of credit migration (downgrade)
- Reinsurers' share of insurance unpaid liabilities
- Amounts due from reinsurers in respect of claims already paid
- Amounts due from insurance contract holders
- Amounts due from insurance intermediaries

BOC Life manages credit risk by placing limits on its exposure to each investment counterparty and issuer. Such limits are subject to review by the Management at least once a year.

Equity price risk management

BOC Life's equity price risk refers to the risk of loss due to volatility of market price in equity securities, equity funds and private equity. BOC Life's asset and liability management framework includes managing the adverse impact due to equity price movement through stress test and exposure limit.

Currency risk management

BOC Life's currency risk refers to the risk of loss due to volatility of exchange rate. BOC Life's asset and liability framework includes managing the adverse impact due to exchange rate movement through stress test, exposure limit and risk limit.

Greater Bay Area Development





Corporate Information

Board of Directors

Chairman

CHEN Siqing[#]

Vice Chairman

LIU Liange[#]

(appointment effective from 15 December 2018)

GAO Yingxin

(re-designation as Executive Director and appointment as Vice Chairman effective from 1 January 2018)

Directors

LIN Jingzhen[#]

(appointment effective from 24 August 2018)

CHENG Eva^{*}

CHOI Koon Shum^{*}

KOH Beng Seng^{*}

LAW Yee Kwan Quinn^{*}

(appointment effective from 13 March 2019)

TUNG Savio Wai-Hok^{*}

REN Deqi[#]

(resignation effective from 12 June 2018)

LIU Qiang[#]

(appointment effective from 24 August 2018 and resignation effective from 18 September 2018)

LI Jiuzhong

(resignation effective from 15 March 2019)

[#] Non-executive Directors

^{*} Independent Non-executive Directors

Company Secretary

LUO Nan

Registered Office

24th Floor
Bank of China Tower
1 Garden Road
Hong Kong

Auditor

Ernst & Young

Share Registrar

Computershare Hong Kong Investor Services Limited
17M Floor
Hopewell Centre
183 Queen's Road East
Wan Chai
Hong Kong

ADR Depository Bank

Citibank, N.A.
388 Greenwich Street
6th Floor
New York, NY 10013
United States of America

Website

www.bochk.com

Senior Management

Chief Executive

GAO Yingxin

(appointment effective from 1 January 2018)

Chief Risk Officer

LI Jiuzhong

(resignation effective from 15 March 2019)

Deputy Chief Executives

WANG Qi

(appointment effective from 17 December 2018)

YUAN Shu

LIN Jingzhen

(resignation effective from 1 February 2018)

Chief Operating Officer

ZHONG Xiangqun

Deputy Chief Executive

WANG Bing

(appointment effective from 17 December 2018)

Chief Financial Officer

SUI Yang

Deputy Chief Executive

KUNG YEUNG Ann Yun Chi



Board of Directors and Senior Management

DIRECTORS



Mr CHEN Siqing
Chairman

Aged 58

Board appointments: Mr CHEN is currently Chairman of the Board and a member of the Nomination and Remuneration Committee of the Company and BOCHK. He has been appointed as Non-executive Director of the Company and BOCHK since December 2011, Vice Chairman of the Company and BOCHK from March 2014 to August 2017 and Chairman of the Company and BOCHK since August 2017.

Positions and experience: Mr CHEN has been appointed as Chairman of BOC since August 2017 and was Vice Chairman of BOC from April 2014 to August 2017. Mr CHEN was President of BOC from February 2014 to August 2017. He is also Director of BOC (BVI) and BOCHKG. Mr CHEN joined BOC in 1990 and worked in the Hunan Branch before he was seconded to the Hong Kong Branch of China and South Sea Bank Ltd. as Assistant General Manager. Mr CHEN held various positions in BOC from June 2000 to May 2008, including Assistant General Manager, Vice General Manager of the Fujian Branch, General Manager of the Risk Management Department of BOC and General Manager of the Guangdong Branch. He served as Executive Vice President of BOC from June 2008 to February 2014. Mr CHEN also served as Chairman of the Board of Directors of BOC Aviation Limited from December 2011 to March 2018, which has been listed on Hong Kong Stock Exchange on 1 June 2016.

Qualifications: Mr CHEN graduated from Hubei Institute of Finance and Economics in 1982 and obtained an MBA from Murdoch University, Australia in 1999. He is a Certified Public Accountant and holds the title of Senior Economist.

Board of Directors and Senior Management



Mr LIU Liange

Aged 57

Vice Chairman

Board appointments: Mr LIU was appointed as Vice Chairman of the Board and Chairman of the Strategy and Budget Committee of the Company and BOCHK in December 2018.

Positions and experience: Mr LIU is Vice Chairman and Executive Director of BOC since October 2018 and President of BOC since August 2018. He is the President of Shanghai RMB Trading Unit of BOC since October 2018. Mr LIU is also Director of BOC (BVI) and BOCHKG. Prior to joining BOC in 2018, Mr LIU served as Vice Chairman and President of the Export-Import Bank of China from July 2015 to June 2018. Mr LIU served as Vice President of the Export-Import Bank of China from March 2007 to February 2015. He also served as Director of the African Export-Import Bank from September 2007 to February 2015, Chairman of the Board of Supervisors of Sino-Italian Mandarin Capital Partners from March 2009 to June 2015, and Chairman of the Board of Directors of Regional Credit Guarantee and Investment Facility (Asia) from March 2014 to May 2015. Mr LIU worked in the People's Bank of China for many years, and successively served as Deputy Director-General of the International Department of the People's Bank of China, President of the Fuzhou Central Sub-branch of the People's Bank of China and Director of the Fujian Branch of the State Administration of Foreign Exchange, Director General of the Anti-Money Laundering Bureau (the Security Bureau) of the People's Bank of China.

Qualifications: Mr LIU graduated from Graduate School of the People's Bank of China and received a Master's Degree in Economics in 1987. He holds the title of Senior Economist.



Mr GAO Yingxin
Vice Chairman and Chief Executive

Aged 56

Board appointments: Mr GAO is Vice Chairman, Chief Executive, and a member of the Strategy and Budget Committee of the Company and BOCHK. He was Executive Director of the Company and BOCHK from May 2007 to March 2015, as well as Non-executive Director and a member of the Risk Committee of the Company and BOCHK from March 2015 to December 2017. He has been re-designated as Executive Director of the Company and BOCHK since January 2018.

Positions and experience: Mr GAO joined BOC in 1986. He was Executive Vice President of BOC from May 2015 to January 2018, Executive Director of BOC from December 2016 to January 2018. He has held a number of positions in various domestic and overseas institutions of BOC Group, including General Manager of Corporate Banking at BOC Head Office, and President and Chief Operating Officer of BOCI, among others. Mr Gao was Deputy Chief Executive (Corporate Banking) of the Company and BOCHK from February 2005 to March 2015. He also holds other roles with BOCHK Group currently, including Chairman of BOC Insurance (International) Holdings Company Limited, Chairman of BOC Life and Chairman of BOCHK Charitable Foundation. Mr GAO holds a number of public offices in Hong Kong. He serves as Chairman of both the Hong Kong Chinese Enterprises Association and the Chinese Banking Association of Hong Kong, and sits on the Exchange Fund Advisory Committee and the Banking Advisory Committee. He is also Chairman of Hong Kong Interbank Clearing Limited, a member of both the Risk Management Committee of Hong Kong Exchanges and Clearing Limited, and Human Resources Planning Commission of the Hong Kong Special Administrative Region, as well as Vice President of The Hong Kong Institute of Bankers, etc.

Qualification: Mr GAO graduated from the East China University of Science and Technology with a Master's Degree in Engineering in 1986.

Board of Directors and Senior Management



Mr LIN Jingzhen

Aged 53

Non-executive Director

Board appointments: Mr LIN was appointed as Non-executive Director and a member of the Strategy and Budget Committee of the Company and BOCHK in August 2018.

Positions and experience: Mr LIN is Executive Vice President of BOC since March 2018 and Executive Director of BOC since February 2019. He joined BOC in 1987. Mr LIN served as Deputy Chief Executive of the Company and BOCHK from May 2015 to January 2018. He served as General Manager of Corporate Banking Department from March 2014 to May 2015 and General Manager (Corporate Banking) of the Corporate Banking Unit of BOC from October 2010 to March 2014. He previously served as Deputy General Manager of Corporate Banking Department and Deputy General Manager of Corporate Banking Unit of BOC. Mr LIN has been serving as Chairman of the board of directors of BOCI since April 2018 and Chairman of BOC International (China) Co, Ltd since May 2018.

Qualifications: Mr LIN obtained a Bachelor's Degree in Economics from Xiamen University in 1987 and a Master's Degree in Business Administration from Xiamen University in 2000.



Mdm CHENG Eva

Aged 58

Independent Non-executive Director

Board appointments: Mdm CHENG was appointed as Independent Non-executive Director and a member of each of the Audit Committee and the Strategy and Budget Committee of the Company and BOCHK in October 2014.

Positions and experience: Mdm CHENG was former Secretary for Transport and Housing of the Government of the HKSAR. She joined the government's Administrative Service in August 1983 and was posted to various bureaux and departments, including serving as Permanent Secretary for Economic Development and Labour (Economic Development) and Commissioner for Tourism. She retired from the Government of the HKSAR on 30 June 2012.

Qualification: Mdm CHENG holds a Bachelor's Degree in Social Sciences from University of Hong Kong.



Dr CHOI Koon Shum

Independent Non-executive Director

Aged 61

Board appointments: Dr CHOI was appointed as Independent Non-executive Director in June 2016. He is Chairman of the Nomination and Remuneration Committee and a member of the Audit Committee of the Company and BOCHK.

Positions and experience: Dr CHOI is Chairman of Sunwah Group, Sunwah International Limited (listed in Toronto), Sunwah Kingsway Capital Holdings Limited (listed in Hong Kong) and Vietnam VinaCapital. He is also Independent Non-executive Director of Hui Xian Asset Management Limited, the Manager of Hui Xian Real Estate Investment Trust (listed in Hong Kong). Dr CHOI has extensive experience in food industry, real estate development, international trade as well as technology and finance related business.

Dr CHOI is a Standing Committee Member of the National Committee of the Chinese People's Political Consultative Conference of the People's Republic of China. He also holds a number of public positions including Chairman of the Chinese General Chamber of Commerce in Hong Kong, Standing Committee Member of the All-China Federation of Industry and Commerce, Chairman of Guangdong-HK-Macao Bay Area Entrepreneurs Union, Economic Advisor to the President of the Chinese Academy of Sciences, Founding Patron and Senior Advisor to the President of the Academy of Sciences of Hong Kong, Executive Director of the China Overseas Friendship Association, Hong Kong China's Representative of Asia Pacific Economic Co-operation (APEC) Business Advisory Council and Council Member of the Hong Kong Trade Development Council, Founding Chairman of the Hong Kong-Vietnam Chamber of Commerce, Founding Chairman of the Hong Kong-Korea Business Council, Honorary Ambassador of Foreign Investment Promotion for the Republic of Korea, Chairman of the China-India Software Association, Chairman of the China Hong Kong Israel Technology Cooperation and Promotion Center and Chairman of the US-China Center for Research on Educational Excellence of the Michigan State University. Dr CHOI is a Court or Council Member of a number of universities including the Fudan University, the Nanjing University, United College of the Chinese University of Hong Kong and the Hong Kong Polytechnic University.

Qualifications: Dr CHOI was conferred Honorary Doctor of Humanities by the Michigan State University in the United States in 2005. He became University Fellow of the Hong Kong Polytechnic University in 2007. He was also conferred Honorary Professor by the University of Glamorgan in the United Kingdom in 2009, Honorary Doctor of Social Sciences by the Lingnan University in Hong Kong in 2011, Honorary Doctor by the Vietnam National University, Hanoi in 2013, Honorary Doctor of Business Administration by the De Montfort University in United Kingdom in 2014, and Honorary Doctor of Law by the University of Alberta in Canada in 2015.

Board of Directors and Senior Management



Mr KOH Beng Seng Independent Non-executive Director

Aged 68

Board appointments: Mr KOH was appointed as Independent Non-executive Director in March 2006. He is Chairman of the Risk Committee and a member of each of the Audit Committee and the Nomination and Remuneration Committee of the Company and BOCHK.

Positions and experience: Mr KOH is currently Chief Executive Officer of Octagon Advisors Pte Ltd, a business and management consulting company based in Singapore. He is also Non-executive Chairman of Great Eastern Holdings Limited, a company listed in Singapore. Mr KOH was formerly Director of Sing Han International Financial Services Limited and Hon Sui Sen Endowment CLG Limited. He was also Independent Non-executive Director of Singapore Technologies Engineering Ltd and United Engineers Limited, companies listed in Singapore. Mr KOH was Deputy President of United Overseas Bank (“UOB”) and a member of UOB’s Executive Committee from 2000 to 2004. During this period, he was in charge of UOB’s operations, delivery channels, information technology, corporate services, risk management and compliance functions. Prior to that, Mr KOH has spent over 24 years at the Monetary Authority of Singapore where he made significant contributions to the development and supervision of the Singapore financial sector in his capacity as Deputy Managing Director, Banking & Financial Institutions Group. He has also served as Director of Chartered Semiconductor Manufacturing and as part-time adviser to the International Monetary Fund.

Qualifications: Mr KOH holds a Bachelor’s Degree in Commerce from Nanyang University in Singapore and a Master’s Degree in Business Administration from Columbia University in the United States.



Mr LAW Yee Kwan Quinn

Independent Non-executive Director

Aged 66

Board appointments: Mr LAW was appointed as Independent Non-executive Director and a member of each of the Audit Committee and Risk Committee of the Company and BOCHK in March 2019.

Positions and experience: Mr LAW currently serves as a court member of The Hong Kong University of Science and Technology ("HKUST") and an advisor of Hong Kong Business Accountants Association. He previously served as a council member cum audit committee chairman and standing committee member of the HKUST, and also as member of a number of committees of Hong Kong Institute of Certified Public Accountants ("HKICPA"), including Corporate Governance Committee, Professional Accountants in Business Committee, Professional Conduct Committee and Ethics Committee. He held directorships in several listed companies both in Hong Kong and overseas in the past. He was formerly the Deputy Chairman and Managing Director of Urban Renewal Authority, and a Director of The Wharf (Holdings) Limited. Mr LAW is currently an Independent Non-executive Director of Bank of Tianjin Co., Ltd., ENN Energy Holdings Limited and HKBN Limited, all are listed on the Main Board of Hong Kong Stock Exchange.

Qualifications: Mr LAW is a certified public accountant and also a fellow member of HKICPA, a fellow member of The Association of Chartered Certified Accountants and an associate member of The Institute of Chartered Secretaries and Administrators.



Mr TUNG Savio Wai-Hok

Independent Non-executive Director

Aged 67

Board appointments: Mr TUNG was appointed as Independent Non-executive Director in December 2005. He is Chairman of the Audit Committee and a member of each of the Nomination and Remuneration Committee, the Risk Committee and the Strategy and Budget Committee of the Company and BOCHK.

Positions and experience: Mr TUNG is currently Chairman of Investcorp Technology Partners and Senior Advisor of Investcorp, he was Chief Investment Officer and one of the founding partners of Investcorp. Mr TUNG was appointed Director and a member of the Compensation Committee of Tech Data Corporation, a company listed on NASDAQ. Before joining Investcorp in 1984, he worked for Chase Manhattan Bank for about 11 years, holding various positions in its front, middle and back offices and served in its offices in New York, Bahrain, Abu Dhabi and London. Mr TUNG has served on the boards of many of Investcorp portfolio companies, including Club Car, Circle K, Saks Fifth Avenue, Simmons Mattresses, Star Market, and Stratus Computer. He is also a board member and treasurer of the Aaron Diamond AIDS Research Center, an affiliate of Rockefeller University. Mr TUNG is a trustee emeritus and a member of the Columbia University Medical Center Board of Visitors.

Qualification: Mr TUNG holds a BSc in Chemical Engineering from Columbia University of New York.

Board of Directors and Senior Management

SENIOR MANAGEMENT



Mdm WANG Qi
Deputy Chief Executive

Aged 56

Mdm WANG is Deputy Chief Executive of the Group, overseeing the Legal & Compliance and Operational Risk Management Department, as well as Economics & Strategic Planning Department. Prior to joining the Group, Mdm WANG was General Manager of Internal Control, Legal and Compliance Department of BOC. Mdm WANG has held various positions in BOC since she joined BOC in 1984. She served as Deputy General Manager of Legal Affairs Department, General Manager of Legal and Compliance Department, General Manager (Operational Risk Management) of Risk Management Department, and General Manager of Internal Control Department, etc. Mdm WANG has an international vision, a solid legal and compliance professional background as well as extensive management experience. Mdm WANG graduated from Peking University with a Bachelor's Degree of Economic Law. She also obtained a Master's Degree in Banking and Financial Development at the University of Pavia in Italy. She is an arbitrator of China International Economic and Trade Arbitration Commission (CIETAC).



Mr YUAN Shu
Deputy Chief Executive

Aged 56

Mr YUAN is Deputy Chief Executive of the Group in charge of the financial market business, including Global Markets, Investment Management, Asset Management and other capital market-related businesses. He is Director and Chairman of BOCI-Prudential Trustee, BOC Group Trustee Company Limited and Po Sang Securities and Futures Limited as well as Director of BOC Insurance (International) Holdings Company Limited. He was also Director of BOC Life. Mr YUAN has over 30 years of experience in the industry with solid professional expertise and management experience. He has held different positions in the financial market businesses at Head Office and in various overseas branches of BOC. Mr YUAN joined the Trading Department of BOC in 1983, then held positions in the Paris and Tokyo branches, as well as the Trading Department and Global Financial Markets Department of BOC Head Office. Mr YUAN was Director (Trading) of the Global Financial Markets Department in 2006 and was promoted to General Manager (Trading) of the Financial Markets Unit in 2010. Prior to joining the Group as Deputy Chief Executive (Financial Markets), he served as General Manager of the Hong Kong Branch, BOC, from December 2014. Mr YUAN graduated from Renmin University of China majoring in International Finance.



Mr ZHONG Xiangqun
Chief Operating Officer

Aged 49

Mr ZHONG is Chief Operating Officer of the Group, overseeing the Bank-wide Operation Department, Information Technology Department, Innovation and Optimisation Centre and Corporate Services Department. He is also Director of BOC Thailand and BOCCC. Prior to joining the Group, Mr ZHONG served as General Manager of E-Finance Department of BOC in charge of the development of e-finance business, covering mobile payment, e-business, e-financing and big data application. Joining BOC in 1994, Mr ZHONG has held management positions in Information Technology Department, Personal Banking Unit, Card Centre and Innovation & Development Department, etc. He was Director of China UnionPay and a member of China Financial Standardisation Technical Committee. Mr ZHONG has solid expertise in information technology and cyber security as well as practical business experience. Mr ZHONG graduated from Peking University with a Bachelor's Degree in Information Science specialised in Software and a Master's Degree in Applied Mathematics.



Mr WANG Bing
Deputy Chief Executive

Aged 47

Mr WANG is Deputy Chief Executive of the Group, overseeing Global Corporate Banking Department, Commercial Banking Department, Institutional Business Department, Transaction Banking Department, as well as Custody and Trust Services. Prior to joining the Group, Mr WANG served as General Manager of Jiangsu Branch of BOC. Since joining BOC in 1996, Mr WANG has held management positions in various institutions including Suzhou, Ningbo and Jiangsu Branches. He served as Deputy General Manager of Jiangsu Branch and General Manager of Ningbo Branch, etc. He is innovative with sound professional capabilities in corporate banking as well as extensive business and management experience. Mr WANG graduated from Soochow University with a Bachelor's and Master's Degree in English. He also obtained a Master's Degree in Business Administration at the City University of London in the UK.

Board of Directors and Senior Management



Mdm SUI Yang
Chief Financial Officer

Aged 45

Mdm SUI is Chief Financial Officer of the Group, overseeing Financial Management Department, General Accounting and Accounting Policy Department and Treasury. Mdm SUI is Chairman of BOCHK Asset Management Limited. She was also Director of Nanyang Commercial Bank, Limited. Prior to joining the Group in August 2014, Mdm SUI served as Deputy General Manager of Financial Management Department of BOC. She joined BOC in April 1997 and assumed various positions in Finance & Accounting Department of BOC including Deputy General Manager of Management Information System ("MIS") Centre of BOC from September 2008 to March 2011, Assistant General Manager of MIS Centre of BOC from March 2007 to September 2008 and Assistant General Manager of MIS Centre and Finance & Accounting Department of BOC from August 2006 to March 2007. Mdm SUI possesses extensive knowledge and experience in financial management. She obtained a Bachelor's Degree and a Master's Degree in Economics from the Central University of Finance & Economics (formerly the Central Institute of Finance and Banking). Mdm SUI is a member of the Chinese Institute of Certified Public Accountants.



Mrs KUNG YEUNG Ann Yun Chi
Deputy Chief Executive

Aged 56

Mrs KUNG is Deputy Chief Executive of the Group in charge of Personal Banking and Wealth Management Department, Personal Banking Risk and Integrated Management Department, Personal Banking Products Department, Private Banking, BOCCC and BOC Life. She is also Vice Chairman of BOCCC and Director of BOC Insurance (International) Holdings Company Limited and BOC Life. Mrs KUNG joined BOCHK in August 2007 as Head of Channel Management. She was appointed as Head of Personal Banking in April 2011, and was promoted to her current role in March 2015. Prior to joining the Group, Mrs KUNG had held various senior positions in Standard Chartered Bank (Hong Kong) Limited. With over 28 years of experience in the industry, Mrs KUNG possesses extensive knowledge in personal banking and a strong background in financial services. Mrs KUNG graduated from the University of Southern California in the United States of America where she obtained her Bachelor of Science Degree in Business Administration with a concentration in Accounting. In addition to business pursuits, Mrs KUNG plays an active role in the business community and public service in Hong Kong.



Report of the Directors

The Directors are pleased to present their report together with the audited consolidated financial statements of the Group for the year ended 31 December 2018.

Principal Activities

The principal activities of the Group are the provision of banking and related financial services. An analysis of the Group's performance for the year by business segments is set out in Note 47 to the Financial Statements.

Business Review

For business review of the Group for the year, please refer to "Message from the Chairman", "Message from the Chief Executive", "Management Discussion and Analysis", "Corporate Governance" and "Corporate Social Responsibility" sections.

Results and Appropriations

The results of the Group for the year are set out in the consolidated income statement on page 129.

The Board has recommended a final dividend of HK\$0.923 per share, amounting to approximately HK\$9,759 million, subject to the approval of shareholders at the forthcoming annual general meeting to be held on Thursday, 16 May 2019. If approved, the final dividend will be paid on Monday, 3 June 2019 to shareholders whose names appear on the Register of Members of the Company on Monday, 27 May 2019. Together with the interim dividend of HK\$0.545 per share declared in August 2018, the total dividend payout for 2018 would be HK\$1.468 per share.

Closure of Register of Members for Entitlement to Attend and Vote at Annual General Meeting

The Register of Members of the Company will be closed, for the purpose of determining shareholders' entitlement to attend and vote at the Annual General Meeting of the Company, from Thursday, 9 May 2019 to Thursday, 16 May 2019 (both days inclusive), during which period no transfer of shares will be registered. In order to attend and vote at the Annual General Meeting of the Company, shareholders should ensure that all transfer documents, accompanied by the relevant share certificates, are lodged with the Company's Share Registrar, Computershare Hong Kong Investor Services Limited, at Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong, not later than 4:30 p.m. on Wednesday, 8 May 2019. The Annual General Meeting of the Company will be held at 2:00 p.m. on Thursday, 16 May 2019.

Closure of Register of Members for Entitlement to Final Dividend

The Register of Members of the Company will be closed, for the purpose of determining shareholders' entitlement to the proposed final dividend, from Wednesday, 22 May 2019 to Monday, 27 May 2019 (both days inclusive), during which period no transfer of shares will be registered. In order to qualify for the proposed final dividend, shareholders should ensure that all transfer documents, accompanied by the relevant share certificates, are lodged with the Company's Share Registrar, Computershare Hong Kong Investor Services Limited, at Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong, not later than 4:30 p.m. on Tuesday, 21 May 2019. Shares of the Company will be traded ex-dividend as from Monday, 20 May 2019.

Report of the Directors

Donations

Charitable and other donations made by the Group during the year amounted to approximately HK\$80 million.

Note: These donations do not include the donations and sponsorships made by BOCHK Charitable Foundation (“the Foundation”. For details, please refer to the “Corporate Social Responsibility” section). The Foundation is a separate legal entity established in Hong Kong and is a charitable institution exempt from tax under the Inland Revenue Ordinance.

Shares Issued

Details of the Company’s issued shares are set out in Note 40 to the Financial Statements.

As at the latest practicable date prior to the issue of this Annual Report and based on publicly available information, the public float of the Company was approximately 34%. The Directors consider that there is sufficient public float in the shares of the Company.

Other Equity Instruments Issued

During the year, BOCHK issued the following instruments to raise funds for general corporate purposes and to improve its Tier 1 capital level in accordance with the requirements of the Banking (Capital) Rules (Cap. 155L).

Class	Amount issued	Consideration received
Undated non-cumulative subordinated Additional Tier 1 capital securities	USD3,000,000,000	USD3,000,000,000

Details of the issued other equity instruments are set out in Note 41 to the Financial Statements.

Distributable Reserves

Distributable reserves of the Company as at 31 December 2018, calculated under Part 6 of the Hong Kong Companies Ordinance, amounted to approximately HK\$14,330 million.

Five-year Financial Summary

A summary of the results, assets and liabilities of the Group for the last five years is set out on page 3.

Directors

The list of Directors of the Company is set out on page 56. The biographical details of the Directors and senior management are set out on pages 57 to 66. The term of office for each Non-executive Director is approximately three years.

Mr GAO Yingxin has been re-designated from Non-executive Director to Executive Director and appointed as Vice Chairman and Chief Executive effective from 1 January 2018. Mr LIN Jingzhen was appointed as Non-executive Director effective from 24 August 2018. Mr LIU Liange was appointed as Vice Chairman and Non-executive Director effective from 15 December 2018. Mr LAW Yee Kwan Quinn was appointed as Independent Non-executive Director effective from 13 March 2019. Mr REN Deqi resigned as Non-executive Director effective from 12 June 2018. Mr LIU Qiang was appointed and resigned as Non-executive Director on 24 August 2018 and 18 September 2018 respectively. Mr LI Jiuzhong resigned as Executive Director and Chief Risk Officer with effect from 15 March 2019. The Board would like to express its sincere gratitude and the highest respect to Mr REN Deqi, Mr LIU Qiang and Mr LI Jiuzhong for their valuable contributions during their tenure of office.



In accordance with Article 98 of the Articles of Association and pursuant to Code provision A.4.2 of the Corporate Governance Code, the terms of office of Mdm CHENG Eva and Dr CHOI Koon Shum will expire at the forthcoming annual general meeting. All the retiring Directors being eligible, will offer themselves for re-election at the forthcoming annual general meeting. Further, pursuant to Article 102 of the Articles of Association, any Director appointed by the Board shall hold office only until the

next following general meeting or the next following annual general meeting, and shall then be eligible for re-election at such meeting. Accordingly, the terms of office of Mr LIN Jingzhen, Mr LIU Liange and Mr LAW Yee Kwan Quinn, who were appointed on 24 August 2018, 15 December 2018 and 13 March 2019 respectively, will expire at the forthcoming annual general meeting and, being eligible, will offer themselves for re-election.

Save for the list of Directors of the Company as set out on page 56, other directors of the Company's subsidiaries during the year ended 31 December 2018 are as follows:

YUAN Shu	ZHONG Xiangqun	SUI Yang	KUNG YEUNG Ann Yun Chi
ZHU Yanlai	CHAI Woon Chew	Chaoyuth SUDTHITANAKORN	CHAN Chi Fai
CHAN Hing Wah	CHAN Lap Bong	CHAN Siu Ping Chordio	CHENG Po Kee
CHEUNG Wing Shing Vincent	CHEW Lee Lin	CHU Wing Yiu	DATO' LOW Kian Chuan
Eugene KHOO Kong Hooi	FUNG Pui Cheung	GWEE Siew Ping	HAN Jianchiu
HUANG Jinyue	KAN Wai Mun Carmen	Krish FOLLETT	KWONG Shu Ming
LAU Hon Chuen	LAU Tim	LEUNG Yuen Hong	LI Feng
LI Jun	LI Siu Ling	LIU Guizhen	LIU Min
LIU Yalin	LO Kin Wing Terry	LO Ping Wa	LO Wai Man Mary
MOK Chung Man	Neil Anthony TORPEY	NG Chor Chu	NG Leung Sing
QIU Hengchang	QU Helei	SHEN Hua	SHING Sze Yee
SUN Dawei	SZE Ying Tat	TANG Fong Chai Francis	Thiraphong TANGHIRASUNAN
TSANG Kam Yin Wendy	WANG Jian	WANG Tong	WANG Yunchao
WONG Chun Keung	WONG Kine Yuen	WONG Man Chiu	WONG Man Yee
WU Lin	WU Shiqiang	YIP Kwun Hung	ZHANG Zhao
Chatchai VIRAMETEEKUL*	WANG Hongwei*	GUAN Xuefei [#]	KAN Wai Hung Victor [#]
LIU Qiang [#]			

* Resigned/ceased as a director of the relevant subsidiary(ies) during the year.

[#] Resigned/ceased as a director of the relevant subsidiary(ies) after the year ended 31 December 2018 and up to the date of this Annual Report.

Report of the Directors

Directors' Service Contracts

No Director offering for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the employing company within one year without payment of compensation other than the normal statutory compensation.

Directors' Interests in Transactions, Arrangements or Contracts

No transactions, arrangements or contracts of significance, in relation to the Group's business to which the Company, its holding companies, or any of its subsidiaries or fellow subsidiaries was a party and in which a Director or his/her connected entity had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Directors' Interests in Competing Business

Mr CHEN Siqing, Mr LIU Liange and Mr LIN Jingzhen are Executive Directors of BOC (Mr LIN has been appointed as such position with effect from 3 February 2019). During the year, Mr GAO Yingxin and Mr REN Deqi were Executive Directors of BOC, and Mr LIU Qiang was Executive Vice President of BOC.

BOC is a joint stock commercial bank with limited liability, established under the laws of the PRC, providing a full range of commercial banking and other financial services through its associates throughout the world. Certain of the Group's operations overlap with and/or are complementary to those of BOC and its associates. To the extent that BOC or its associates compete with the Group, the Directors believe that the Group's interests are adequately protected by good corporate governance practices and the involvement of the Independent Non-executive Directors.

Further, the Board's Mandate also expressly provides that unless permissible under applicable laws or regulations, if a substantial shareholder or a Director has a conflict of interest in the matter to be considered by the Board, the matter shall not be dealt with by way of written resolutions, but a Board meeting attended by the Independent Non-executive Directors who have no material interest in the matter shall be held to deliberate on the same.

Save as disclosed above, none of the Directors is interested in any business apart from the Group's business, which competes or is likely to compete, either directly or indirectly, with the Group's business.

Directors' Rights to Acquire Shares

At no time during the year was the Company, its holding companies, or any of its subsidiaries or fellow subsidiaries a party to any arrangements to enable the Directors to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Directors' and Chief Executive's Interests in Shares, Underlying Shares and Debentures

As at 31 December 2018, the interests and short position of the Directors, Chief Executive and their respective associates, in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 of the Listing Rules (the "Model Code") are set out below:



The Company:

American Depository Shares (ADS)

Name of director	Number of shares/underlying shares held			Total	Approximate % of the total issued shares
	Personal interests	Family interests	Corporate interests		
TUNG Savio Wai-Hok	2,000 ¹	–	–	2,000	0.00% ²

Notes:

1. Each ADS represents 20 ordinary shares of the Company.
2. Such shares held by Mr TUNG Savio Wai-Hok representing approximately 0.0004% of the total issued shares of the Company.

Associated corporation of the Company:

Bank of China Limited (H Shares)

Name of director	Number of shares/underlying shares held			Total	Approximate % of the total issued H shares
	Personal interests	Family interests	Corporate interests		
GAO Yingxin	1,100	–	–	1,100	0.00% ¹
CHOI Koon Shum	4,000,000	40,000 ²	1,120,000 ³	5,160,000	0.01%

Notes:

1. Such shares held by Mr Gao Yingxin representing approximately 0.000001% of the total issued H shares of BOC.
2. Such shares are held by the spouse of Dr CHOI Koon Shum.
3. Dr CHOI Koon Shum is deemed to be interested in the 1,120,000 shares held through Choi Koon Shum Education Foundation Limited by virtue of the SFO.

All the interests stated above represented long positions. Save as disclosed above, as at 31 December 2018, none of the Directors, Chief Executive or their respective associates had any interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

Report of the Directors

Interest of Substantial Shareholders

The register maintained by the Company pursuant to section 336 of the SFO recorded that, as at 31 December 2018, the following parties had the following interests (as defined in the SFO) in the Company set opposite their respective names:

Name of Corporation	No. of shares held in the Company	Approximate % of total issued shares
Central Huijin	6,984,274,213	66.06%
BOC	6,984,274,213	66.06%
BOCHKG	6,984,175,056	66.06%
BOC (BVI)	6,984,175,056	66.06%

Notes:

1. Following the reorganisation of BOC in August 2004, Central Huijin holds the controlling equity capital of BOC on behalf of the State. Accordingly, for the purpose of the SFO, Central Huijin is deemed to have the same interests in the Company as BOC.
2. BOC holds the entire issued shares of BOCHKG, which in turn holds the entire issued shares of BOC (BVI). Accordingly, BOC and BOCHKG are deemed to have the same interests in the Company as BOC (BVI) for the purpose of the SFO. BOC (BVI) beneficially held 6,984,175,056 shares of the Company.
3. BOC holds the entire issued shares of BOCI, which in turn holds the entire issued shares of BOCI Asia Limited and BOCI Financial Products Limited. Accordingly, BOC is deemed to have the same interests in the Company as BOCI Asia Limited and BOCI Financial Products Limited for the purpose of the SFO. BOCI Asia Limited had an interest in 24,479 shares of the Company and an interest in 72,000 shares held under physically settled equity derivatives while BOCI Financial Products Limited had an interest in 2,678 shares of the Company.

All the interests stated above represented long positions. Apart from the disclosure above, according to the register maintained by the Company pursuant to section 336 of the SFO, BOCI Financial Products Limited had an interest in 143,522 shares which represented short positions. BOC and Central Huijin are deemed to be interested in such number of shares for the purpose of the SFO. Save as disclosed, no other interests or short positions were recorded in the register maintained by the Company under section 336 of the SFO as at 31 December 2018.

Management Contracts

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

Equity-linked Agreements

No equity-linked agreements were entered into by the Company during the year or subsisted at the end of the year.

Permitted Indemnity Provision

Pursuant to the Articles of Association, every Director shall be indemnified out of funds of the Company against all liabilities incurred by him/her to the extent permitted by the Hong Kong Companies Ordinance. The Company has maintained insurance for the benefit of the Directors against liability which may lawfully be insured by the Company.

Purchase, Sale or Redemption of the Company's Shares

During the year, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares.

Major Customers

During the year, the five largest customers of the Group accounted for less than 30% of the total of interest income and other operating income of the Group.



Connected Transactions

The Independent Non-executive Directors have reviewed the transactions which the Company disclosed in a public announcement on 14 December 2016 and confirmed that these transactions were:

- (i) entered into in the ordinary and usual course of business of the Group;
- (ii) conducted on normal commercial terms or better; and
- (iii) entered into according to the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

In accordance with paragraphs 14A.56 and 14A.71(6)(b) of the Listing Rules, the Board of Directors engaged the auditor of the Company to report on the Group's continuing connected transactions in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised) "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. The auditor has issued its unqualified letter containing its findings and conclusions in respect of the above continuing connected transactions. In accordance with paragraph 14A.57 of the Listing Rules, a copy of the auditor's letter has been provided by the Company to the Stock Exchange of Hong Kong.

Compliance with the Banking (Disclosure) Rules and the Listing Rules

This Annual Report complies with the applicable requirements set out in the Banking (Disclosure) Rules under the Banking Ordinance and the applicable disclosure provisions of the Listing Rules.

Auditor

The financial statements for the year 2018 have been audited by Ernst & Young who will retire and offer themselves for re-appointment at the 2019 annual general meeting.

On behalf of the Board

CHEN Siqing

Chairman
Hong Kong, 29 March 2019

Corporate Governance

The Company is committed to maintaining and upholding high standards of corporate governance in order to safeguard the interests of shareholders, customers and employees. It abides strictly by the relevant laws and regulations in Hong Kong, and observes the rules and guidelines issued by regulatory authorities including the HKMA, Hong Kong Securities and Futures Commission and the Stock Exchange of Hong Kong. The Company from time to time reviews the corporate governance practices as adopted and strives to comply with the relevant requirements of international and local corporate governance best practices.

The Company has been in full compliance with all code provisions as set out in the Corporate Governance Code contained in Appendix 14 of the Listing Rules. The Company also complies with nearly all the recommended best practices set out in the Corporate Governance Code. In particular, the Company publishes quarterly financial and business reviews within one month after the end of the relevant quarter so that shareholders and investors can be kept up to date of the performance, financial positions and prospects of the Company on a timely basis.

BOCHK, the Company's wholly-owned and principal operating subsidiary, has followed the guidelines as set

out in the Supervisory Policy Manual module CG-1 entitled "Corporate Governance of Locally Incorporated Authorised Institutions" ("SPM CG-1") issued by the HKMA.

To further enhance corporate governance standard, the Company will revamp its corporate governance system and strengthen relevant measures by referencing to market trend as well as guidelines and requirements issued by regulatory authorities. The Company will continue to maintain sound corporate governance standards and procedures to ensure the completeness, transparency and quality of our information disclosure.

Corporate Governance Policy

Policy Statement

The Company recognises the importance of high standards of corporate governance and maintains an effective corporate governance framework which delivers long-term success of the Group. The Company is also strongly committed to embracing and enhancing sound corporate governance principles and practices. The established well-structured corporate governance framework directs and regulates the business ethical conduct of the Company, thereby protects and upholds the interests of shareholders and stakeholders as a whole in a sustainable manner.



Essential Principles

(1) Eminent Board

Authority	The Board is responsible for supervising the management of the business and affairs of the Group with due regard to maximising shareholder value and enhancing corporate governance standard of the Group. The Board is obliged to act honestly and in good faith and to make decisions objectively in the best interests of the Group and its shareholders as a whole.
Structure	<p>The Company is led by a high caliber Board with strong representation of Independent Non-executive Directors. The Board has a well-balanced composition of the Executive Directors, Non-executive Directors and Independent Non-executive Directors.</p> <p>Both the number and percentage of Independent Non-executive Directors are well above the requirements set by relevant rules and regulations. All Directors are eminent individuals from diverse disciplines with extensive professional experience and are able to make objective judgement.</p>
Roles of the Chairman and the Chief Executive	In order to promote balance of power, the roles of the Chairman and the Chief Executive are segregated. The Company benefits from the segregation as the Chairman can focus on leading the Board and monitoring corporate governance and shareholder issues, while the Chief Executive leading the Management to perform the day-to-day operations and affairs of the Company.
Board Committees	<p>During the year, the Board has established four standing Board Committees (originally five Board Committees as detailed below) which were delegated with different responsibilities to assist the Board in performing its duties. They are Audit Committee, Nomination and Remuneration Committee (previously the Nomination Committee and the Remuneration Committee before the re-organisation in October 2018), Risk Committee, as well as Strategy and Budget Committee. Most of them are composed of a majority of Independent Non-executive Directors.</p> <p>Each of the Board Committees has a well-defined mandate with the roles and responsibilities delineated therein. The performance and effectiveness of these standing Board Committees are evaluated periodically with a view to making further enhancement.</p> <p>Other Board Committees like Independent Board Committee and Search Committee will be formed as and when required under the appropriate circumstances.</p>

(2) Prudent Risk Management

The Board recognises the need for risk control and management being a vital component of the business of the Group. The Board formulates and oversees the risk management strategies, and the related framework and policies with the assistance of the Risk Committee and other relevant Board Committee(s). The Management performs the daily risk management responsibilities of the Group under the guidance of the Risk Committee.

(3) Fair Remuneration System

The Company ensures that Directors' remuneration should be appropriate and reflect their duty and responsibility to fulfil the expectations of the shareholders and meet regulatory requirements. Directors' fees are subject to the approval of the shareholders. The Board, based on the recommendations of the Nomination and Remuneration Committee which is mainly responsible for ensuring the fairness and reasonableness of the overall human resources and remuneration strategies, approves the remuneration policies of the Group. No Director shall be involved in deciding his or her own remuneration.

(4) Effective Disclosure Mechanism

The Board reviews and monitors from time to time the effectiveness of the Group's disclosure process for reports, announcements and inside information. It encourages and takes necessary steps to disclose information in a timely manner and to ensure the information concerning the Group is expressed and communicated in a clear and objective manner that enables the shareholders and the public to appraise the position of the Group to make informed investment decisions.

(5) Upholding Shareholders' Rights

The Board respects the rights of shareholders as mandated by the articles of association of the Company (the "Articles of Association") and relevant applicable laws and regulatory requirements. The Board places utmost importance on maintaining effective communications with shareholders and also makes its best efforts to keep the shareholders informed of the business and affairs of the Company by maintaining various channels of communications and having direct dialogue with shareholders.

In addition, the shareholders also have the rights to obtain all available information of the Company, propose a resolution at annual general meetings, nominate a person for election as a director, and make enquiries about the Company.

(6) Safeguarding Stakeholders' Interests

The Board has a fiduciary duty to protect and serve, with due care and consideration of, the interest of all stakeholders of the Company including but not limited to employees, customers, business partners, suppliers, regulators and the community. All the interests of stakeholders of the Company are further safeguarded by strictly complying with applicable laws and regulations as well as governance policies.

(7) Sustainable Corporate Social Responsibility

The Company attaches great importance to corporate social responsibility. The Board is committed to undertaking corporate social responsibility by strengthening relationship with its stakeholders with a view to contributing to the sustainable development of the economy, society and environment. The Company consistently supports and participates in activities that are beneficial to the community.

(8) Pursuit of "Good to Great"

The Board encourages the pursuit of "Good to Great". With the assistance of the Nomination and Remuneration Committee, the Board ensures that each Board Committee shall conduct regular self-assessment of its effectiveness, and based on the evaluation results, the Board gives such feedback, directions and guidance as may be necessary to enhance its efficiency and effectiveness.

Policy Goal

The Board and the senior management of the Company are responsible for adhering to the corporate governance principles and executing this policy. The Company seeks to manage its business in accordance with the well-defined corporate governance principles which therefore provide a solid governance framework for excellent performance and sustainable growth.



Corporate Governance Framework

Responsibilities of the Board and Management

The Board is at the core of the Company's corporate governance framework and there is a clear division of responsibilities between the Board and the Management. The Board is responsible for providing high-level guidance and effective oversight of the Management. Generally, the Board is responsible for:

- formulating the Group's mid and long-term strategies and monitoring the implementation thereof;
- reviewing and approving the annual business plans and financial budgets;
- approving the annual results, interim results and quarterly financial and business reviews;
- reviewing and monitoring the Group's risk management and internal control;
- ensuring good corporate governance of the Group and effective compliance; and
- monitoring the performance of the Management.

Six physical Board meetings were held during the year. Major agenda items reviewed and approved included important matters such as the Group's strategies, business plans, financial budget, disclosure of financial results, risk management and internal controls. Besides physical meetings, the Board also approved written resolutions on certain changes of senior management, and important work such as the commencement of assessment of individual Directors' performance pursuant to the HKMA's guideline on Empowerment of Independent Non-Executive Directors in the Banking Industry in Hong Kong.

The Board authorises the Management to implement the strategies as approved by the Board. The Management is responsible for the day-to-day operations of the Group and reports to the Board. For this purpose, the Board has formulated clear written guidelines which stipulate the

circumstances whereas the Management should report to and obtain prior approval from the Board before making decisions or entering into any commitments on behalf of the Group. The Board will conduct regular review on these authorisation and guidelines.

Roles of the Chairman and the Chief Executive

To avoid concentration of power in any single individual, the positions of the Chairman and the Chief Executive of the Company are held by two different individuals. Their roles are distinct, clearly established and stipulated in the Board's Mandate.

The Chairman is responsible for ensuring that the Board properly discharges its responsibilities and conforms to good corporate governance practices and procedures. In addition, as the Chairman of the Board, he is also responsible for ensuring that all Directors are properly briefed on all issues currently on hand, and that all Directors receive adequate, accurate and reliable information in a timely manner.

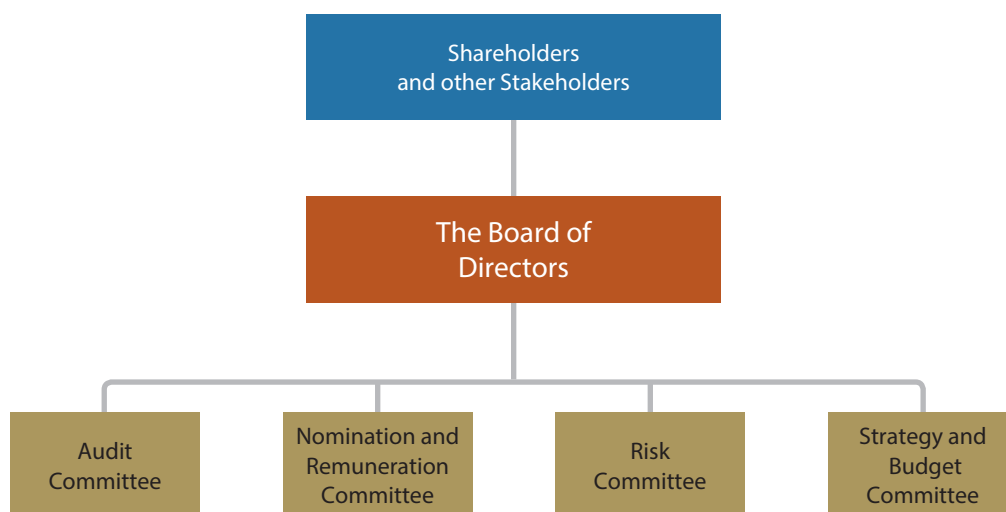
The Chief Executive is responsible for providing leadership for the whole management and implementing important policies and development strategies as adopted by the Board. Led by the Chief Executive, the Management Committee fulfils responsibilities including management of the Group's routine operation, implementation of business development strategies and realisation of the Group's long-term targets and strategies.

Board Committees

Taking into consideration the latest regulatory requirements, guidelines as well as market practices and international best practices, the Board has established four standing Board Committees to assist in performing its responsibilities, namely the Audit Committee, the Nomination and Remuneration Committee, the Risk Committee, and the Strategy and Budget Committee. In addition, the Board will authorise an Independent Board Committee comprising all the Independent Non-executive Directors as and when required to review, approve and monitor connected transactions (including continuing connected transactions) in accordance with relevant rules and regulations that should be approved by the Board.

Corporate Governance

Each of the Board Committees has a well-defined Mandate and makes recommendations to the Board on relevant matters within its scope of responsibilities or makes decisions under appropriate circumstances in accordance with the power delegated by the Board. All Board Committees are assigned a professional secretarial department which ensures that the Board Committees have adequate resources to perform their duties effectively and properly. All Board Committees adopt the same governance process as the Board as far as possible and report regularly to the Board on their decisions and their recommendations. The Board and Board Committees will participate in the annual performance appraisal of those professional secretarial departments to warrant and enhance the services provided and ensure that adequate and efficient supports are provided to the Board and Board Committees. In addition, according to their respective Mandates, the Board and each of the Board Committees will evaluate and review their work process and effectiveness annually, with a view to identifying areas for further improvements.



Details including the Company's corporate governance principles and framework adopted by the Board, the composition of the Board and each of the Board Committees and their respective Mandates, Corporate Governance Policy, Shareholder Communication Policy and Information Disclosure Policy are available under the sub-section "Corporate Governance" of the section headed "About Us" on the Company's website at www.bochk.com.

Board of Directors

Composition and Terms of Office of the Board

As at the date of this Annual Report, the Board is composed of nine Directors, of whom one is Executive Director, three are Non-executive Directors and five are Independent Non-executive Directors. The Board maintains an appropriate level of checks and balances to ensure independence and objectivity of the decisions of the Board, as well as the impartial oversight of the Management. The Board acts honestly and in good faith so that decisions are made objectively with a view to delivering long-term and

maximum shareholder value and fulfilling its corporate responsibility to other stakeholders of the Group.

Mr GAO Yingxin has been re-designated from Non-executive Director to Executive Director, appointed as Vice Chairman, Chief Executive and ceased to be a member of the Risk Committee effective from 1 January 2018, but remained as a member of the Strategy and Budget Committee. Mr REN Deqi resigned as Non-executive Director and ceased as Chairman of the Strategy and Budget Committee and a member of the Risk Committee with effect from 12 June 2018. Mr LIU Qiang was appointed as Non-executive Director, a member of each of the former Remuneration Committee and the Strategy and Budget Committee on 24 August 2018, and resigned such positions with effect from 18 September 2018. Mr LIN Jingzhen was appointed as Non-executive Director and a member of the Strategy and Budget Committee on 24 August 2018. Upon the re-organisation of the Nomination Committee and the Remuneration Committee into the Nomination and Remuneration Committee on 29 October 2018,



Dr CHOI Koon Shum was appointed as Chairman of the Nomination and Remuneration Committee, and other members are Mr CHEN Siqing, Mr KOH Beng Seng and Mr TUNG Savio Wai-Hok. Mr LIU Liange was appointed as Vice Chairman and Non-executive Director with effect from 15 December 2018; and was appointed as Chairman of the Strategy and Budget Committee with effect from 17 December 2018. Mr LAW Yee Kwan Quinn was appointed as Independent Non-executive Director and a member of each of the Audit Committee and the Risk Committee with effect from 13 March 2019. Mr LI Jiuzhong resigned as Executive Director and Chief Risk Officer with effect from 15 March 2019. Save as disclosed above, there are no other changes to the composition of the Board and Board Committees during the year and up to the date of this Annual Report.

All Non-executive Directors and Independent Non-executive Directors of the Company have been appointed for a fixed term of approximately three years, with formal letters of appointment setting out the key terms and conditions of their appointment. In accordance with Article 98 of the Articles of Association and pursuant to Code provision A.4.2 of the Corporate Governance Code, the terms of office of Mdm CHENG Eva and Dr CHOI Koon Shum will expire at the forthcoming annual general meeting, and being eligible, offer themselves for re-election. Further, pursuant to Article 102 of the Articles of Association, any Director appointed by the Board shall hold office only until the next following general meeting or the next following annual general meeting of the Company, and shall then be eligible for re-election at such meeting. Accordingly, the terms of office of Mr LIN Jingzhen, Mr LIU Liange and Mr LAW Yee Kwan Quinn, who were appointed on 24 August 2018, 15 December 2018 and 13 March 2019 respectively, will expire at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

Further details regarding the proposed re-election of Directors are set out in the section headed "Report of the Directors". In addition, the Company has also established a written and formal process for the appointment of the

Independent Non-executive Directors to ensure that the appointment procedures are standardised, thorough and transparent.

Selection, Diversity and Independence of Board Members

The Company recognises the importance and benefits of board diversity. In order to promote the Board's effectiveness and standards of corporate governance, the Company has adopted the "Board Diversity Policy" which will be considered in identifying suitable and qualified candidates to be a Board member. The said policy provides that in designing the Board's composition, board diversity should be considered in a number of aspects, including but not limited to gender, age, cultural and educational background, ethnicity, geographical location, professional experience, skills and knowledge, etc., to ensure an appropriate diversity of skills, backgrounds and viewpoints. At the same time, all Board appointments are made on merit, in the context of the skills and experience the Board as a whole required. The various perspectives of Board diversity elements as mentioned above shall also be adequately considered during the selection process of new Board members.

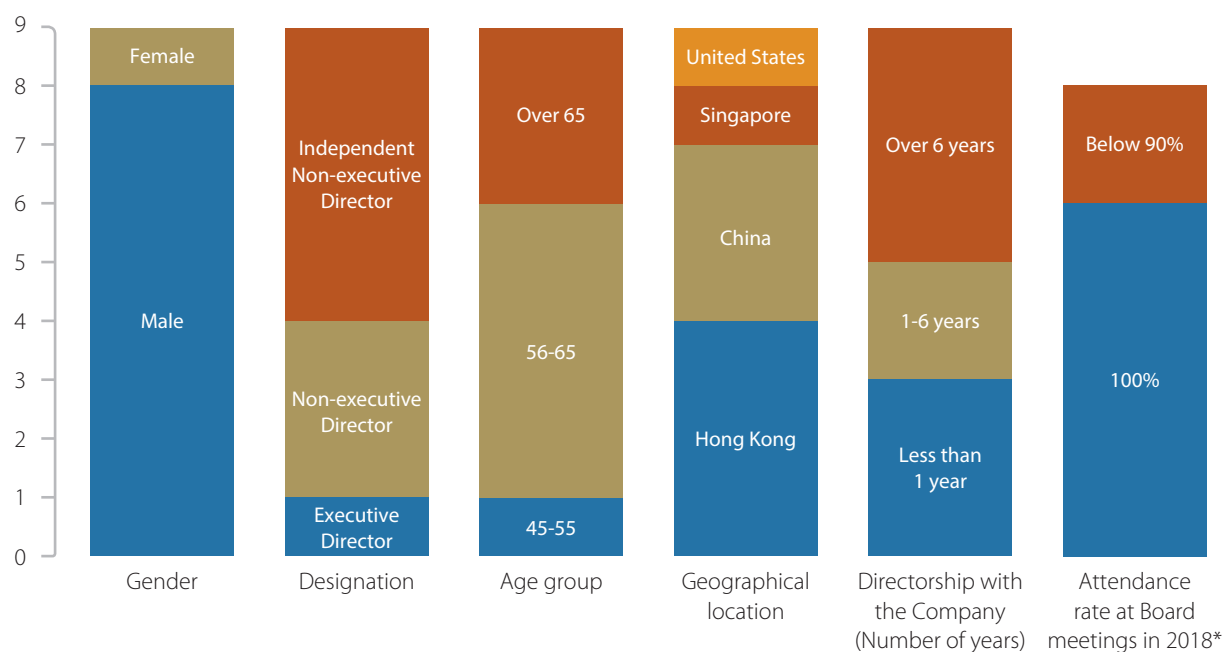
The Nomination and Remuneration Committee shall be responsible for the identification, nomination and selection of Directors. Potential candidates of Executive Directors could be sourced and selected amongst the senior management. Potential candidates of Independent Non-executive Directors could be recruited through global selection. Pursuant to the provisions of the Company's Articles of Association and relevant regulations, shareholders could also nominate a person other than a retiring Director for election as a Director (including Non-executive Director) at a general meeting. Where necessary, the Nomination and Remuneration Committee may appoint external advisors to assist in recruiting appropriate individuals. The appointment of Directors shall be eventually approved by the Board and/or shareholders at general meetings.

Corporate Governance

Under the current board membership, all Directors possess extensive experience in banking and/or management. In addition, over one-third of them are Independent Non-executive Directors, of whom possess experience in banking and financial industry as well as expertise in strategic development and risk management. The Board has formulated the “Policy on Independence of Directors” which stipulates the criteria on independence of the Independent Non-executive Directors. The Company has received from each of the Independent Non-executive Directors an annual confirmation of his/her independence by reference to the said independence policy. Based on the information available to the Company, it considers that all of the Independent Non-executive Directors are independent. Moreover, all Directors have disclosed to the Company their significant commitments and have undertaken and confirmed that they are able to devote sufficient time to the affairs of the Company. Biographical details of the professional experience, skills and knowledge of the Directors are set out in the section headed “Board of Directors and Senior Management” and are available under the sub-section “Organisation” of the section headed “About Us” on the Company’s website at www.bochk.com.

An analysis of the Board’s composition as at the date of this Annual Report is set out below:

Number of Directors



* Mr LAW Yee Kwan Quinn was appointed as Independent Non-executive Director with effect from 13 March 2019. Accordingly, attendance rate at Board meetings in 2018 is not applicable to him.

Mr CHEN Siqing, Mr LIU Liange and Mr LIN Jingzhen are Executive Directors of BOC. Mr GAO Yingxin was former Executive Director of BOC (he resigned such position with effect from 24 January 2018). During the year, Mr REN Deqi and Mr LIU Qiang were Executive Vice Presidents of BOC (they resigned such positions with effect from 12 June 2018 and 18 September 2018 respectively). Save as disclosed above, there are no other relationships between the Board members, including financial, business, family or other material relationships.

In addition, it is expressly provided in the Board’s Mandate that, unless the applicable laws or regulations allow

otherwise, if a substantial shareholder or Director has a conflict of interest in the matter to be considered by the Board, a Board meeting must be convened and attended by the Independent Non-executive Directors who have no material interest, and give professional advice to the subject matter for further consideration and approval.

Directors’ Liability Insurance Policy

During the year, the Company has arranged for appropriate cover on Directors’ Liability Insurance Policy to indemnify the Directors for liabilities arising from the corporate activities. The coverage and the amount insured under such policy are reviewed annually by the Company.



Self-evaluation of the Board

During the year, the Board conducted annual self-evaluation pursuant to the “Regulations on Self-Evaluation of the Board and Individual Evaluation of the Directors”. With the endorsement of the former Nomination Committee, the annual self-evaluation questionnaire was distributed to Directors for completion. Based on the completed questionnaire, the Company analysed the results and a report delineated the results and recommendation has been submitted to the Board for review and consideration.

Review of Effectiveness of the Individual Directors

During the year, the Company has also engaged an external professional consultant to conduct independent review of the effectiveness of the individual Directors. A questionnaire was distributed to all Directors for their completion and included Directors’ self-assessment in areas such as their time commitment and participation, interaction and communication with senior management, as well as evaluation of other members of the Board and Board Committees, and other factors that impact director effectiveness. Based on the completed questionnaire and other available information, the external consultant assessed the effectiveness of individual Directors and prepared a report setting out its observations and recommendations, which has been submitted to the Board for review and follow up actions.

Directors’ Training and Professional Development

To ensure the newly appointed Directors have adequate understanding of the Company’s business operations and to enable all Directors to update their knowledge regularly so as to provide informed recommendation and advice and make contribution to the Company, the Board has established a set of written policies specifying guidelines on Directors’ induction and training upon appointment.

The Company arranges appropriate Directors induction through the use of induction handbook, face to face meetings and other means, and in accordance with the needs of individual Directors. Topics include but not limited to:

- governance structure;
- standing agenda of the Board;

- regulatory requirements on corporate governance;
- focus of concern of regulators; and
- business operation, development plan and focus of internal control.

The Company also provides regular updates to Board members on material changes to regulatory requirements applicable to the Directors and the Group on a timely basis; and the Company arranges regular meetings with the Management to facilitate the understanding of its latest business development. In addition, Board members are encouraged to participate actively in continuous training programmes. The Company also arranges relevant professional training programmes for Board members at the Company’s expense.

During the year, all Directors have participated in continuous professional development to develop and refresh their knowledge and skills in accordance with Code provision A.6.5 of the Corporate Governance Code contained in Appendix 14 to the Listing Rules. In 2018, the Company invited expert to conduct seminar to the Directors and senior management with regard to cyber security.

Furthermore, each of the Directors has received a series of training locally or overseas as he/she thought fit, hosted or attended briefings, meetings, seminars, forums and conferences organised by the Company or regulatory authorities, including conference for independent non-executive directors organised by the HKMA which covered bank culture and technology impact; and regulator’s dialogue on recent developments in supervision of anti-money laundering and counter terrorist financing. Areas of relevant training included, among others:

- risk management and internal control;
- business conduct, anti-corruption and ethical standards;
- independent directors’ role in corporate governance;
- anti-money laundering;
- corporate governance and bank culture transformation;
- developments of technology;
- regulatory updates; and
- banking industry development trend, etc.

Corporate Governance

The Directors' records of annual training information have been entered in the register of directors' training records maintained and updated by the Company from time to time. As at year end, the participation of all Directors on continuous professional development is summarised as follows:

Directors ^{Note}	Business Conduct, Anti-Corruption and Ethical Standards/Corporate Governance	Risk Management and Internal Control/ Regulatory Updates	Banking Industry Development Trend
Non-executive Directors			
Mr CHEN Siqing	✓	✓	✓
Mr LIU Liange <i>(appointment effective from 15 December 2018)</i>	✓	✓	✓
Mr LIN Jingzhen <i>(appointment effective from 24 August 2018)</i>	✓	✓	✓
Independent Non-executive Directors			
Mdm CHENG Eva	✓	✓	✓
Dr CHOI Koon Shum	✓	✓	✓
Mr KOH Beng Seng	✓	✓	✓
Mr TUNG Savio Wai-Hok	✓	✓	✓
Executive Directors			
Mr GAO Yingxin <i>(re-designation from Non-executive Director to Executive Director effective from 1 January 2018)</i>	✓	✓	✓
Mr LI Jiuzhong <i>(resignation effective from 15 March 2019)</i>	✓	✓	✓

Note: The training records for those Directors who have resigned during the year and appointed after year end are not included herein. Please refer to the section headed "Composition and Terms of Office of the Board" under "Board of Directors" for details of changes in Directors during the year and up to the date of this Annual Report.

Directors' Attendance of the Meetings of the Board of Directors, Board Committees and General Meeting

Six Board meetings were held during 2018 with an average attendance rate of 96%. Regular meeting schedule for the year was prepared and approved by the Board in the preceding year. Formal notices of regular Board meetings were sent to all Directors at least 14 days before the date of the scheduled meetings and Board agenda and meeting materials were despatched to all Board members for review at least 7 days prior to the scheduled meetings. Board agendas were approved by the Chairman following consultation with other Board members and the senior management.

In addition, in order to facilitate open discussion with all the Non-executive Directors and on their requests, the Chairman met with all the Non-executive Directors (including the Independent Non-executive Directors) in the absence of the Executive Directors and the senior management, during the discussion session after each Board meeting. Relevant practice has been incorporated in the Working Rules of the Board.



Details of respective Directors' attendance at the Board meetings, Board Committee meetings and annual general meeting in 2018 are set out as follows:

Directors ^{Note}	Number of meetings attended/Number of meetings convened during Directors' term of office							
	Board	Board Committees						General Meeting
		Audit Committee	Nomination Committee	Remuneration Committee	Nomination and Remuneration Committee	Risk Committee	Strategy and Budget Committee	Annual General Meeting
Number of meetings held during the year	6	5	2	1	1	5	5	1
Non-executive Directors								
CHEN Siqing (<i>Chairman</i>)	5/6	–	1/2	0/1	1/1	–	–	1/1
LIU Liange (<i>Vice Chairman</i>) (<i>appointed with effect from 15 December 2018</i>)	1/1	–	–	–	–	–	–	–
LIN Jingzhen (<i>appointed with effect from 24 August 2018</i>)	3/3	–	–	–	–	–	0/3	–
LIU Qiang (<i>appointed with effect from 24 August 2018, resigned effective from 18 September 2018</i>)	1/1	–	–	–	–	–	0/1	–
REN Deqi (<i>resigned effective from 12 June 2018</i>)	2/2	–	–	–	–	0/1	0/1	–
Independent Non-executive Directors								
CHENG Eva	6/6	5/5	–	–	–	–	5/5	1/1
CHOI Koon Shum	5/6	2/5	2/2	1/1	1/1	–	–	0/1
KOH Beng Seng	6/6	5/5	2/2	1/1	1/1	5/5	–	1/1
TUNG Savio Wai-Hok	6/6	5/5	2/2	1/1	1/1	5/5	5/5	1/1
Executive Directors								
GAO Yingxin (<i>re-designated as Executive Director and appointed as Vice Chairman and Chief Executive effective from 1 January 2018</i>)	6/6	–	–	–	–	–	5/5	1/1
LI Jiuzhong (<i>resigned effective from 15 March 2019</i>)	6/6	–	–	–	–	–	–	1/1
Average Attendance Rate	96%	85%	88%	75%	100%	93%	77%	86%

Note: The attendance record for Director who has been appointed after year end is not included herein. Please refer to the section headed "Composition and Terms of Office of the Board" under "Board of Directors" for details of changes in Directors during the year and up to the date of this Annual Report.

Apart from formal Board meetings and annual general meeting, the Company has set up a system of pre-communication meeting for the Independent Non-executive Directors, where major agenda items have been presented to the Independent Non-executive Directors before each Board meeting, and their comments have been timely conveyed to the Management for follow up actions so as to enhance the effectiveness of deliberation at Board meetings.

Corporate Governance

Moreover, the Company has arranged, on a regular basis, other informal events for the Board members and the senior management to facilitate their communication and interactions. For example, the Company has organised working meals from time to time, Board members and the senior management have been invited to join and share insights on the Company's business and strategic issues. In consideration of the schedule of Directors (in particular the Independent Non-executive Directors), a board retreat will be held to enhance communication between the Board and the senior management.

Board Committees

Audit Committee

The Audit Committee comprised 4 members at the end of the year, all of whom are Independent Non-executive Directors. Its composition, main duties and major works performed during the year are as follows:

Composition

Mr TUNG Savio Wai-Hok (Chairman)
Mdm CHENG Eva
Dr CHOI Koon Shum
Mr KOH Beng Seng

Main duties

- integrity of financial statements and financial reporting process
- monitoring of risk management and internal control systems
- effectiveness of internal audit function and performance appraisal of the General Manager of Group Audit
- appointment of external auditor and assessment of its qualification, independence and performance and, with authorisation of the Board and shareholders at general meeting, determination of its remuneration
- periodic review and annual audit of the Company's and the Group's financial statements, and financial and business review
- compliance with applicable accounting standards as well as legal and regulatory requirements on financial disclosures
- corporate governance framework of the Group and implementation thereof

Major works performed during the year (included the review and, where applicable, approval of)

- the Company's financial statements for the year ended 31 December 2017 and the annual results announcement that were recommended to the Board for approval
- the Company's interim financial statements for the six months ended 30 June 2018 and the interim results announcement that were recommended to the Board for approval
- the Company's announcements on quarterly financial and business review for the period ended 31 March 2018 and 30 September 2018 that were recommended to the Board for approval
- the audit reports and report on internal control recommendations submitted by external auditor, the audit reports submitted by internal audit, and the on-site examination reports issued by regulators
- the proposed appointment of external auditor, the fees payable to external auditor for the annual audit, interim review and other non-audit services
- the Group's audit plan for next year and key areas identified
- the organisation structure, deployment of human resources and pay level of the Internal Audit, its budget for next year
- annual review of the effectiveness of the internal audit function
- the 2017 performance appraisal and key performance indicators for the General Manager of Group Audit and the Group Audit for next year
- the annual review of the effectiveness of the Group's risk control and internal control systems
- annual review of the "Policy on External Auditor Management", the "Policy on Staff Reporting of Irregularities" and the "Internal Audit Charter"



Nomination and Remuneration Committee

The Nomination Committee and the Remuneration Committee have been re-organised into Nomination and Remuneration Committee with effect from 29 October 2018 (the "Re-organisation"), which comprised 4 members at the end of the year, including 1 Non-executive Director and 3 Independent Non-executive Directors. Immediately before the Re-organisation, each of the Nomination Committee and the Remuneration Committee comprised 4 members, including 1 Non-executive Director and 3 Independent Non-executive Directors.

The composition, main duties and major works of the Nomination Committee, the Remuneration Committee and the Nomination and Remuneration Committee performed during the year are as follows:

Composition

Dr CHOI Koon Shum¹ (Chairman)
 Mr CHEN Siqing²
 Mr KOH Beng Seng³
 Mr TUNG Savio Wai-Hok³

Main duties

Main duties of the Nomination Committee before the Re-organisation

- review of overall human resources strategies of the Group
- selection and nomination of Directors, Board Committee members and Senior Management
- regular monitoring and review of structure, size and composition (including but not limited to gender, age, cultural and educational background, ethnicity, geographical location, professional experience, skills and knowledge, etc.) of the Board and Board Committees
- review of the effectiveness of the Board and Board Committees
- ensuring the participation in training and continuous professional development of Directors and Senior Management

Main duties of the Remuneration Committee before the Re-organisation

- review and recommendation of remuneration strategy and incentive framework of the Group
- setting of the remuneration of Directors, Board Committee members, Senior Management and Key Personnel
- oversight of corporate culture of the Group
- regular review of code of conduct applicable to employees

Main duties of the Nomination and Remuneration Committee

- All the duties of the Nomination Committee and the Remuneration Committee have been assigned to the Nomination and Remuneration Committee upon the Re-organisation

Nomination and Remuneration Committee (continued)

Major works performed during the year (included the approval, review and proposal to the Board)

Performed by the Nomination Committee before the Re-organisation

- formulation, review and amendment on the major human resources policies
- consideration of the matters related to the appointment of directors
- consideration of the matters relating to the appointment and dismissal of Senior Management
- consideration of the re-organisation of the Nomination Committee and the Remuneration Committee
- set the tenure limit for the members of Board committees
- coordination and oversight of the annual self-evaluation of the Board and individual evaluation of the directors
- annual review on the “Policy on Independence of Directors”

Performed by the Remuneration Committee before the Re-organisation

- formulation, review and amendment on the major remuneration policies
- performance appraisal result of the Executive Director and Senior Management for year 2017
- proposal on staff bonus for year 2017 and salary adjustment for year 2018 for the Group, including Senior Management
- annual review on the “Policy on Directors’ Remuneration”
- annual review on the “Staff Code of Conduct”
- implementation of the HKMA bank culture reform

Performed by the Nomination and Remuneration Committee

- formulation, review and amendment on the major human resources and remuneration policies
- consideration of the matters related to the appointment of directors
- consideration of the matters relating to the appointment and remuneration of Senior Management
- key performance indicators of the Group and the Senior Management for year 2019
- proposal on human resources budget of the Group for year 2019

Notes:

1. Independent Non-executive Director, Chairman of the former Remuneration Committee and a member of the former Nomination Committee, appointed as Chairman of the Nomination and Remuneration Committee with effect from 29 October 2018
2. Non-executive Director, Chairman of the former Nomination Committee and a member of the former Remuneration Committee, a member of the Nomination and Remuneration Committee with effect from 29 October 2018
3. Independent Non-executive Director, member of the former Nomination Committee and former Remuneration Committee, member of the Nomination and Remuneration Committee with effect from 29 October 2018



Risk Committee

The Risk Committee comprised 2 members at the end of the year, both of whom are Independent Non-executive Directors. Its composition, main duties and major works performed during the year are as follows:

Composition

Mr KOH Beng Seng (Chairman)
Mr TUNG Savio Wai-Hok

Main duties

- formulation of the risk appetite and risk management strategy of the Group and determination of the Group's risk profile
- identification, assessment and management of material risks faced by various business units of the Group
- review and assessment of the adequacy and effectiveness of the Group's risk management policies, systems and internal controls
- review and monitoring of the Group's capital management
- review and approval of the Group's target balance sheet
- review and monitoring of the Group's compliance with risk management policies, systems and internal controls, including the Group's compliance with prudential, legal and regulatory requirements governing the businesses of the Group
- review and approval of high-level risk-related policies of the Group
- review and approval of significant or high risk exposures or transactions
- review of key reports, including risk exposure reports, model development and validation reports, and credit risk model performance reports

Major tasks performed during the year

- review and approval of key risk management policies of the Group, including the risk appetite, the "Operating Principles", the "Risk Management Policy Statement", the "Capital Management Policy", the "Financial Instruments Valuation Policy", the "Risk Data Aggregation and Risk Reporting Policy", the "Policy for Validating Internal Rating Systems", the "Anti-Money Laundering and Counter-Terrorist Financing Policy", the "Product Development and Risk Monitoring Management Policy", the "Connected Transactions Management Policy", the "Sharing and Use of Credit Data Management Policy", the "Data Management Policy", the "Stress Test Policy" and stress test scenarios, and a range of risk management policies covering credit risk, market risk, liquidity risk, interest rate risk, operational risk, technology risk, legal, compliance and reputation risk, strategic risk, etc.
- review and approval of the proposal for the annual review of the Group's recovery plan, the proposal for the annual review of the market risk stressed VaR model parameter, the risk adjustment method for group bonus funding mechanics and the approval of the results of risk adjustment of the Group for 2017
- review and approval of the Group's operating plans, including the Group's target balance sheets, the banking book investment plans and portfolio key risk indicators, medium term capital planning, as well as risk management limits
- review and monitoring of Basel Accord implementation, including review of model validation reports, model performance reports, and receiving the status reports of the allocation of risk-weighted assets and update
- review of various risk management reports, including the Group's risk management reports, reports on assessment of the impact of market volatility on the Bank's business and its credit risk, market risk, interest rate risk and liquidity risk, the report on comparison of the expected credit loss under the HKFRS 9 and the collective/individual impairment under HKAS 39, the report on the "Guidelines on Risk Management, Compliance and Internal Control of ASEAN entities" and its implementation status and the 2017 institutional money laundering/terrorist financing risk assessment report, etc.

Corporate Governance

Strategy and Budget Committee

The Strategy and Budget Committee comprised 5 members at the end of the year, including 2 Non-executive Directors, 2 Independent Non-executive Directors as well as the Chief Executive and Executive Director of the Company. Its composition, main duties and major works performed during the year are as follows:

Composition

Mr LIU Liange¹
Mr GAO Yingxin²
Mr LIN Jingzhen³
Mdm CHENG Eva⁴
Mr TUNG Savio Wai-Hok⁴

Main duties

- review the Group's medium to long-term strategic plan for Board approval
- monitor the Group's implementation of medium to long-term strategy, provide guidance on strategy direction for management
- review of major investments, capital expenditure and strategic commitments of the Group, and make recommendations to the Board
- review and monitoring of the Group's regular/periodic (including annual) business plan
- review of budget for Board's approval and monitoring of performance against budgeted targets

Major works performed during the year

- review of the Group's capital injection to Southeast Asian entities for Board's approval
- review of the Group's acquisition of certain Southeast Asian branches of BOC and setting up the Southeast Asian business operation centre for Board's approval
- review of the proposals for fintech projects and capital injection in order to promote the Group's digital development for Board's approval
- received and discussed on the Group's medium and long-term development strategy plan
- received and discussed on the strategic positioning, deployments and key measures determined by the Group around the Guangdong-Hong Kong-Macao Greater Bay Area Plan
- review of the Group's proposal of property redevelopment and adjustment of the cap on charitable donations for Board's approval
- review and monitoring of the implementation of 2018 Financial Budget and Business Plan of the Group, and also review and endorsement of the Financial Budget and Business Plan of the Group submitted by the Management for the year 2019 and recommendation of the same to the Board

Notes:

1. Non-executive Director and appointed as Chairman of Strategy and Budget Committee with effect from 17 December 2018
2. Executive Director
3. Non-executive Director
4. Independent Non-executive Director



Directors' Securities Transactions

The Company has established and implemented the "Code for Securities Transactions by Directors" (the "Company's Code") to govern the Directors' dealings in securities transactions of the Company. Terms of the Company's Code are more stringent than the mandatory standards set out in the "Model Code for Securities Transactions by Directors of Listed Issuers" as contained in Appendix 10 of the Listing Rules. Apart from the securities of the Company, the Company's Code also applies to the Director's dealings in the securities of BOC and its subsidiary, BOC Aviation Limited, which have been listed on the Stock Exchange of Hong Kong since June 2006 and June 2016 respectively.

Upon specific enquiry by the Company, all Directors confirmed that they have strictly complied with the provisions as set out in both the Company's Code and the said Model Code throughout year 2018.

Directors' Remuneration

Pursuant to the "Policy on Directors' Remuneration" adopted by the Company, when recommendation of the remuneration of Directors is made, the Nomination and Remuneration Committee should benchmark against companies of comparable business type or scale, the role (chairmanship or membership) they played, job nature and workload at both the Board and Board Committee levels (including frequency of meetings and nature of agenda items) in order to compensate Directors fairly. The remuneration of Directors is subject to regular review based on market practices, regulatory requirements and inflation, etc. No individual Director is allowed to participate in the procedures for deciding his/her individual remuneration package. The remuneration of the Independent Non-executive Directors is not linked with the performance of the Company. Information relating to the remuneration of each Director for 2018 is set out in Note 21

to the Financial Statements. The present scale of Director's fees, including additional fees for membership of Board Committees, is given below:

Board of Directors:	
All Directors	HK\$400,000 p.a.
Board Committees:	
Chairman	HK\$100,000 p.a.
Other Committee members	HK\$50,000 p.a.

Note: For the year ended 31 December 2018, all Non-executive Directors (excluding Independent Non-executive Directors) have not received their Directors' fees as mentioned above and Executive Directors did not receive any fees for being members of the Board and its Committees.

The Nomination and Remuneration Committee also has the delegated responsibility from the Board to determine the remuneration packages of the Executive Directors and the Senior Management, including benefits in kind, pension rights and compensation payments (including any compensation payable for loss or termination of their office or appointment, early payout of deferred remuneration), as well as the performance-based remuneration. Moreover, it will recommend to the Board on their remuneration package upon joining, sign-on bonus and contract guaranteed bonus, etc.

Remuneration and Incentive Mechanism

The Remuneration and Incentive Mechanism of the Group is based on the principles of "effective motivation" and "sound remuneration management". It links remuneration with performance and risk factors closely. It serves to encourage staff to enhance their performance, and at the same time, to strengthen their awareness of risk so as to achieve sound remuneration management.

Corporate Governance

The Remuneration and Incentive Policy of the Group is generally in line with the broad principles set out in the HKMA's "Guideline on a Sound Remuneration System" and applicable to the Company and all of its subsidiaries (including the branches and entities in and out of Hong Kong).

- **"Senior Management" and "Key Personnel"**

The Remuneration and Incentive Policy of the Group defines "Senior Management" and "Key Personnel" as follows:

- "Senior Management": The senior executives designated by the Board who are responsible for oversight of the firm-wide strategy or material business lines, including the Chief Executive, Deputy Chief Executives, Chief Financial Officer, Chief Risk Officer, Chief Operating Officer, Board Secretary and General Manager 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, senior executives of Southeast Asian entities, head of trading, as well as heads of risk control functions.

- **Determination of the Remuneration Policy**

To fulfil the above-mentioned principles and to facilitate effective risk management within the framework of the Remuneration Policy of the Group, the Remuneration Policy of the Group is initiated by Human Resources Department with consultation of the risk control units including risk management, financial management and compliance in order to balance the needs for staff motivations, sound remuneration and prudent risk management. After the proposed Remuneration Policy is cleared by the Management Committee, it will be submitted to the Nomination and Remuneration Committee for review and thereafter to the Board for approval. The Nomination and Remuneration Committee

and the Board will seek opinions from other Board Committees (e.g. Risk Committee, Audit Committee, etc.) where they consider necessary under the circumstances.

- **Key Features of the Remuneration and Incentive Mechanism**

1. *Performance Management Mechanism*

To reflect the "performance-driven" corporate culture, the Group has put in place a performance management mechanism to formalise the performance management at the levels of the Group, units and individuals. The annual targets of the Group will be cascaded down under the framework of balanced scorecard whereby the performance of the "Senior Management" and different units (including business units, risk control units and other units) would be assessed from the perspectives of financial, customer, building blocks/key tasks, human capital, risk management and compliance. For individual staff at different levels, annual targets of the Group will be tied to their job requirements through the performance management mechanism. Performance of individuals will be appraised on their achievement against targets, their contribution towards performance of their units, fulfilment of risk management duties and compliance and adherence to the Group's corporate culture, etc. Not only is target accomplishment taken into account, but also the values-based behaviours and sufficient risk management during the course of work, ensuring prudent operation and sustainable development of the Group.

2. *Risk Adjustment of Remuneration*

To put the principle of aligning performance and remuneration with risk into practice, based on "The Risk Adjustment Method", the key risk modifiers of BOCHK have been incorporated into the performance management mechanism of the Group. Credit risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk, compliance risk and reputation risk form the framework of "The Risk Adjustment Method". The size of the bonus pool of the Group is calculated according to the risk adjusted performance results approved by the Board and is subject to the Board's discretion. This method ensures the Group to fix the Group's bonus pool after considering risk exposures and changes and to maintain effective risk management through the remuneration mechanism.



3. Performance-based and Risk-adjusted Remuneration Management

The remuneration of staff is composed of “fixed remuneration” and “variable remuneration”. The proportion of one to the other for individual staff members depends on job grades, roles, responsibilities and functions of the staff with the prerequisite that balance has to be struck between the fixed and variable portion. Generally speaking, the higher the job grades and/or the greater the responsibilities, the higher will be the proportion of variable remuneration so as to encourage the staff to follow the philosophy of prudent risk management and sound long-term financial stability.

Every year, the Group will conduct periodic review on the fixed remuneration of the staff with reference to various factors like remuneration strategy, market pay trend and staff salary level, and will determine the remuneration based on the affordability of the Group as well as the performance of the Group, units and individuals. As mentioned above, performance assessment criteria include quantitative and qualitative factors, as well as financial and non-financial indicators.

According to the “BOCHK Group Bonus Funding Policy”, the size of the bonus pool of the Group is determined by the Board on the basis of the financial performance of the Group and the achievement of non-financial strategic business targets under the long-term development of the Group. Thorough consideration is also made to the risk factors in the determination process. The size of the bonus pool is reached based on pre-defined formulaic calculations but the Board can make discretionary adjustment to it if deemed appropriate under prevailing circumstances. When the Group’s performance is relatively weak (e.g. failed to meet the threshold performance level), no bonus will be paid out that year in principle. However, the Board reserves the rights to exercise its discretion.

As far as individual units and individual staff are concerned, allocation of the variable remuneration is closely linked to the performance of the units, and that of each individual staff as well as the unit he/she is attaching to, and the assessment of which should include risk modifiers. The performance and remuneration arrangement of risk control personnel are determined by the achievement of their core job responsibilities, independent from the business they oversee; for front-

line risk controllers, a cross-departmental reporting and performance management system is applied to ensure the suitability of performance-based remuneration. Within the acceptable risk level of the Group, the better the performance of the unit and the individual staff, the higher will be the variable remuneration for the individual staff. The allocation of variable remuneration to staff should also consider individual behaviour comprehensively. For behaviour which is positive and adhering to the Group’s corporate culture, the variable remuneration should be tilted forward; for misconduct or behaviour which is negative and not adhering to the Group’s corporate culture, the variable remuneration should be forfeited or reduced.

4. Linking the payout of the variable remuneration with the time horizon of the risk to reflect the long-term value creation of the Group

To work out the principle of aligning remuneration with the time horizon of risk and to ensure that sufficient time is allowed to ascertain the associated risk and its impact before the actual payout, payout of the variable remuneration of staff is required to be deferred in cash if such amount reaches certain prescribed threshold. The Group adopts a progressive approach towards deferral. The longer the time horizon of risk in the activities conducted by the staff and the higher amount of the variable remuneration, the higher will be the proportion of deferral. Deferral period lasts for 3 years.

The vesting of the deferred variable remuneration is linked with the long term value creation of the Group. The vesting conditions are closely linked to the annual performance of the Group in the next 3 years and the individual behaviour of the staff concerned. When the Group’s performance has met the threshold requirement, the deferred variable remuneration would be vested following the corresponding schedule. However, if a staff is found to have committed fraud, or any financial or non-financial factors used in performance measurement or variable pay determination are later proven to have been manifestly worse than originally understood in a particular year, or individual behaviour/management style pose negative impacts to the business unit and even the Group, including but not limited to improper or inadequate risk management, significant incident and economic loss incurred by improper management, etc., the unvested portion of the deferred variable remuneration of the relevant staff would be forfeited.

Corporate Governance

- **Annual Review of Remuneration Policy**

The Remuneration Policy of the Group is subject to annual review with reference to changes on external regulatory requirements, market conditions, organisational structure and risk management requirements, etc. Due to changes in organisational structure and job establishment, the Group reviewed the position lists of “Senior Management”, “Key Personnel” etc. as delineated in the “BOCHK Group Remuneration and Incentive Policy”.

- **External Remuneration Consultant**

To ensure the suitability and competitiveness of the remuneration and incentive mechanism, the Group appointed Willis Towers Watson for independent consultation in areas of pay management of the Independent Non-executive Directors, Senior Management and key positions, regional remuneration management mechanics and market remuneration data, etc.

- **Disclosure on Remuneration**

The Group has fully complied with the guideline in Part 3 of the “Guideline on a Sound Remuneration System” issued by the HKMA to disclose information in relation to our remuneration and incentive mechanism.

External Auditor

Pursuant to the “Policy on External Auditor Management” adopted by the Board, the Audit Committee reviewed and monitored and was satisfied with the independence and objectivity of Ernst & Young, the Group’s external auditor, and the effectiveness of its audit procedures, based on the principles and standards set out in the said Policy that were in line with international best practices. Upon the recommendation of the Audit Committee, the Board will propose that Ernst & Young be re-appointed as auditor of the Group at the Company’s 2019 annual general meeting. Subject to shareholders’ authorisation, the Board will authorise the Audit Committee to determine the remuneration of Ernst & Young. For 2018, the fee paid or payable by the Group to Ernst & Young was HK\$51 million (2017: HK\$39 million), of which HK\$28 million (2017: HK\$28 million) related to audit services and HK\$23 million (2017: HK\$11 million) related to other services (mainly including tax-related and advisory services). The Audit Committee was satisfied that the non-audit services in 2018 did not affect the independence of Ernst & Young.

Risk Management and Internal Control

The Board is responsible for evaluating and determining the nature and extent of the risks it is willing to take in achieving the Group’s strategic objectives, and ensuring that the Group establishes and maintains appropriate and effective risk management and internal control systems. The Board oversees the Management in the design, implementation and monitoring of the risk management and internal control systems. According to the Board’s scope of delegation, the Management is responsible for the day-to-day operations and risk management, and the Management needs to provide a confirmation to the Board on the effectiveness of these systems.

The risk management and internal control systems are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss; to manage the risk of system failure; and to assist in the achievement of the Group’s objectives. In addition to safeguarding the Group’s assets, it also ensures the maintenance of proper accounting records and compliance with relevant laws and regulations.

The Group conducts an annual review of the effectiveness of its risk management and internal control systems covering all material controls, including financial, operational and compliance controls as well as risk management. The review is conducted by reference to the guidelines and definitions given by the regulatory and professional bodies for the purpose of assessing five different internal control elements, namely, the control environment, risk assessment, control activities, information and communication, and monitoring. The assessment covers all the major internal controls and measures, including financial, operational and compliance controls as well as risk management functions. The review also considers the adequacy of resources, staff qualifications and experience and training of the Group’s accounting, financial reporting and internal audit functions. The review is coordinated by the Group’s internal audit which, after the Management and various business departments have performed their self-assessment and the Management has confirmed the effectiveness of the relevant systems, then carries out an independent examination and other post-assessment work on the review process and results. The results of the 2018 review, which have been reported to the



Audit Committee and the Board, revealed that the Group's risk management and internal control systems were effective and adequate.

In addition, the key procedures that the Group has essentially established and implemented to provide internal controls are summarised as follows:

- a rational organisational structure with appropriate personnel is developed and whose responsibility, authority, and accountability are clearly delineated. The Group has formulated policies and procedures to ensure reasonable checks and balances for all the operating units, reasonable safeguard for the Group's assets and adherence to relevant laws and regulations and risk management in its operations;
- the Management draws up and continuously monitors the implementation of the Group's strategies, business plans and financial budgets. The accounting and management systems that are in place provide the basis for evaluating financial and operational performance;
- the Group has various risk management and human resources policies. There are specific units and personnel that are responsible for handling reputation, strategic, legal, compliance, credit, market, operational, liquidity and interest rate risks. There are also procedures and internal controls for the handling and dissemination of inside information. The Group has set up mechanisms to identify, evaluate and manage all the major risks, and has established corresponding internal control procedures as well as processes for resolving internal control defects. (The Group's risk management is given on pages 48 to 53);
- the Group has established an information technology governance structure that produces a range of reports on information systems and management, including information on the monitoring of various business units, financial information and operating performance. Such

information facilitates the Management, business units and the regulatory bodies in assessing and monitoring the Group's operation and performance. Proper communication channels and reporting mechanisms are in place at various business units and levels to facilitate exchange of information;

- pursuant to a risk-based approach and in accordance with the internal audit plan approved by the Audit Committee, the Group's internal audit conducts independent reviews on such aspects as financial activities, various business areas, various kinds of risks, operations and activities. Reports are submitted directly to the Audit Committee. The Group's internal audit closely follows up on the items that require attention in a systematic way and reports to the Management and the Audit Committee in a timely manner; and
- the Audit Committee reviews the reports submitted by external auditor to the Group's Management in connection with the annual audit as well as the recommendations made by regulatory bodies on risk management and internal control. The Group's internal audit follows up on the same to ensure timely implementation of the recommendations, and also periodically reports the status of the implementation to the Management and the Audit Committee.

The Group is committed to upholding good corporate governance practices and the internal control system of all subsidiaries are reviewed regularly. During the year of 2018, continuous improvements on the organisation structure and segregation of duty, the risk management policy and procedure, and the enhancement of disclosure transparency have been undertaken by the Group. In response to internal and external changes in global economic condition, operating environment, regulatory requirement and business development, the Group has implemented a series of measures and undertaken an on-going review on the effectiveness of the internal control mechanism. In 2018, areas for improvement have been identified and appropriate measures have been implemented.

Corporate Governance

Communication with Shareholders

The Board attaches a high degree of importance to continuous communication with shareholders, particularly through direct dialogue with them at the Company's annual general meetings. Shareholders are encouraged to actively participate in such meetings.

Mr CHEN Siqing (Chairman of the Company and the former Nomination Committee), Mr TUNG Savio Wai-Hok (Chairman of the Audit Committee), and Mr KOH Beng Seng (Chairman of the Risk Committee), were present at the Company's 2018 annual general meeting held on 27 June 2018 at Grand Ballroom, The Lobby Floor, Grand Hyatt Hong Kong, 1 Harbour Road, Wan Chai, Hong Kong, as well as Ernst & Young, the auditor, were also present at the Company's 2018 annual general meeting to respond to enquiries raised by shareholders. Dr CHOI Koon Shum (Chairman of the former Remuneration Committee) was unable to attend the meeting due to other business engagements. Save as disclosed above, all other Directors including Mr GAO Yingxin, Mr LI Jiuzhong and Mdm CHENG Eva were also present at the meeting.

Summary of the resolutions passed at the Company's 2018 annual general meeting and the percentage of votes cast in favour are as follows:

Resolutions	Percentage Voted For
Approval of audited financial statements and the Reports of Directors and of the Auditor	99.96%
Declaration of final dividend	99.99%
Re-election of Directors	99.26% to 99.99%
Re-appointment of Auditor	99.65%
Grant of general mandate to issue shares	84.93%
Grant of general mandate to buy back shares	99.99%
Extension of the general mandate to issue shares by adding the number of shares bought back	85.86%

Further details of the voting results are available under the sub-section "Stock Exchange Announcements" of the section headed "Investor Relations" on the Company's website at www.bochk.com.

As disclosed in the 2017 Annual Report of the Company, in view of the investors' concern regarding the potential dilution of the shareholder value arising from the exercise of power pursuant to the grant of a general mandate to issue shares to the Board, the Board has voluntarily reduced the general mandate to issue shares of up to 5% of the total number of shares in issue as compared to the 20% limit permitted under the Listing Rules in the event that the issue of shares is for cash and not related to any acquisition of assets for approval by the shareholders at the 2018 annual general meeting. The Board would also recommend the threshold of up to 5% of the total number of shares in issue (subject to adjustment in case of any subdivision and consolidation of shares after the passing of the relevant resolution) at the 2019 annual general meeting for approval by shareholders.



Further, given its commitment to high standards of corporate governance, the Board also adopted certain internal policies for the exercise of the powers granted to the Board under the general mandates to issue shares solely for cash and buy back shares. The relevant policies are summarised as follows:

- the Board will not exercise the mandate at a discount that will result in significant dilution of shareholder value. In the exercise of such power to issue shares for cash, the Board will have regard to factors such as the Group's total capital ratio, and in particular, its Tier 1 capital, cost and benefit of raising Tier 2 capital, need for cash for the Group's business development, the principle that shareholders should be treated equally and the alternative of conducting a rights issue; and
- the Board has set the triggering events for the exercise of the power to buy back shares, which include: market price of the Company's shares is lower than the fair value of the shares; the Group has surplus funds which is in excess of its short to mid term development requirements; and the Board considers it proper and appropriate to exercise relevant mandate for enhancing the return on equity or net assets or earnings per share of the Company. In general, such share buy-backs will be made on the Stock Exchange. However, if it is expected that the size of the share buy-backs may lead to a disorderly market for the Company's shares, then the Board will consider making

the share buy-backs through a general offer, i.e. offer to all existing shareholders in proportion to their respective shareholdings. The price at which shares are bought back will not be higher than the fair value of the shares of the Company.

All the resolutions to be proposed at the Company's 2019 annual general meeting will be voted on by poll. Accordingly, the Company will engage Computershare Hong Kong Investor Services Limited, the Company's Share Registrar, to act as the scrutineer for such purpose. The results of the poll voting will be posted on the Stock Exchange's website and the Company's website as soon as practicable following conclusion of the vote-counting for shareholders' information.

Besides, in order that shareholders can have a better understanding of the agenda items to be discussed at the 2019 annual general meeting and to encourage their active participation so that exchange of views and communication can be further enhanced, the Company will provide detailed information on the 2019 annual general meeting in a circular to shareholders which will include introduction to the proposed resolutions to be approved at the annual general meeting, information on the retiring Directors who are eligible for re-election, information on voting and other issues relating to the 2019 annual general meeting in the form of "Frequently Asked Questions".

Shareholders' Rights

Shareholders are entitled to convene an extraordinary general meeting, propose a resolution at an annual general meeting, and propose a person for election as a Director. Please see the detailed procedures as follows:

- **the way in which shareholders can convene an extraordinary general meeting:**

Any shareholder(s) holding not less than 5% of total voting rights of all the shareholders who have a relevant right to vote may request the Board to convene an extraordinary general meeting. The request, duly signed by the shareholder(s) concerned, must clearly state the general nature of the business to be dealt with at the meeting and may include the text of the proposed resolution. Such request must be deposited at the registered office of the Company, 24th Floor, Bank of China Tower, 1 Garden Road, Hong Kong. The Company would take appropriate actions and make necessary arrangements in accordance with the requirements under sections 566 to 568 of the Hong Kong Companies Ordinance once a valid request is received.

- **the procedures for proposing a resolution at an annual general meeting:**

The following shareholders are entitled to request the Company to give notice of a resolution that may properly be moved at an annual general meeting of the Company:

- (a) shareholders representing at least 2.5% of the total voting rights of all the shareholders who have a relevant right to vote; or
- (b) at least 50 shareholders who have a relevant right to vote.

The request identifying the proposed resolution, duly signed by the shareholders concerned, must be deposited at the registered office of the Company, 24th Floor, Bank of China Tower, 1 Garden Road, Hong Kong not less than six weeks before the annual general meeting, or if later, the time at which notice is given of that meeting. The Company would take appropriate

actions and make necessary arrangements in accordance with the requirements under sections 615 to 616 of the Hong Kong Companies Ordinance once valid documents are received.

- **the procedure for Director's nomination and election by shareholders:**

If a shareholder wishes to propose a person other than a retiring Director for election as a Director at a general meeting, the shareholder should lodge at the registered office of the Company (24th Floor, Bank of China Tower, 1 Garden Road, Hong Kong), (a) a notice in writing signed by such shareholder (other than the proposed person) duly qualified to attend and vote at the meeting of his/her intention to propose such person for election; (b) a notice signed by the proposed person indicating his/her willingness to be elected; and (c) a sum reasonably sufficient to meet the Company's expenses in giving effect thereto.

The period during which the aforesaid notices may be given will be at least seven days. Such period will commence on the day after the despatch of the notice of the general meeting for which such notices are given and end no later than seven days prior to the date of such general meeting. The Company would take appropriate actions and make necessary arrangements in accordance with the requirements under Article 99 of the Articles of Association of the Company once valid notices and the aforesaid sum are received.

Further shareholder information is set out in the section headed "Investor Relations". Shareholders are welcome to send in any written enquiries to the Board for the attention of the Company Secretary either by post to the registered office of the Company at 24th Floor, Bank of China Tower, 1 Garden Road, Hong Kong or by way of email to investor_relations@bochk.com. The Company Secretary would direct the enquiries received to appropriate Board Member(s) or the Chairman of the Board Committee(s) who is in charge of the areas of concern referred therein for further handling. The Board, assisted by the Company Secretary, would make its best efforts to ensure that all such enquiries are addressed in a timely manner.



Disclosure of Information

The Company recognises the importance of timely and effective disclosure of information and formulates its policies, procedures and controlling measures on information disclosure (including inside information) in accordance with the requirements under applicable laws, regulations and regulatory requirements which includes the Securities and Futures Ordinance, Listing Rules and Hong Kong Monetary Authority Supervisory Policy Manual.

The Group has established controlling measures for the oversight of business and corporate development of the Group to enable prompt identification and escalation of any inside information by all departments/units. The Management Committee reviews relevant information submitted and assess its possible impact, and reports the result to the Board. The Board will assess and determine whether it is inside information, and whether it is appropriate to disclose the inside information after consideration of relevant circumstances and regulatory requirements.

The Information Disclosure Policy requires that heads of relevant departments/units should restrict access to the inside information to a limited number of employees on a need-to-know basis during the escalation process and maintain a list of insider employees for management's inspection from time to time. The Group provides regular refreshment courses on the Information Disclosure Policy to employees to ensure those employees are fully conversant of their obligations under the said policy.

Details of the Information Disclosure Policy has been posted on the Company's website at www.bochk.com.

Directors' Responsibility Statement in relation to Financial Statements

The following statement should be read in conjunction with the auditor's statement of their responsibilities as set out in the auditor's report. The statement aims to distinguish the responsibilities of the Directors and the auditor in relation to the financial statements.

The Directors are required by the Hong Kong Companies Ordinance to prepare financial statements, which give a true and fair view of the state of affairs of the Company. The financial statements should be prepared on a going concern basis unless it considers inappropriate. The Directors are responsible for ensuring that the accounting records kept by the Company at any time reasonably and accurately reflect the financial position of the Company, and also ensure that the financial statements comply with the requirements of the Hong Kong Companies Ordinance. The Directors also have duties to take reasonable and practicable steps to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors consider that in preparing the financial statements, the Company has adopted appropriate accounting policies which have been consistently applied and supported by reasonable judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

Investor Relations

Investor Relations Policy and Guidelines

The Company recognises the fundamental importance of maintaining effective communication with its existing and potential investors. We aim to provide clear and timely information that is reasonably required to make a fair investment decision with regard to the Company's equity and debt securities. We also highly value investor feedback and comments for the formulation of the Company's growth strategies to ensure its sustainable development and enhance shareholder value.

Investor Relations Programmes

The objectives of the Company's investor relations programmes are to promote, through various channels, timely and effective communication with the investment community to enhance their knowledge and understanding of the Company's development and strategies. The investment community refers to existing and potential investors of the Company's securities, analysts and securities market professionals. The Company's securities include both equity securities and debt securities.

The Company's investor relations strategies and programmes are formulated and overseen by the Investor Relations Committee, which is chaired by the Company's Chief Executive and comprises members of the senior management. The Investor Relations Division of the Board Secretariat, which reports directly to the Board, is responsible for the implementation of these strategies and acts as an intermediary between the Company and the investment community. Both the Board and the Committee evaluate the effectiveness of the investor relations programmes on a regular basis.

The Company's senior management is highly supportive and actively involved in investor relations activities. We communicate with the investment community in meetings, conferences and road-shows during which we discuss general public information, including disclosed financial information and historical data, markets and product strategies, business strengths and weaknesses, growth opportunities and threats. Any topic will be discussed so long as it is not considered to be material non-public information.

Information Disclosure Policy

Relevant laws in respect of information disclosure of Hong Kong listed companies became effective on 1 January 2013. The Company attaches high importance to the principles of information disclosure with regard to timeliness, fairness and transparency, and proactively discloses information that may have an impact on investment decision-making. In accordance with relevant legislation and statutory requirements, the Company has prepared an Information Disclosure Policy, which is available on the Company's



website for public reference. The policy contains clear guidelines to ensure the following:

1. information disclosure is in compliance with the Listing Rules and other regulatory requirements;
2. all communications with the public, including the investment community and the media, follow the principles of timeliness, fairness, truthfulness, accuracy and compliance; and
3. effective monitoring of procedures for information disclosure is in place.

Access to Corporate Information

The Investor Relations section of the Company's website (www.bochk.com) provides shareholders and investors with access to information on the Company's latest developments according to the principles of the Information Disclosure Policy. These include information in relation to the Company's key developments, interim and annual results as well as quarterly financial and business review updates. Members of the public can access important announcements through the Stock Exchange of Hong Kong. The website also includes regulatory disclosure information that complies with the applicable requirements set out in the Banking (Disclosure) Rules as stipulated by the Hong Kong Monetary Authority.

The Investor Relations section also includes information on credit ratings, shares and dividends, as well as a corporate calendar with dates of important events.



Shareholders and investors are encouraged to view the Company's corporate materials online to support environmental conservation. The Investor Relations website also includes an e-mail alert service to provide corporate updates on the Company's financial performance and latest developments. Shareholders and other interested parties may register on the website to receive updates by email.

Overview of Investor Relations Activities in 2018

In 2018, the Company continued its efforts to provide effective channels for communication with the investment community.

Annual General Meeting

At the Annual General Meeting held in June 2018, Chairman of the Board, Chairmen and members of the Audit Committee, the Nomination Committee and the Risk Committee, members of the Remuneration Committee and the Strategy and Budget Committee respectively, the Company's senior management and external auditor were present to respond to questions and comments from shareholders. A total of 1,814 registered shareholders and 761 authorised proxies holding an aggregate of 8,482,337,571 shares, representing 80.23% of the Company's total number of shares in issue, were present. Minutes of the 2018 Annual General Meeting were made available to shareholders on the Company's website.

Results Announcements

At the Company's 2017 annual results announcement and 2018 interim results announcement, the senior management led by the Chief Executive conducted briefings with analysts and the press to apprise them of the Company's operating and financial results, business strategies and outlook. The presentation materials, announcements and webcasts were available to the public on the Company's website. In order to allow investors to closely follow the Company's latest financial data release and communication at the results briefings, downloadable financial data pack and transcripts of analyst briefing sessions have been made available on its corporate website beginning from 2018 interim results announcement.

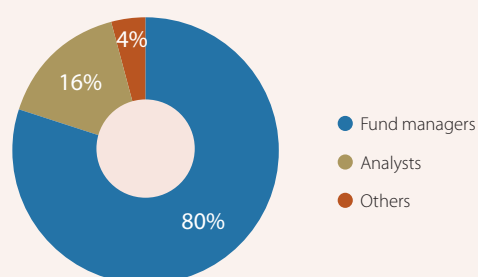
In addition to the interim and annual results announcements, the Company published quarterly financial and business reviews to keep shareholders up-to-date about the Company's performance and financial position.

Communication with the Investment Community

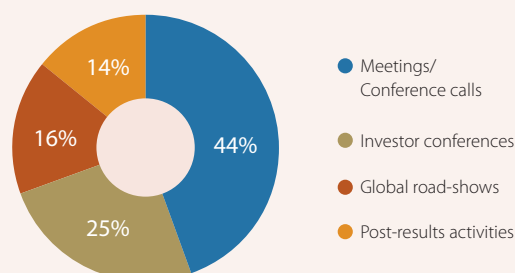
In 2018, the Company held approximately 180 meetings with equity investors and analysts across the world, with a total attendance of over 600. These meetings, which were conducted to give investors a better understanding of the Company's strategies and new business initiatives, were held during global road-shows, investor conferences, company visits and conference calls. The Company was widely covered by more than 15 securities research institutions. In order to expand investor base, optimise its geographical distribution and capture the increasing popularity of the Mutual Market Access programme between the Chinese mainland and Hong Kong, the Company proactively conducted visits to institutional investors across China, the U.S, Europe and Southeast Asia covering a wide range of major cities including Beijing, Shanghai, Shenzhen, New York, London, Frankfurt, Singapore etc., which earned positive reaction from the investment community.

Through emails, direct dialogue with investors and investor feedback, the Company continued to promote two-way communication. The responses received from investors enabled the Company to better understand its market focus which helped formulate its investor relations plan and continually improved its investor relations practices. The Company also proactively communicated with investors regarding its issuance of US\$3 billion additional tier 1 capital securities in the year. The relevant issuance was named the "Best Hong Kong Deal of 2018" by *FinanceAsia* magazine.

Investor Meetings by Category



Investors Met by Event



Investor Relations

Going Forward

Under the principles of timeliness, fairness and transparency, the Company will continue to pursue proactive investor relations practices, including effective investor relations programmes to keep the investment community adequately informed of the Company's present and future development. The Company will also benchmark its programmes against best practices for continuous improvement and more efficient communication with the investment community.

Investor Relations Contact

Enquiries can be directed to:

Investor Relations Division
BOC Hong Kong (Holdings) Limited
24th Floor, Bank of China Tower
1 Garden Road, Hong Kong

Telephone: (852) 2826 6314
Facsimile: (852) 2810 5830
E-mail: investor_relations@bochk.com

Shareholder Information

Financial Calendar 2019

Major Events

Dates

Announcement of 2018 annual results	29 March (Friday)
Latest time for lodging transfers for entitlement to attend and vote at the 2019 Annual General Meeting	8 May (Wednesday) 4:30 p.m.
Book closure period (both days inclusive)	9 May (Thursday) to 16 May (Thursday)
Latest time for lodging proxy forms for the 2019 Annual General Meeting	14 May (Tuesday) 2:00 p.m.
2019 Annual General Meeting	16 May (Thursday) 2:00 p.m.
Last day in Hong Kong for dealing in the Company's shares with entitlement to final dividend	17 May (Friday)
Ex-dividend date	20 May (Monday)
Latest time for lodging transfers for entitlement to final dividend	21 May (Tuesday) 4:30 p.m.
Book closure period (both days inclusive)	22 May (Wednesday) to 27 May (Monday)
Record date for final dividend	27 May (Monday)
Final dividend payment date	3 June (Monday)
Announcement of 2019 interim results	Mid to late August

Annual General Meeting

The 2019 Annual General Meeting will be held at 2:00 p.m. on Thursday, 16 May 2019 at Grand Ballroom, The Lobby Floor, Grand Hyatt Hong Kong, 1 Harbour Road, Wan Chai, Hong Kong.



Share Information

Listing and Stock Codes

Ordinary Shares		Level 1 ADR Programme	
The Company's ordinary shares are listed and traded on The Stock Exchange of Hong Kong Limited ("HKEX").		The Company maintains a Level 1 ADR facility for its ADSs. Each ADS represents 20 ordinary shares of the Company.	
Stock codes		Stock codes	
HKEX	2388	CUSIP No.	096813209
Reuters	2388.HK	OTC Symbol	BHKLY
Bloomberg	2388 HK		

Market Capitalisation and Index Recognition

As at 31 December 2018, the Company's market capitalisation was HK\$307.7 billion, among the top 25 leading stocks on the Main Board of Hong Kong Stock Exchange in terms of market capitalisation. Given the Company's market capitalisation and liquidity, its shares are a constituent of Hang Seng Index, MSCI Index, FTSE and CES Belt and Road Index series. In addition, the Company is a constituent of Hang Seng Corporate Sustainability Index Series and Hang Seng High Dividend Yield Index, which recognises its performance in related areas.

Debt Securities

Issuer	:	Bank of China (Hong Kong) Limited, a wholly-owned and principal subsidiary of the Company
Listing	:	The Notes are listed and traded on The Stock Exchange of Hong Kong Limited

Subordinated Notes

Description	:	Bank of China (Hong Kong) Limited 5.55% Subordinated Notes due 2020
Issue size	:	US\$2,500 million*
Stock codes	:	HKEX 4316
		ISIN USY1391CAJ00 (Regulation S)
		US061199AA35 (Rule 144A)
		Bloomberg E11388897

Subordinated Notes

Description	:	Bank of China (Hong Kong) Limited 5.90% Undated Non-cumulative Subordinated Additional Tier 1 Capital Securities
Issue size	:	US\$3,000 million
Stock codes	:	HKEX 5163
		ISIN US06428YAA47 (Regulation S)
		US06428JAA79 (Rule 144A)
		Bloomberg AU4771195 (Regulation S)
		AU4771229 (Rule 144A)

* U.S.\$876,749,000 in aggregate principal amount of the notes were redeemed and cancelled on 14 September 2018. U.S.\$1,623,251,000 of the aggregate principal amount of notes remain outstanding.

Investor Relations

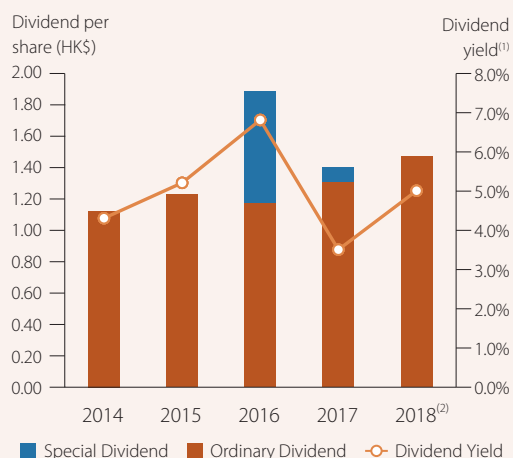
Share Price and Trading Information

Share price (HK\$)	2018	2017	2016
Closing price at year end	29.10	39.60	27.75
Highest trading price during the year	42.15	40.50	29.85
Lowest trading price during the year	28.50	27.65	18.82
Average daily trading volume (m shares)	10.85	11.63	11.55
Number of ordinary shares issued (shares)	10,572,780,266		
Public float	Approximately 34%		

Dividends

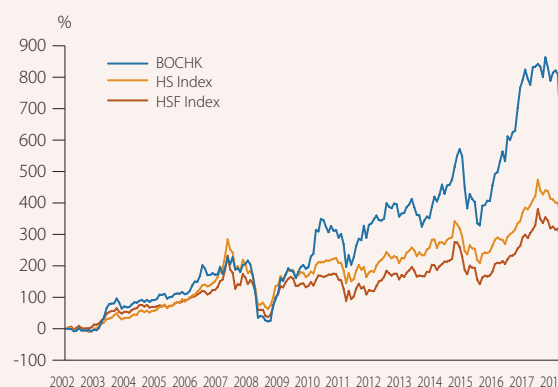
The Board of Directors has recommended a final dividend of HK\$0.923 per share, which is subject to the approval of shareholders at the 2019 Annual General Meeting. With the interim dividend per share of HK\$0.545 paid during 2018, the total dividend per share will amount to HK\$1.468 for the full year.

Dividend Per Share and Dividend Yield⁽¹⁾



- (1) Annual dividend yield is calculated based on dividends of the year (i.e. interim dividend, special dividend and proposed final dividend of the year) and closing share price at that year-end.
- (2) 2018 proposed final dividend will be subject to shareholders' approval at the Company's forthcoming Annual General Meeting.

Total Shareholder Return since Initial Public Offering



Source: Bloomberg

Total shareholder return is measured by share price appreciation and reinvested dividends.

Credit Ratings (long-term)

Standard & Poor's:
 Moody's Investors Service:
 Fitch Ratings:

A+
 Aa3
 A



Shareholding Structure and Shareholder Base

As at 31 December 2018, the Company had 10,572,780,266 shares in issue of which approximately 34% was held by the public and 0.33% was held in the form of ADSs. The Company's 73,482 registered shareholders were distributed in various parts of the world, including Asia, Europe, North America and Australia. Apart from BOC, the Company is not aware of any major shareholders with a shareholding of more than 5% which has to be reported under the SFO.

During the year, the shareholder structure of the Company remained stable. The following table shows the distribution of ownership according to the register of members which includes registered shareholders and shareholders recorded in the participant shareholding report generated from the Central Clearing and Settlement System as at 31 December 2018:

Category	Number of registered shareholders	% of registered shareholders	Number of shares held by registered shareholders	Approximate % of total issued shares
Individuals	73,360	99.83	219,380,367	2.07
Institutions, corporates and nominees ^{Note}	121	0.17	3,412,322,143	32.28
Bank of China Group ^{Note}	1	0.00	6,941,077,756	65.65
Total	73,482	100.00	10,572,780,266	100.00

Note:

As recorded in the register maintained by the Company pursuant to section 336 of the SFO, the total number of shares held by Bank of China Group was 6,984,274,213 shares, representing approximately 66.06% of the total number of shares in issue of the Company as at 31 December 2018. This figure included certain numbers of shares held for Bank of China Group in the securities account opened with BOCI Securities Limited, a participant of the Central Clearing and Settlement System. Accordingly, these shares are included under the category of 'Institutions, corporates and nominees'.

Shareholder Enquiries

For any enquiries or requests relating to shareholder's shareholding, e.g. change of personal details, transfer of shares, loss of share certificates and dividend warrants, etc., please send in writing to:

Hong Kong	Computershare Hong Kong Investor Services Limited 17M Floor, Hopewell Centre 183 Queen's Road East, Wan Chai, Hong Kong Telephone: (852) 2862 8555 Facsimile: (852) 2865 0990 E-mail: hkinfo@computershare.com.hk
USA	Citibank, N.A. Shareholder Services P.O. Box 43077, Providence, Rhode Island 02940-3077, USA Telephone: 1-877-248-4237 (toll free) 1-781-575-4555 (outside USA) E-mail: citibank@shareholders-online.com

Other Information

This Annual Report is available in both English and Chinese. A copy prepared in the language different from that in which you have received is available by writing to the Company's Share Registrar, Computershare Hong Kong Investor Services Limited, at 17M Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong or email to bochk.ecom@computershare.com.hk. This Annual Report is also available (in both English and Chinese) on the Company's website at www.bochk.com and the Stock Exchange's website at www.hkexnews.hk. You are encouraged to access the corporate communications of the Company through these websites in lieu of receiving printed copies to help protect the environment. We believe that it is also the most efficient and convenient method of communication with our shareholders.

If you have any queries about how to obtain copies of this Annual Report or how to access the corporate communications on the Company's website, please call the Company's hotline at (852) 2846 2700.

「一带一路」7大区域的经济特点特征

香港银行及金融服务业的机遇及挑战

香港最主要的优势是发挥金融中心功能

- 多层次机构体系健全有效，监管体系稳健透明
- 数据可在立法机关及监管机构跨境
- 金融服务网络
- 业务网络
- 风险管理



People Centricism



Corporate Social Responsibility

As a leading commercial and internationalised regional bank firmly rooted in Hong Kong for over a century, we understand our important responsibility to contribute to Hong Kong's long-term development, enhance its status as an international financial centre and facilitate the sustainable development of the places in which we operate. The Group is committed to undertaking its corporate social responsibility (CSR). We attach great importance to the needs and opinions of our various stakeholders and have implemented a number of CSR initiatives that have been widely recognised by various sectors of the community.

BOCHK was named the Strongest Bank in Asian Pacific and Hong Kong by *The Asian Banker* for the fifth consecutive year, and the Best Bank for CSR in Hong Kong by *Asiamoney*. BOCHK was also selected as a constituent stock of the Hang Seng Corporate Sustainability Index Series for the ninth consecutive year and a top 10 company in the Hong Kong Business Sustainability Index in 2018. The Group has been recognised a Caring Company by the Hong Kong Council of Social Service for 16 consecutive years since 2003. In addition, our Environmental, Social and Governance (ESG) performance was rated AA by the rating agency MSCI ESG Research LLC in 2018.

This section gives an overview of the Group's CSR initiatives during 2018. For details, please refer to the Group's 2018 CSR Report.



Promoting Economic Development and Financial Inclusion

With the goal to “Build a Top-class, Full-service and Internationalised Regional Bank”, the Group leverages its advantages as a major commercial banking group in Hong Kong to increase local market penetration and expand business in the Southeast Asian region. We strive to provide customers with comprehensive, professional and high-quality services. We adhere to major national development strategies and grasp the opportunities arising from “meeting the country's needs by leveraging Hong Kong's advantages”, striving to provide enterprises and individuals with diversified and innovative cross-border financial services. We support the development of local infrastructure and enhance our financial services in the region. By upholding our customer-centric principle, we offer convenient banking and financial services to people from various sectors of society. We also promote financial inclusion advocated by the Hong Kong Monetary Authority (HKMA), demonstrating our responsibilities to the community. Through the extensive application of new technologies, we provide our customers with more convenient and secure financial services.





To promote cooperation and exchange, as well as exploring business opportunities among enterprises through various means in the region, we organised the Guangdong-Hong Kong-Macao Greater Bay Area Financial Forum jointly hosted by the Hong Kong Chinese Enterprises Association and Chinese Banking Association of Hong Kong. We also sponsored the third Belt and Road Summit organised by the HKSAR Government and Hong Kong Trade Development Council.



We participated in the construction of the Faster Payment System (FPS) initiated by the HKMA, and provided 24-hour interbank transfer services in HKD and RMB for both individual and corporate customers.

Our smart branch at the Hong Kong Science Park adopts an electronic and digital service model. It is also equipped with 7x24 digital network facilities that provide start-ups and innovation and technology enterprises with one-stop services.



Corporate Social Responsibility

Adopting a People-oriented Approach and Caring for Employees

The Group considers employees to be precious assets. With our people-oriented philosophy, we constantly enhance our human resources management system so as to attract, identify and nurture talent. We are committed to providing a harmonious, diverse and friendly working environment for our employees and helping them realise their potential. As of the end of 2018, the Group has 14,046 employees, hailing from different backgrounds with various experiences and expertise.



The Group has **14,046** employees



The Group has won a number of accolades for its human resources management. During the year, we were awarded “QF Gold Star Employer” by the HKSAR Government. We also received the “Manpower Developer 1st” award by the Employees Retraining Board for five consecutive times. In addition, we were granted a number of Asia Recruitment Awards 2018 by *Human Resources* magazine, including the “Gold Award for Excellence in Change Management”.

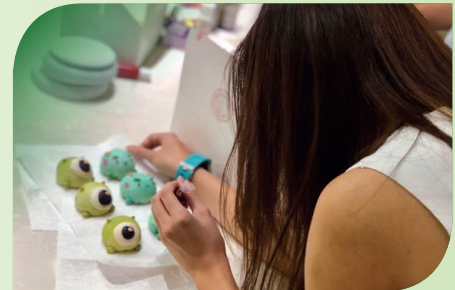


We encourage our employees to take part in inter-departmental exchanges. Our staff are also provided with exchange opportunities on the mainland and overseas to enrich their business knowledge and broaden their horizons.





Advocating work-life balance, we organised a series of recreational activities for our employees.



Corporate Social Responsibility

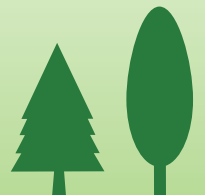


In 2018, our staff from BOC Thailand participated in the foreign banks football league matches in Thailand with the aim of strengthening our relationship with counterparts, as well as enhancing cohesion among our employees.



Our volunteer team served for **50,000+** hours

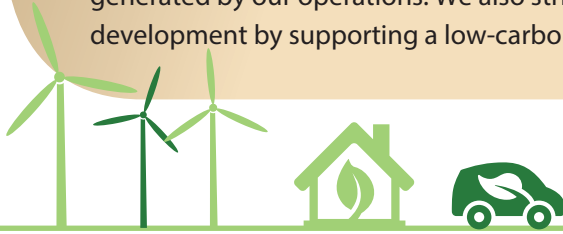
The Group encourages its employees to participate in volunteer activities. In 2018, our volunteer team served for over 50,000 hours and received the Gold Award for Volunteer Service from the Social Welfare Department for the ninth consecutive year.





Conserving Resources and Protecting the Environment

The Group encourages environmentally responsible business practices. Adhering to our green banking strategy, we aim to reduce the adverse environmental impacts and related risks generated by our operations. We also strive to promote sustainable development by supporting a low-carbon economy.



We encourage customers to opt for consolidated e-statements to save paper. As of the end of 2018, the number of customers choosing e-statements increased by nearly 33% year-on-year.



Customers choosing e-statements **↑ 33%**



The Group participated in and sponsored the launch ceremony of the Hong Kong Green Finance Association and the Hong Kong Green Finance Forum to support the development of innovative green financial products in Hong Kong.



Corporate Social Responsibility



We joined the launch ceremony of A Waste Reduction Guidebook for Large Scale Event Organisers hosted by the Environmental Protection Department. We are committed to implementing measures to minimise waste generated from the organisation of events. These measures include using recycled materials in stage setup, re-using event supplies, and sending unwanted supplies to recycling or donation centres.

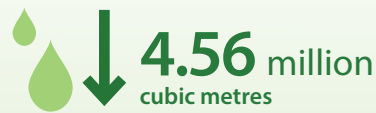


Annual Electricity Consumption



= the electricity consumed by 26,743 average three-member Hong Kong households in one year

Annual Water Usage



= the volume of more than 2,571 standard 50-metre swimming pools

Annual Waste



= the weight of 6,286 Airbus A380s

Recycled Materials



= the weight of 187,319 double-decker buses

Emissions



= the carbon dioxide absorbed by 3.78 million trees every year

We jointly organised the BOCHK Corporate Environmental Leadership Awards Programme with the Federation of Hong Kong Industries. In 2018, corporate participants of the programme completed 1,600 green projects.





Sharing and Caring

The Group cares for our community and attaches great importance to community investment. Through a diverse range of initiatives, we aim to promote the steady development of the community and bring positive energy to society. We share the success of our corporate development with the community and strive to build a harmonious society.

The BOCHK Charitable Foundation (the "Foundation") was established in 1994. Over the years, BOCHK and the Foundation have been supporting a wide range of local charity activities covering poverty alleviation and support for the disadvantaged, youth education, sports and the arts, as well as environmental protection and carbon reduction. Since its inception, BOCHK and the Foundation have donated over HK\$520 million to the community.



Poverty Alleviation and Support for the Disadvantaged



We sponsored the Community Chest Walk for Millions with the engagement of more than 1,600 of our staff and their families, to raise funds for the Chest's Family and Child Welfare Services.



Corporate Social Responsibility



The Group sponsored the Kids The Future Programme which subsidised kindergarteners and primary students from local underprivileged families to participate in interest classes and training courses, accumulating number of beneficiaries over 1,600.



Youth Development



Through BOCHK Excellence Scholarship in Chinese History, we encourage students to study Chinese history, deepen their knowledge of the subject and establish a correct understanding on our history and the nation.



We supported the BOCHK JPC Intelligent Crime Prevention Experience programme organised by the Junior Police Call of the Hong Kong Police Force, which aims at encouraging youths in Hong Kong to become good citizens. The programme benefitted about 8,000 young people aged 6 to 25 annually.



BOC Malaysia hosted the cultural and financial educational activity “520 Bring Home Love Filial Piety and Wealth” with Kuen Cheng High School in Kuala Lumpur and SJK(C) Han Chiang Primary School in Penang. The activity allowed children to learn about Chinese culture, understand the significance of filial piety, strengthen the parent-child relationship, and learn about financial management.



Sports and Arts



We supported the Music Subsidy Scheme of the Musicus Society and the Hong Kong Chinese Orchestra to allow more people from grassroots communities to appreciate music and nurture local musical talent.



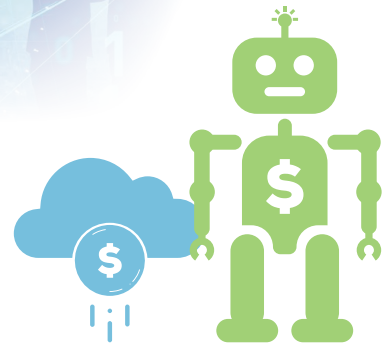
The Group sponsored the Rue du Moulin-Vert art exhibition during Le French May, one of Asia's major cultural events.

We sponsored the Hong Kong Island & Kowloon Regional Inter-school Sports Competition. Nearly 80,000 students from about 270 secondary schools participated in over 8,000 competitions. The BOCHK Schools Sports Volunteer Team contributed over 9,700 hours of volunteer service.



Corporate Social Responsibility

Innovative Technology Education



We set up an innovative workshop at Cyberport and launched a Fintech talent cultivation scheme. Through diverse activities, we supported start-ups, offered banking-related project experience to students and cultivating technology talent.



Fintech Talent Development



主理機構：明報 獨家贊助：中國銀行(香港) BANK OF CHINA (HONG KONG)

《世界級工程系列：STEM@港珠澳大橋》

比賽頒獎禮 暨 教育特刊發佈會



The Group sponsored the publication of education supplement "STEM" World-class Engineering Projects Series: Hong Kong-Zhuhai-Macao Bridge and related competitions, with the objective of encouraging students to understand the construction of the bridge from perspectives of Science, Technology, Engineering and Mathematics ("STEM"). Nearly 9,000 students entered the competition.





Awards and Recognition



Financial Strength and Corporate Governance

- Strongest Bank in Asia Pacific and Strongest Bank in Hong Kong (*The Asian Banker*)
- Listed Company Award of Excellence (Blue Chip) (*Hong Kong Economic Journal*)
- Best Listed Company (*Sina Finance*)

Service Excellence

- Best Trade Finance Bank in Hong Kong and Best Corporate Trade Finance Deal in Hong Kong (*The Asian Banker*)
- Hong Kong Domestic Cash Management Bank of the Year, and Gold and Precious Metals Bank of the Year – Hong Kong (*Asian Banking & Finance*)
- Achievement Awards 2018: Best Hong Kong Deal (BOCHK's US\$3 billion 5.9% additional tier 1 perpetual bond deal) (*FinanceAsia*)
- Rank No. 1 as mandated lead arranger in the Hong Kong and Macao syndicated loan market for 14 consecutive years (*Basis Point*)
- Best Local Currency Bond Award (*Global Capital*)
- Syndicated Leveraged & Acquisition Finance Deal of the Year 2018 (*Asia Pacific Loan Market Association*)
- Best SME's Partner Gold Award 2018 (*The Hong Kong General Chamber of Small and Medium Business*)
- Outstanding Import & Export Industry Partner Award 2018 (*The Hong Kong Chinese Importers' and Exporters' Association*)

- Ten Awards in the 12th Outstanding Financial Management Planner Awards (*The Hong Kong Institute of Bankers*)
- Bond Connect Best Custodian (*Bond Connect Company Limited*)
- Offshore Institutional Investor Excellence Award (*China Foreign Exchange Trade System*)
- 2018 Best Bank Capital Bond, Best Custodian – QDII (China) and Best QDII Mandate (*The Asset*)
- One Year Overseas Golden Mutual Recognition Fund – BOCHK All Weather China High Yield Bond Fund (*China Securities Journal*)
- Financial Institution of the Year – Greater China of 2018 Wealth & Money Management Awards: Most Innovative Mixed Asset Fund: BOCHK All Weather China Income Fund (*Wealth & Financial International*)



Awards and Recognition



Service Excellence (continued)

- 2018 International Finance Financial Awards: Most Innovative Asset Management Company (**International Finance**)
- Customer Service Excellence Award 2018: Counter Service Team Award – Silver, Contact Center Service Individual Award – Bronze and Internal Support Service Team Award – Bronze (**Hong Kong Association for Customer Service Excellence**)
- 2018 Financial Institution Awards: Cross Border Insurance Services – Excellence, Claims Management – Excellence, Annuity Plan – Outstanding and Customer Service – Outstanding (**Bloomberg Businessweek**)
- SME Partner Awards of Excellence 2018: Retail and Business Integrated Services and Guangdong – Hong Kong – Macao Greater Bay Area Commercial Banking Services (**Hong Kong Economic Journal**)
- 2018 Benchmark Wealth Management Awards (**Benchmark**):
High Net Worth Client Servicing – Best-in-Class
Client Servicing & Engagement – Best-in-Class
Client Digital Experience – Best-in-Class
Risk and Compliance – Outstanding Achiever
- Hong Kong Leaders' Choice 2018: Excellent Brand of Payroll Services – Banking, Excellent Brand of Mortgage Services – Banking and Excellent Brand of Securities Services – Banking (**Metro Finance**)
- ISO9001: 2015 Quality Management System Certification (Treasury & Investment Settlement, Nostro & Vostro Account Administration) (**SGS Hong Kong Limited**)
- 2018 GC Powerlist: Hong Kong Teams (**The Legal 500**)



Innovative Technology

- Best Consumer Digital Banks (**Global Finance**)
- Digital Banking Initiative of the Year – Hong Kong, Mobile Banking Initiative of the Year – Hong Kong and Service Innovation of the Year – Hong Kong (**Asian Banking & Finance**)
- FinTech Initiatives Award (**Hong Kong Monetary Authority and Office of Financial Development Service, People's Government of Shenzhen Municipality**)
- Excellent Brand of FinTech – Banking and Platinum Award for Hong Kong FinTech Impetus Awards (**Metro Finance**)
- The Best of Mobile Banking Service Provider (**e-zone**)



RMB Business

- Key Business Partner in FIC Market (**HKEX's 5th Annual RMB Fixed Income & Currency Conference**)
- 2018 RMB Business Outstanding Awards: Innovation – Greater Bay Area Financial Services Award (**Metro Finance and Ta Kung Wen Wei Media Group**)
- Fund of the Year Awards 2018 (**Benchmark**):
Best-in-Class of High Yield Fixed Income House Award
Best-in-Class of RMB Fixed Income House Award
Outstanding Achiever of China Fixed Income House Award





Social Responsibility

- Best Bank Awards 2018: Best Bank for CSR in Hong Kong (*Asiamoney*)
- A constituent of the *Hang Seng Corporate Sustainability Index*, *Hang Seng (Mainland and HK) Corporate Sustainability Index* and *Hang Seng Corporate Sustainability Benchmark Index*
- A top 10 constituent stock of the *Hong Kong Business Sustainability Index*
- Rated AA on environmental, social and governance-related business practices (*MSCI ESG Research LLC*)
- Awarded Caring Company Logo for 16 consecutive years (*The Hong Kong Council of Social Service*)
- Social Capital Builder Logo Award (*Community Investment and Inclusion Fund of the Labour and Welfare Bureau*)
- Gold Award for Volunteer Service – Organisation, The Award of 10,000 Hours for Volunteer Service and Merit Award for Highest Service Hour Award (Private Organisations – Category 1) (*Social Welfare Department*)



Talent Development Management

- **Human Resources:**
 - Gold Award for Excellence in Change Management
 - Gold Award for Best Use of Recruitment Technology
 - Silver Award for Best Regional Recruitment Strategy
 - Silver Award for Best Employer Brand Development
 - Silver Award for Excellence in Graduate Recruitment/Development
 - Bronze Award for Excellence in Learning and Development
 - Bronze Award for Best Recruitment Advertising Strategy
- QF Gold Star Employer (*Education Bureau*)
- 2017/18 Good MPF Employer Award, 2017/18 e-Contribution Award and 2017/18 Support for MPF Management Award (*Mandatory Provident Fund Schemes Authority*)
- Manpower Developer 1st (*Employees Retraining Board*)
- Gold Award for Corporate Financial Education Leadership and Accredited Professional Financial Planning Firm (*The Institute of Financial Planners*)
- Family-friendly Employers, Gold Award for Special Mention and Award for Breastfeeding Support (*Home Affairs Bureau and Family Council*)
- Silver Stevie® Winner Award for Innovative Management in Financial Industries and Bronze Stevie® Winner Award for Innovation in Human Resources Management, Planning & Practice (*Asia-Pacific Stevie® Awards*)
- Selection of 30 enterprises that are most welcomed by international innovation talents (*Innovating Hong Kong – Global Talent Carnival 2018*)
- Employer of Choice Award and Leadership Development Award (*JobMarket*)

Contact Us

Bank of China (Hong Kong)

Enquiry Hotline

Contents	Telephone	Contents	Telephone
Personal Customer Service Hotline	(852) 3988 2388	BOC Credit Card Hotline	(852) 2853 8828
24-hour <i>Wealth Management</i> Service Hotline	(852) 3988 2888	BOC Credit Card Loss Card Hotline	(852) 2544 2222
24-hour <i>Enrich Banking Service</i> Hotline	(852) 3988 2988	ATM Card Hotline	(852) 2691 2323
Corporate Customer Service Hotline	(852) 3988 2288	BOC Express Cash Customer Service Hotline	(852) 2108 3611

Branch Locator



www.bochk.com/en/branch.html

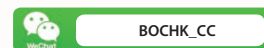
Internet Banking and Mobile Banking

Internet Banking:
www.bochk.com

Mobile Banking:



Social Media



中銀香港 BOCHK

www.youtube.com/user/bankofchinahk

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Independent Auditor's Report



Ernst & Young
22/F, CITIC Tower
1 Tim Mei Avenue
Central, Hong Kong

To the members of BOC Hong Kong (Holdings) Limited

(Incorporated in Hong Kong with limited liability)

Opinion

We have audited the consolidated financial statements of BOC Hong Kong (Holdings) Limited (the "Company") and its subsidiaries (the "Group") set out on pages 129 to 311, which comprise the consolidated balance sheet as at 31 December 2018, and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAAs") issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the HKICPA's Code of Ethics for Professional Accountants ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matters:	How our audit addressed the key audit matters:
<p><i>Impairment assessment of advances to customers</i></p> <p>Refer to significant accounting policies in Note 2.14, critical accounting estimates and judgements in applying accounting policies in Note 3.1, and disclosures on credit risk and loan impairment allowances in Note 4.1 and Note 25 to the financial statements.</p> <p>The Group has adopted a forward-looking “expected-loss” impairment model to recognise the expected credit losses (“ECL”) of its advances to customers from 1 January 2018. The assessment of credit risk and the measurement of ECL are required to be based on unbiased and probability-weighted possible outcomes, and reasonable and supportable information at the reporting date about past events, current conditions and forecasts of future economic conditions. Significant management judgements and estimates are involved in the development and the application of models and the choices of inputs in the calculation of ECL, including:</p> <ol style="list-style-type: none"> 1) segmentation of financial assets according to credit risk characteristics; 2) estimation of probability of defaults, loss given defaults, exposure at defaults and macroeconomic factor forecasts; 3) criteria on significant credit deterioration; and 4) selection of forward-looking macroeconomic scenarios and their probability weightings. <p>As at 31 December 2018, gross advances to customers amounted to HK\$1,266,705 million, representing 42.9% of total assets; and the impairment allowance for advances to customers amounted to HK\$5,411 million, representing 89.3% of total impairment allowance on financial instruments.</p> <p>In view of the significance of the impairment allowance recorded by the Group and the management judgements and estimates involved, impairment assessment of advances to customers is considered a key audit matter.</p>	<p>We obtained an understanding of the Group’s credit management and practices and evaluated the Group’s impairment methodology, including the management judgement over the segmentation of portfolio, the criteria on significant credit deterioration and the measurement approach of expected credit losses. We tested the design and the operating effectiveness of the key controls over the processes of credit assessment, loan classification, stage classification and calculation of impairment allowances. Our control testing on the loan impairment process included an evaluation of the governance over the use of economic scenarios and the system interfaces of inputs or other data sources such as internal loan gradings and probability of default.</p> <p>We adopted a risk-based sampling approach for our loan review procedures. We selected samples based on risk characteristics of individual items including the industry and geographic location of the operations of borrowers, internal loan grading and past due history. We formed an independent view on the loan staging through reviewing the borrowers’ detailed information about their financial performance, recoverable cash flows, valuation of collaterals and other available information.</p> <p>For the impairment allowance as at 31 December 2018, we performed testing on the relevant data quality by sample checking to the relevant data source and re-computed management’s calculation of the impairment allowance. In addition, we assessed management’s consideration of forward-looking information including macroeconomic factor forecasts and probability weighted economic scenarios. For Stage 3 advances, on a sample basis we re-calculated the impairment allowance with consideration of recoverable cash flows and valuation of collaterals.</p> <p>We also evaluated and tested the design and operating effectiveness of the Group’s key controls related to disclosures on credit risk in Note 4.1 to the financial statements.</p>

Independent Auditor's Report

Key audit matters:	How our audit addressed the key audit matters:
<p data-bbox="151 372 494 394"><i>Valuation of financial instruments</i></p> <p data-bbox="151 444 762 610">Refer to significant accounting policies in Note 2.12, critical accounting estimates and judgements in applying accounting policies in Note 3.2, and disclosures on fair values of financial instruments in Notes 5.1 and 5.2 to the financial statements.</p> <p data-bbox="151 659 762 929">The Group has applied valuation techniques to determine the fair value of financial instruments that are not quoted in active markets. These valuation techniques, in particular those that include significant unobservable inputs, involve management using subjective judgements and assumptions. With different valuation techniques and assumptions applied, the valuation results can vary significantly.</p> <p data-bbox="151 978 762 1349">As at 31 December 2018, the Group's financial assets and liabilities measured at fair value amounted to HK\$825,383 million and HK\$59,661 million respectively, representing 28.0% and 2.2% of total assets and total liabilities respectively. Financial instruments which had significant unobservable inputs in the valuation, and hence were categorised within level 3 of the fair value hierarchy, involved a higher degree of uncertainty in their valuation. As at 31 December 2018, 88.7% and 0.7% of the Group's financial assets measured at fair value were categorised within level 2 and level 3, respectively.</p>	<p data-bbox="813 444 1444 577">We evaluated and tested the design and operating effectiveness of key controls related to the valuation of financial instruments, including independent price verification, independent model validation and approval.</p> <p data-bbox="813 627 1444 929">We focused on the valuation methodologies and assumptions of financial instruments that were classified as level 2 and level 3 in the fair value hierarchy. We involved our valuation specialists in evaluating the valuation techniques, inputs and assumptions through comparison with the valuation techniques that are commonly used in the market, the validation of observable inputs using external market data, and comparison with valuation outcomes obtained from various pricing sources.</p> <p data-bbox="813 978 1444 1112">We also evaluated and tested the design and operating effectiveness of the Group's key controls related to the fair value disclosures in Notes 5.1 and 5.2 to the financial statements.</p>

Key audit matters:	How our audit addressed the key audit matters:
<p><i>Recognition of deferred tax assets</i></p> <p>Refer to significant accounting policies in Note 2.23, critical accounting estimates and judgements in applying accounting policies in Note 3.4, and disclosures on deferred taxation in Note 36 to the financial statements.</p> <p>As at 31 December 2018, the Group recognised deferred tax assets of HK\$724 million relating to temporary differences arising from impairment allowances and HK\$1,478 million relating to other temporary differences and tax credits. The majority of other temporary differences and tax credits related to tax credits recoverable from the tax authorities in Hong Kong under double tax treaty arrangements, arising from withholding income taxes payable in other jurisdictions on certain income. Application on such tax credits will be made to the tax authorities in Hong Kong after the corresponding withholding income taxes payable is settled and evidenced by respective payment receipts issued from the corresponding tax authorities. These deferred tax assets, where required by accounting standards, were offset against and included within deferred tax liabilities as shown in Note 36 to the financial statements. The recognition of the deferred tax assets involved significant management judgements and assumptions, based upon the estimation of available tax credits and the possibility to recover such deferred tax assets recognised.</p>	<p>Our audit procedures included, amongst others, the involvement of our tax specialists to assist in evaluating the judgements and assumptions adopted by management to determine the recognition and recoverability of the deferred tax assets, in light of current tax laws. We also assessed management's estimates of the Group's entitlement to the tax credits and examined correspondences between the Group and relevant tax authorities.</p> <p>In addition, we also assessed the adequacy of disclosures in Note 36 to the financial statements with respect to compliance with HKAS 12 – Income Taxes.</p>

Independent Auditor's Report

Key audit matters:	How our audit addressed the key audit matters:
<p><i>Valuation of insurance contract liabilities</i></p> <p>Refer to significant accounting policies in Note 2.19, critical accounting estimates and judgements in applying accounting policies in Note 3.3, and disclosures on insurance contract liabilities in Note 37 to the financial statements.</p> <p>As at 31 December 2018, the Group, through its consolidated subsidiary BOC Group Life Assurance Company Limited, had insurance contract liabilities amounting to HK\$104,723 million, representing 3.9% of the Group's total liabilities.</p> <p>The measurement of insurance contract liabilities involved significant judgements over uncertain future outcomes, mainly the estimated ultimate total settlement value of insurance contract liabilities, including any guarantees provided to policyholders. Economic assumptions, such as investment return and associated discount rates, and operating assumptions, such as mortality and morbidity, were the key inputs used to estimate these insurance contract liabilities as reported in the consolidated balance sheet.</p>	<p>We used our actuarial specialists to assist in the performance of our audit procedures. These included a review of the product features and the methodology used in valuing the insurance contract liabilities in accordance with the relevant regulations and accounting requirements. We also tested the internal controls performed by management over the valuation process.</p> <p>We also assessed the economic assumptions and operating assumptions used in the insurance contract liabilities valuation with reference to market data and policyholder experience and assessed the accuracy of the calculation of policy reserves through performing independent recalculation.</p> <p>In addition, we assessed the validity of the Group's liability adequacy test under HKFRS 4 – Insurance Contracts. Our assessment included an evaluation of management's projected cash flows based on relevant product features. We tested the associated assumptions by comparing with industry experience data.</p>

Other information included in the Annual Report

The directors of the Company are responsible for the other information. The other information comprises the information included in the Annual Report, other than the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors for the consolidated financial statements

The directors of the Company are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors of the Company are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors of the Company either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The directors of the Company are assisted by the Audit Committee in discharging their responsibilities for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Our report is made solely to you, as a body, in accordance with section 405 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSAAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

Independent Auditor's Report

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

The engagement partner on the audit resulting in this independent auditor's report is LEE Shun Yi, Jasmine.

The logo for Ernst & Young, featuring the company name in a stylized, cursive script font.

Ernst & Young

Certified Public Accountants

Hong Kong, 29 March 2019

Consolidated Income Statement

For the year ended 31 December	Notes	2018 HK\$'m	(Restated) 2017 HK\$'m
CONTINUING OPERATIONS			
Interest income		61,736	49,077
Interest expense		(22,342)	(14,259)
Net interest income	6	39,394	34,818
Fee and commission income		15,513	15,500
Fee and commission expense		(4,206)	(3,899)
Net fee and commission income	7	11,307	11,601
Gross earned premiums		20,858	21,792
Gross earned premiums ceded to reinsurers		(6,735)	(7,127)
Net insurance premium income		14,123	14,665
Net trading gain	8	3,078	1,368
Net (loss)/gain on other financial instruments at fair value through profit or loss	9	(1,282)	2,181
Net gain on other financial assets	10	19	1,163
Other operating income	11	981	931
Total operating income		67,620	66,727
Gross insurance benefits and claims and movement in liabilities		(21,236)	(25,881)
Reinsurers' share of benefits and claims and movement in liabilities		8,027	8,160
Net insurance benefits and claims and movement in liabilities	12	(13,209)	(17,721)
Net operating income before impairment allowances		54,411	49,006
Net charge of impairment allowances	13	(1,237)	(1,055)
Net operating income		53,174	47,951
Operating expenses	14	(15,180)	(13,848)
Operating profit		37,994	34,103
Net gain from disposal of/fair value adjustments on investment properties	15	906	1,197
Net gain/(loss) from disposal/revaluation of properties, plant and equipment	16	18	(25)
Share of profits less losses after tax of associates and joint ventures	27	70	100
Profit before taxation		38,988	35,375
Taxation	17	(6,404)	(6,068)
Profit from continuing operations		32,584	29,307
DISCONTINUED OPERATIONS			
Profit from discontinued operations	39	–	2,623
Profit for the year		32,584	31,930

Consolidated Income Statement

For the year ended 31 December	Notes	2018 HK\$'m	(Restated) 2017 HK\$'m
Profit attributable to:			
Equity holders of the Company			
– from continuing operations		32,000	28,574
– from discontinued operations	39	–	2,589
		32,000	31,163
Non-controlling interests			
– from continuing operations		584	733
– from discontinued operations	39	–	34
		584	767
		32,584	31,930
Dividends	18	15,521	14,781
		HK\$	HK\$
Earnings per share			
Basic and diluted	19		
– profit for the year		3.0266	2.9475
– profit from continuing operations		3.0266	2.7026

The notes on pages 138 to 311 are an integral part of these financial statements.

Consolidated Statement of Comprehensive Income

For the year ended 31 December	Notes	2018 HK\$'m	(Restated) 2017 HK\$'m
Profit for the year		32,584	31,930
Items that will not be reclassified subsequently to income statement:			
Premises:			
Revaluation of premises	29	2,136	2,129
Deferred tax	36	(298)	(298)
		1,838	1,831
Equity instruments at fair value through other comprehensive income:			
Change in fair value		(846)	N/A
Deferred tax		14	N/A
		(832)	N/A
Own credit risk:			
Change in fair value of own credit risk of financial liabilities designated at fair value through profit or loss		25	N/A
		1,031	1,831
Items that may be reclassified subsequently to income statement:			
Debt instruments at fair value through other comprehensive income:			
Change in fair value		(2,581)	N/A
Change in impairment allowances charged to income statement	13	14	N/A
Release upon disposal/redemption reclassified to income statement	10	(26)	N/A
Amortisation of accumulated amount of fair value hedge adjustment reclassified to income statement		17	N/A
Deferred tax		505	N/A
		(2,071)	N/A
Available-for-sale securities:			
Change in fair value		N/A	1,967
Release upon disposal reclassified to income statement	10	N/A	(1,107)
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities reclassified to income statement		N/A	63
Deferred tax		N/A	(85)
		N/A	838
Currency translation difference		(98)	459
Release upon disposal of discontinued operations reclassified to income statement	39	–	48
		(2,169)	1,345
Other comprehensive income for the year, net of tax		(1,138)	3,176
Total comprehensive income for the year		31,446	35,106

Consolidated Statement of Comprehensive Income

For the year ended 31 December	Notes	2018 HK\$'m	(Restated) 2017 HK\$'m
Total comprehensive income attributable to:			
Equity holders of the Company		31,371	34,178
Non-controlling interests		75	928
		31,446	35,106

The notes on pages 138 to 311 are an integral part of these financial statements.

Consolidated Balance Sheet

As at 31 December	Notes	2018 HK\$'m	(Restated) 2017 HK\$'m
ASSETS			
Cash and balances and placements with banks and other financial institutions	22	431,524	426,604
Financial assets at fair value through profit or loss	23	300,929	93,194
Derivative financial instruments	24	34,912	33,543
Hong Kong SAR Government certificates of indebtedness		156,300	146,200
Advances and other accounts	25	1,282,472	1,191,554
Investment in securities	26	598,247	618,191
Interests in associates and joint ventures	27	483	417
Investment properties	28	19,684	19,669
Properties, plant and equipment	29	49,430	47,268
Current tax assets		65	–
Deferred tax assets	36	270	58
Other assets	30	78,587	74,388
Total assets		2,952,903	2,651,086
LIABILITIES			
Hong Kong SAR currency notes in circulation	31	156,300	146,200
Deposits and balances from banks and other financial institutions		376,807	223,427
Financial liabilities at fair value through profit or loss	32	15,535	19,720
Derivative financial instruments	24	30,880	31,046
Deposits from customers	33	1,893,357	1,775,090
Debt securities and certificates of deposit in issue	34	9,453	21,641
Other accounts and provisions	35	59,420	53,088
Current tax liabilities		2,510	4,338
Deferred tax liabilities	36	5,765	5,704
Insurance contract liabilities	37	104,723	103,229
Subordinated liabilities	38	13,246	18,980
Total liabilities		2,667,996	2,402,463

Consolidated Balance Sheet

As at 31 December	Notes	2018 HK\$'m	(Restated) 2017 HK\$'m
EQUITY			
Share capital	40	52,864	52,864
Reserves		204,206	191,154
Capital and reserves attributable to equity holders of the Company		257,070	244,018
Other equity instruments	41	23,476	–
Non-controlling interests		4,361	4,605
Total equity		284,907	248,623
Total liabilities and equity		2,952,903	2,651,086

The notes on pages 138 to 311 are an integral part of these financial statements.

Approved by the Board of Directors on 29 March 2019 and signed on behalf of the Board by:



CHEN Siqing

Director



GAO Yingxin

Director

Consolidated Statement of Changes in Equity

	Attributable to equity holders of the Company									
	Reserves							Total HK\$'m	Non- controlling interests HK\$'m	Total equity HK\$'m
	Share capital HK\$'m	Premises revaluation reserve HK\$'m	Reserve for fair value changes of available- for-sale securities HK\$'m	Regulatory reserve* HK\$'m	Translation reserve HK\$'m	Merger reserve** HK\$'m	Retained earnings HK\$'m			
At 1 January 2017, as previously reported	52,864	35,608	(592)	9,227	(1,217)	3,455	129,302	228,647	5,907	234,554
Effect of merger of entities under common control	-	-	-	-	(59)	1,062	183	1,186	-	1,186
At 1 January 2017, as restated	52,864	35,608	(592)	9,227	(1,276)	4,517	129,485	229,833	5,907	235,740
Profit for the year	-	-	-	-	-	-	31,163	31,163	767	31,930
Other comprehensive income:										
Premises	-	1,831	-	-	-	-	-	1,831	-	1,831
Available-for-sale securities	-	-	682	-	-	-	-	682	156	838
Currency translation difference	-	2	(58)	-	510	-	-	454	5	459
Release upon disposal of discontinued operations reclassified to income statement	-	-	10	-	38	-	-	48	-	48
Total comprehensive income	-	1,833	634	-	548	-	31,163	34,178	928	35,106
Acquisition of entities under common control	-	-	-	-	-	(6,618)	-	(6,618)	-	(6,618)
Transfer from retained earnings	-	-	-	1,156	-	3,163	(4,319)	-	-	-
Release upon disposal of discontinued operations	-	(752)	-	(159)	-	-	911	-	(2,078)	(2,078)
Dividends	-	-	-	-	-	-	(13,375)	(13,375)	(152)	(13,527)
At 31 December 2017	52,864	36,689	42	10,224	(728)	1,062	143,865	244,018	4,605	248,623

Consolidated Statement of Changes in Equity

	Attributable to equity holders of the Company											
	Reserves									Other equity instruments	Non-controlling interests	Total equity
	Share capital	Premises revaluation reserve	Reserve for fair value changes/ Reserve for fair value changes of available-for-sale securities	Reserve for own credit risk	Regulatory reserve*	Translation reserve	Merger reserve**	Retained earnings	Total			
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
At 1 January 2018, as previously reported	52,864	36,689	42	-	10,224	(669)	-	143,589	242,739	-	4,605	247,344
Effect of merger of entities under common control	-	-	-	-	-	(59)	1,062	276	1,279	-	-	1,279
At 1 January 2018, as restated	52,864	36,689	42	-	10,224	(728)	1,062	143,865	244,018	-	4,605	248,623
Effect of adoption of HKFRS 9	-	-	(1,816)	-	(750)	-	-	194	(2,372)	-	(106)	(2,478)
At 1 January 2018, after adoption of HKFRS 9	52,864	36,689	(1,774)	-	9,474	(728)	1,062	144,059	241,646	-	4,499	246,145
Profit for the year	-	-	-	-	-	-	-	32,000	32,000	-	584	32,584
Other comprehensive income:												
Premises	-	1,838	-	-	-	-	-	-	1,838	-	-	1,838
Equity instruments at fair value through other comprehensive income	-	-	(787)	-	-	-	-	-	(787)	-	(45)	(832)
Own credit risk	-	-	-	25	-	-	-	-	25	-	-	25
Debt instruments at fair value through other comprehensive income	-	-	(1,607)	-	-	-	-	-	(1,607)	-	(464)	(2,071)
Currency translation difference	-	-	27	-	-	(125)	-	-	(98)	-	-	(98)
Total comprehensive income	-	1,838	(2,367)	25	-	(125)	-	32,000	31,371	-	75	31,446
Release upon disposal of equity instruments at fair value through other comprehensive income:												
Transfer	-	-	30	-	-	-	-	(30)	-	-	-	-
Deferred tax	-	-	(5)	-	-	-	-	-	(5)	-	(2)	(7)
Current tax	-	-	-	-	-	-	-	5	5	-	2	7
Release upon redemption of financial liabilities designated at fair value through profit or loss:												
Transfer	-	-	-	(20)	-	-	-	20	-	-	-	-
Current tax	-	-	-	-	-	-	-	(3)	(3)	-	-	(3)
Acquisition of entities under common control	-	-	-	-	-	-	(2,168)	-	(2,168)	-	-	(2,168)
Transfer from retained earnings	-	-	-	-	1,022	-	1,106	(2,128)	-	-	-	-
Issue of other equity instruments	-	-	-	-	-	-	-	-	-	23,476	-	23,476
Dividends	-	-	-	-	-	-	-	(13,776)	(13,776)	-	(213)	(13,989)
At 31 December 2018	52,864	38,527	(4,116)	5	10,496	(853)	-	160,147	257,070	23,476	4,361	284,907

* In accordance with the requirements of the HKMA, the amounts are set aside for general banking risks, including future losses or other unforeseeable risks, in addition to the loan impairment allowances recognised under HKAS 39/HKFRS 9.

** Merger reserve was arising on the application of merger accounting method in relation to the combination with entities under common control.

The notes on pages 138 to 311 are an integral part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December	Notes	2018 HK\$'m	(Restated) 2017 HK\$'m
Cash flows from operating activities			
Operating cash inflow before taxation	42(a)	273,897	136,933
Hong Kong profits tax paid		(7,106)	(4,703)
Overseas profits tax paid		(610)	(404)
Net cash inflow from operating activities		266,181	131,826
Cash flows from investing activities			
Additions of properties, plant and equipment		(1,174)	(1,526)
Proceeds from disposal of properties, plant and equipment		6	13
Additions of investment properties	28	(13)	(13)
Proceeds from disposal of investment properties		–	2
Dividend received from associates and joint ventures	27	4	2
Acquisition of entities under common control		(2,168)	(6,618)
Net cash inflow from disposal of discontinued operations	39	–	810
Net cash outflow from investing activities		(3,345)	(7,330)
Cash flows from financing activities			
Dividend paid to equity holders of the Company		(13,776)	(13,375)
Dividend paid to non-controlling interests		(213)	(152)
Proceeds from issuance of other equity instruments		23,476	–
Payment for redemption/repayment of subordinated liabilities	42(b)	(7,211)	(16)
Interest paid for subordinated liabilities	42(b)	(1,087)	(595)
Net cash inflow/(outflow) from financing activities		1,189	(14,138)
Increase in cash and cash equivalents		264,025	110,358
Cash and cash equivalents at 1 January		380,922	254,165
Effect of exchange rate changes on cash and cash equivalents		(20,200)	16,399
Cash and cash equivalents at 31 December	42(c)	624,747	380,922

The notes on pages 138 to 311 are an integral part of these financial statements.

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.

The Company is a limited liability company incorporated and listed in Hong Kong. The address of its registered office is 24/F, Bank of China Tower, 1 Garden Road, Hong Kong.

2. 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 Hong Kong Companies Ordinance.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets at fair value through other comprehensive income, financial assets and financial liabilities (including derivative financial instruments) at fair value through profit or loss, precious metals at fair value, investment properties which are carried at fair value and premises which are carried at fair value or revalued amount less accumulated depreciation and accumulated impairment losses. Disposal group and repossessed assets held for sale are stated at the lower of their carrying amounts and fair values less costs to sell as further explained in Notes 2.2 and 2.24 respectively.

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

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) **Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018**

Standards/ Amendments/ Interpretation	Content	Applicable for financial years beginning on/after	Currently relevant to the Group
HKAS 28 (2011) (Amendments)	Investments in Associates and Joint Ventures	1 January 2018	No
HKAS 40 (Amendments)	Transfers of Investment Property	1 January 2018	Yes
HKFRS 1 (Amendments)	First-Time Adoption of Hong Kong Financial Reporting Standards	1 January 2018	No
HKFRS 2 (Amendment)	Share-Based Payment: Classification and Measurement of Share-Based Payment Transactions	1 January 2018	No
HKFRS 4 (Amendments)	Applying HKFRS 9 Financial Instruments with HKFRS 4 Insurance Contracts	1 January 2018	No
HKFRS 9	Financial Instruments	1 January 2018	Yes
HKFRS 9 (Amendments)	Financial Instruments: Prepayment Features with Negative Compensation	1 January 2019	Yes
HKFRS 15	Revenue from Contracts with Customers	1 January 2018	Yes
HKFRS 15 (Amendments)	Clarifications to HKFRS 15	1 January 2018	Yes
HK(IFRIC) – Int 22	Foreign Currency Transactions and Advance Consideration	1 January 2018	Yes

- HKAS 40 (Amendments), “Transfers of Investment Property”. The amendments clarify that there must be a change in use when a property is transferred to or from investment properties. A change in use would involve an assessment of whether a property meets, or has ceased to meet, the definition of investment property; and supporting evidence that a change in use has occurred. The requirements of these amendments are consistent with the Group’s current practice and do not have a material impact on the Group’s financial statements.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)

- HKFRS 9, “Financial Instruments”. The issuance of IFRS 9 “Financial Instruments” completes the International Accounting Standards Board’s comprehensive response to the 2008 financial crisis. HKFRS 9, the equivalent standard of IFRS 9 under HKFRS, includes a logical model for classification and measurement, a single, forward-looking “expected loss” impairment model and a tighter linkage of risk management to hedge accounting. The Group has also early adopted HKFRS 9 (Amendments) “Financial Instruments: Prepayment Features with Negative Compensation” which is mandatorily effective for reporting periods beginning on or after 1 January 2019 with earlier application permitted. The changes introduced in HKFRS 9 are highlighted as follows:

(i) Classification and measurement

Financial assets are required to be classified into one of the following measurement categories from the original four categories under HKAS 39: (1) measured subsequently at amortised cost, (2) measured subsequently at fair value through other comprehensive income (all fair value changes other than interest accrual, amortisation and impairment will be recognised in other comprehensive income), or (3) measured subsequently at fair value through profit or loss. Classification of financial assets was 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 instruments, or the election of fair value option.

For a description of how the Group classifies and measures financial assets and recognises related gains and losses under HKFRS 9, please refer to the respective accounting policy in Note 2.8.

The classification and measurement requirements of financial liabilities have been basically carried forward with minimal amendments from HKAS 39.

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)

(i) Classification and measurement (continued)

The accounting for fair value option of financial liabilities was changed to address own credit risk. The amount of change in fair value attributable to changes in the credit risk of the financial liabilities designated at fair value is presented in other comprehensive income. The remaining amount of the total gain or loss is included in the income statement. If this creates or enlarges an accounting mismatch in profit or loss, then the whole fair value change would be presented in the income statement. The determination of whether there will be a mismatch will need to be made at initial recognition of individual financial liabilities and will not be re-assessed. Amounts presented in other comprehensive income are not subsequently reclassified to the income statement but may be transferred within equity. This removes the volatility in profit or loss that was caused by changes in the credit risk of financial liabilities elected to be measured at fair value. It also means that gains caused by the deterioration of an entity's own credit risk on such liabilities will no longer be recognised in profit or loss. No accumulated fair value change in own credit risk is reclassified by the Group from retained earnings to other comprehensive income upon transition.

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

Upon transition, the Group has performed a detailed analysis for each class of the Group's financial assets and financial liabilities on 1 January 2018, and the below accompanying notes explain the original measurement categories under HKAS 39 and the new measurement categories under HKFRS 9.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) **Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)**

(i) **Classification and measurement (continued)**

Financial assets	Notes	Original classification under HKAS 39	New classification under HKFRS 9	Original gross carrying amount under HKAS 39 HK\$'m	Re-classification HK\$'m	Re-measurement HK\$'m	New gross carrying amount under HKFRS 9 HK\$'m
Cash and balances and placements with banks and other financial institutions		L&R	AC	426,604	–	–	426,604
Financial assets at fair value through profit or loss – debt instruments		FVPL (T)	FVPL (T)	49,710	–	–	49,710
		FVPL (T)	FVPL (M)	183	–	–	183
	(a)	FVPL (T)	FVOCI	179	(179)	–	–
	(b)	FVPL (T)	AC	712	(712)	–	–
	(c)	AFS	FVPL (M)	–	988	–	988
	(d)	HTM	FVPL (M)	–	1,381	(4)	1,377
	(e)	FVPL (D)	FVPL (M)	19,336	–	–	19,336
	(a)	FVPL (D)	FVOCI	5,079	(5,079)	–	–
	(b)	FVPL (D)	AC	5,249	(5,249)	–	–
	(f)	AFS	FVPL (D)	–	7,818	–	7,818
Financial assets at fair value through profit or loss – equity securities and fund		FVPL (T)	FVPL (T)	203	–	–	203
	(g)	FVPL (D)	FVPL (M)	12,543	–	–	12,543
	(h)	AFS	FVPL (M)	–	552	–	552
Hong Kong SAR Government certificates of indebtedness		L&R	AC	146,200	–	–	146,200
Derivative financial instruments		FVPL (T)	FVPL (T)	33,543	–	–	33,543
Advances and other accounts		L&R	AC	1,195,660	–	–	1,195,660

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) **Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)**

(i) **Classification and measurement (continued)**

Financial assets	Notes	Original classification under HKAS 39	New classification under HKFRS 9	Original gross carrying amount under HKAS 39 HK\$'m	Re-classification HK\$'m	Re-measurement HK\$'m	New gross carrying amount under HKFRS 9 HK\$'m
Investment in securities – debt instruments		AFS	FVOCI	531,964	–	–	531,964
	(c)	AFS	FVPL (M)	988	(988)	–	–
	(f)	AFS	FVPL (D)	7,818	(7,818)	–	–
	(i)	AFS	AC	20,931	(20,931)	–	–
	(a)	FVPL (T)	FVOCI	–	179	–	179
	(a)	FVPL (D)	FVOCI	–	5,079	–	5,079
	(j)	HTM	FVOCI	–	123	1	124
	(k)	L&R	FVOCI	–	499	(1)	498
	(l)	HTM	AC	49,118	–	(5)	49,113
	(d)	HTM	FVPL (M)	1,381	(1,381)	–	–
	(j)	HTM	FVOCI	123	(123)	–	–
	(b)	FVPL (T)	AC	–	712	(35)	677
	(b)	FVPL (D)	AC	–	5,249	(186)	5,063
	(i)	AFS	AC	–	20,931	508	21,439
	(k)	L&R	FVOCI	499	(499)	–	–
Investment in securities – equity securities	(m)	AFS	FVOCI	4,862	–	–	4,862
	(h)	AFS	FVPL (M)	552	(552)	–	–
Other financial assets		L&R	AC	23,353	–	–	23,353
Total financial assets				2,536,790	–	278	2,537,068

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) **Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)**

(i) **Classification and measurement (continued)**

Financial liabilities	Notes	Original classification under HKAS 39	New classification under HKFRS 9	Original gross carrying amount under HKAS 39 HK\$'m	Re-classification HK\$'m	Re-measurement HK\$'m	New gross carrying amount under HKFRS 9 HK\$'m
Hong Kong SAR currency notes in circulation		AC	AC	146,200	–	–	146,200
Deposits and balances from banks and other financial institutions		AC	AC	223,427	–	–	223,427
Financial liabilities at fair value through profit or loss		FVPL (T)	FVPL (T)	16,936	–	–	16,936
		FVPL (D)	FVPL (D)	2,784	–	–	2,784
Derivative financial instruments		FVPL (T)	FVPL (T)	31,046	–	–	31,046
Deposits from customers		AC	AC	1,775,090	–	–	1,775,090
Debt securities and certificates of deposit in issue		AC	AC	21,641	–	–	21,641
Subordinated liabilities		AC	AC	63	–	–	63
	(n)	AC	FVPL (D)	18,917	–	2,068	20,985
Other financial liabilities		AC	AC	42,144	–	–	42,144
Total financial liabilities				2,278,248	–	2,068	2,280,316

Remarks:

FVPL (T)	Trading assets/liabilities at fair value through profit or loss
FVPL (M)	Other financial assets mandatorily classified at fair value through profit or loss
FVPL (D)	Financial assets/liabilities designated at fair value through profit or loss
FVOCI	Fair value through other comprehensive income
AC	Amortised cost
AFS	Available-for-sale
HTM	Held-to-maturity
L&R	Loans and receivables

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)

(i) Classification and measurement (continued)

Notes:

- (a) Certain debt securities were reclassified as FVOCI out of FVPL because their contractual cash flows demonstrate solely payments of principal and interest on the principal outstanding. The Group reviewed its business model over these debt securities and concluded that the return of investment shall be achieved by both collecting contractual cash flows and sale of these investments.
- (b) Certain debt securities were reclassified to AC out of FVPL because their contractual cash flows demonstrate solely payments of principal and interest on the principal outstanding. The Group reviewed its business model over these debt securities and concluded these securities shall fulfil the business model of hold-to-collect.
- (c) Certain capital instruments classified as AFS with principal written-down features or equity conversion features at the point of non-viability of issuers were reclassified as FVPL because their cash flows are not solely payments of principal and interest on the principal outstanding.
- (d) Certain debt securities were reclassified out of HTM to FVPL because the Group reassessed its business model upon transition and concluded that the investments shall be managed on a fair value basis and by maximising cash flows through sales.
- (e) Certain debt securities fulfil the business model of being managed on a fair value basis and by maximising cash flows through sale and were mandatorily classified as FVPL.
- (f) Certain AFS securities were designated as financial assets at FVPL because the Group holds related derivatives at FVPL and these designations can eliminate or significantly reduce an accounting mismatch that would otherwise arise.
- (g) Equity securities and fund are mandatorily measured at FVPL under HKFRS 9. As such, these investments are no longer required to be designated at FVPL.
- (h) Certain equity securities were reclassified as FVPL from AFS because the Group manages these investments on a fair value basis and the return of investment shall be achieved by maximising return through sales.
- (i) Certain debt securities investments were reclassified as AC out of AFS because these securities fulfil the cash flow characteristics test and shall be managed solely for collecting contractual cash flows.
- (j) Certain HTM securities were reclassified as FVOCI as the Group reassessed its business model upon transition and concluded that the return on investment shall be achieved both by collection of contractual cash flows and sale of investments.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)

(i) Classification and measurement (continued)

Notes:

- (k) Certain L&R debt securities investments were reclassified as FVOCI because their contractual cash flows demonstrate solely payments of principal and interest on the principal outstanding and are held within a business model of both collecting contractual cash flows and selling investments.
- (l) Certain HTM securities were reclassified as AC. Since these debt securities were AFS securities which had previously been reclassified to HTM securities under HKAS 39, the change in carrying value upon transition is due to the remeasurement from initial recognition of the debt securities.
- (m) The Group elected to present in other comprehensive income the changes in fair value of certain equity investments previously classified as AFS because these investments are held as long-term strategic investments.
- (n) Under HKAS 39, the subordinated liabilities issued were measured at amortised cost and fair value hedge was applied to hedge the interest rate risk of the liabilities. Upon transition, the hedge accounting ceased and the subordinated liabilities were designated in its entirety as at FVPL to eliminate or significantly reduce an accounting mismatch between the liabilities and the hedging instruments that would otherwise arise.

The following table presents the financial impact resulted from the reclassification upon adoption of HKFRS 9.

	Carrying value as at 31 December 2018	Fair value as at 31 December 2018	Assuming no reclassification		Effective interest rate determined on the date of initial application	Interest income
			Losses recognised in income statement	Losses recognised in other comprehensive income		
	HK\$m	HK\$m	HK\$m	HK\$m		HK\$m
Reclassification from available-for-sale to amortised cost						
Debt instruments	19,889	19,306	N/A	(1,426)	N/A	N/A
Reclassification from FVPL to amortised cost						
Debt instruments	5,600	5,403	(400)	N/A	2.03% to 4.34%	256
Reclassification from FVPL to FVOCI						
Debt instruments	2,415	2,415	(100)	N/A	3.37% to 5.18%	142

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)

(ii) Impairment

The standard introduces a new forward-looking “expected-loss” impairment model that will require more timely recognition of expected credit losses. The impairment allowances for financial instruments that are subsequently measured at amortised cost, fair value through other comprehensive income (debt instruments), irrevocable loan commitments and financial guarantee contracts will be governed by this standard. Specifically, it requires entities to assess credit risk and estimate ECL with an unbiased and probability-weighted approach. Not only information about past events, but all available information including current conditions and forecast of future economic conditions shall be considered with discounting for time value of money. The Group will account for expected credit losses within the next 12 months as Stage 1 when those financial instruments are initially recognised; and recognise lifetime expected credit losses as Stage 2 when there has been significant increases in credit risk since initial recognition. Lifetime expected credit losses will be recognised for credit-impaired financial instruments as Stage 3 if one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred and interest will then be accrued net of the impairment amount of the respective Stage 3 financial assets.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)

(ii) Impairment (continued)

For assets within the scope of the HKFRS 9 impairment model, the resulting impairment under HKFRS 9 will probably be more forward-looking than that under HKAS 39. Their impairment losses are generally expected to increase and more volatile. The following table illustrates the impact of the adoption of HKFRS 9's impairment requirements on the Group as at 1 January 2018.

Impairment allowances	At 31 December 2017 under HKAS 39 HK\$'m	Re- measurement HK\$'m	At 1 January 2018 under HKFRS 9 HK\$'m
Cash and balances and placements with banks and other financial institutions	–	83	83
Advances and other accounts	4,106	852	4,958
Investment in securities – debt instruments			
– FVPL reclassified to FVOCI	–	3	3
– AFS, HTM and L&R reclassified to FVOCI	–	124	124
– FVPL reclassified to AC	–	2	2
– AFS and HTM reclassified to AC	45	15	60
Loan commitments and financial guarantee contracts	–	352	352
Others	5	9	14
Total	4,156	1,440	5,596

(iii) Hedge accounting

The requirements under HKFRS 9 related to hedge accounting would better align the accounting treatments with risk management activities and enable entities to better reflect these activities in their financial statements. It relaxes the requirements for assessing hedge effectiveness which may enable more risk management strategies to be eligible for hedge accounting. It also relaxes the rules on using non-derivative financial instruments as hedging instruments and allows greater flexibility on hedged items. Users of the financial statements will be provided with more relevant information about the effect of hedge accounting on the financial statements.

The Group has chosen to prospectively apply HKFRS 9 on transition. As HKFRS 9 does not change the general principles of accounting for effective hedges, applying the hedge accounting requirements of HKFRS 9 will not have a significant impact on the Group's financial statements.

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)

(iv) Overall impact of adoption of HKFRS 9 on equity

The Group has taken an exemption in accordance with the transitional provision of HKFRS 9 not to restate comparative information for prior periods with respect to classification and measurement. The adoption of HKFRS 9 reduced the net assets after tax at 1 January 2018 by approximately HK\$2.5 billion in aggregate, and the Group's total capital ratio decreased by approximately 10 basis points. The following table summarises the impact, net of tax, of transition to HKFRS 9 on the opening balances of reserves, retained earnings and non-controlling interests.

	Other comprehensive income and retained earnings HK\$m
Reserve for fair value changes	
Closing balance as at 31 December 2017	42
Reclassification of debt instruments from HTM to FVOCI	1
Reclassification of debt instruments from L&R to FVOCI	(1)
Reclassification of debt instruments from AFS to AC	508
Reclassification of debt instruments from FVPL(Trading) to FVOCI	4
Reclassification of debt instruments from FVPL(Designated) to FVOCI	149
Release upon reclassification of debt instruments from AFS to FVPL (Mandatory)	4
Release upon reclassification of debt instruments from AFS to FVPL (Designated)	358
Release upon reclassification of equity securities from AFS to FVPL (Mandatory)	(10)
Release upon reclassification of certain debt instruments from HTM to FVPL (Mandatory) ^{Note 1}	9
Release upon reclassification of certain debt instruments from HTM to AC ^{Note 1}	(8)
Recognition of ECL under HKFRS 9 for debt securities at FVOCI	127
Reversal of impairment loss previously recognised on AFS equity securities	(2,730)
Deferred tax in relation to the above	(170)
Share of non-controlling interests due to adoption of HKFRS 9	(57)
	<u>(1,816)</u>
Opening balance as at 1 January 2018	<u>(1,774)</u>
Regulatory reserve	
Closing balance as at 31 December 2017	10,224
Release to retained earnings upon adoption of HKFRS 9	(750)
Opening balance as at 1 January 2018	<u>9,474</u>

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)

(iv) Overall impact of adoption of HKFRS 9 on equity (continued)

	Other comprehensive income and retained earnings HK\$m
Retained earnings	
Closing balance as at 31 December 2017	143,865
Reclassification of debt instruments from HTM to FVPL (Mandatory)	(4)
Reclassification of debt instruments from HTM to AC	(5)
Reclassification of debt instruments from FVPL (Trading) to AC	(35)
Reclassification of debt instruments from FVPL (Designated) to AC	(186)
Reclassification of subordinated liabilities from AC to FVPL (Designated)	(2,068)
Reclassification of debt instruments from FVPL (Trading) to FVOCI	(4)
Reclassification of debt instruments from FVPL (Designated) to FVOCI	(149)
Release upon reclassification of debt instruments from AFS to FVPL (Mandatory)	(4)
Release upon reclassification of debt instruments from AFS to FVPL (Designated)	(358)
Release upon reclassification of equity securities from AFS to FVPL (Mandatory)	10
Release upon reclassification of certain debt instruments from HTM to FVPL (Mandatory) ^{Note 1}	(9)
Release upon reclassification of certain debt instruments from HTM to AC ^{Note 1}	8
Recognition of ECL under HKFRS 9	(1,440)
Reversal of impairment loss previously recognised on AFS equity securities	2,730
Reversal of interest previously reduced under HKAS 39	111
Current tax in relation to the above	494
Deferred tax in relation to the above	190
Release from regulatory reserve upon adoption of HKFRS 9	750
Share of non-controlling interests due to adoption of HKFRS 9	163
	194
Opening balance as at 1 January 2018	144,059
Non-controlling interests	
Closing balance as at 31 December 2017	4,605
Share of non-controlling interests due to adoption of HKFRS 9	(106)
Opening balance as at 1 January 2018	4,499

Note:

1. Certain debt securities that were originally AFS securities had been reclassified to HTM securities in prior years. Upon adoption of HKFRS 9, the original AFS reserve that was subject to amortisation was reversed to retained earnings directly.

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(a) Standards, amendments and interpretation that are initially adopted for the financial year beginning on 1 January 2018 (continued)

- HKFRS 15, "Revenue from Contracts with Customers". HKFRS 15 applies a single model and specifies the accounting treatment for all revenue arising from contracts with customers. The new standard is based on the core principle that revenue is recognised to reflect the consideration expected to be entitled when control of promised good or service transfers to customer. It is also applicable to the recognition and measurement of gains or losses on the sale of some non-financial assets such as properties or equipment that are not an output of ordinary activities.

The Group provides a wide range of financial services in exchange for fee or commission income. Except for a few services, such as safe deposit box service, of which revenue is recognised over time so as to depict the pattern of delivery of services, most of the commission income generated from the provision of financial services, such as security brokerage fee, credit card interchange fees and fees which are not an integral part of the effective yield, are recognised on a point-in-time basis, i.e. when the performance obligation is completed. Loan syndication fees are as before 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 applicable to the other participants.

The Group adopted HKFRS 15 by using the modified retrospective method of adoption. As HKFRS 15 does not change the general principles of accounting for revenue recognition, the application of this standard does not have a material impact on the Group's financial statements.

- HK(IFRIC) – Int 22, "Foreign Currency Transactions and Advance Consideration". The interpretation specifies that the exchange rate on the date of cash payment or receipt is used for transactions that involve advance consideration paid or received in a foreign currency. The application of this interpretation does not have a material impact on the Group's financial statements.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) **Standards, amendments and interpretation issued that are not yet mandatorily effective and have not been early adopted by the Group in 2018**

Standards/ Amendments/ Interpretation	Content	Applicable for financial years beginning on/after	Currently relevant to the Group
HKAS 1 and HKAS 8 (Amendments)	Definition of Material	1 January 2020	Yes
HKAS 19 (2011) (Amendments)	Plan Amendment, Curtailment or Settlement	1 January 2019	No
HKAS 28 (2011) and HKFRS 10 (Amendments)	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	To be determined	Yes
HKAS 28 (2011) (Amendments)	Long-term Interests in Associates and Joint Ventures	1 January 2019	Yes
HKFRS 3 (Amendments)	Definition of a Business	1 January 2020	Yes
HKFRS 16	Leases	1 January 2019	Yes
HKFRS 17	Insurance Contracts	1 January 2021	Yes
HK(IFRIC) – Int 23	Uncertainty over Income Tax Treatments	1 January 2019	Yes

Further information about those HKFRSs that are expected to be applicable to the Group is as follows:

- HKAS 1 and HKAS 8 (Amendments), “Definition of Material”. The amendments clarify the definition of materiality of information and align the definition used across other accounting standards. The amendments are to be applied prospectively and early application is permitted. The application of these amendments will not have a material impact on the Group’s financial statements.
- HKAS 28 (2011) and HKFRS 10 (Amendments), “Sale or Contribution of Assets between an Investor and its Associate or Joint Venture”. The amendments address an acknowledged inconsistency between the requirements in HKAS 28 (2011) and those in HKFRS 10, in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognised when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. The amendments are to be applied prospectively and early application is permitted. The application of these amendments will not have a material impact on the Group’s financial statements.

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretation issued that are not yet mandatorily effective and have not been early adopted by the Group in 2018 (continued)

- HKAS 28 (2011) (Amendments), “Long-term Interests in Associates and Joint Ventures”. The amendments clarify that long-term interests such as preference shares or shareholder’s loans, to which the equity method shall not be applied, are in the scope of both HKFRS 9 and HKAS 28 and explains that HKFRS 9 is applied independently before the allocation of losses under the equity method. The amendments are to be applied retrospectively and early application is permitted. The application of the amendments will not have a material impact on the Group’s financial statements.
- HKFRS 3 (Amendments), “Definition of a Business”. The amendments clarify the definition of a business, with the objective of assisting entities to determine whether a business combination transaction should be accounted for as a business combination or as an asset acquisition. The amendments are to be applied prospectively and early application is permitted. The application of this amendment will not have a material impact on the Group’s financial statements.
- HKFRS 16, “Leases”. HKFRS 16 supersedes the existing standard and interpretations related to leases. It applies a single control model to identify leases and distinguish between leases and service contracts. Significant changes to lessee accounting are introduced, with the distinction between operating and finance leases removed. Also, subject to practical expedients, lessees will account for all leases in a similar way as the current finance lease accounting under HKAS 17, i.e. the lessee will recognise and measure the corresponding “right-of-use” asset and lease liability at the inception of the lease by discounting the total future lease payment. Subsequently, the lessee will recognise interest expense through the unwinding of the lease liability, and the expense on the depreciation of the right-of-use asset, instead of recognising as rental expenses under operating leases. As a practical expedient, the lessee can elect not to apply this accounting model to short-term leases (i.e. where the lease term is 12 months or less) and to leases of low-value assets, in which case the rental expenses would continue to be recognised on a systematic basis over the lease term. There will be no significant changes to the lessor accounting requirements as compared with the current HKAS 17.

The Group is considering to elect to use the modified retrospective approach for the adoption of HKFRS 16 and will recognise the cumulative effect of the initial application as an adjustment to the opening balances at 1 January 2019 with no restatement of the comparative information. As a reference, at 31 December 2018, the Group’s future minimum lease payments under non-cancellable operating leases as shown in Note 45 amounted to approximately HK\$1.4 billion, the majority of which are payable between 1 and 5 years after the reporting date. Upon the initial adoption of HKFRS 16, the opening balances of lease liabilities and the corresponding right-of-use assets are estimated to be adjusted by HK\$1.7 billion, net of tax, as at 1 January 2019. The above overall financial impact is subject to change of assumptions, judgements and estimates to be finalised in the financial statements of 2019.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Standards, amendments and interpretation issued that are not yet mandatorily effective and have not been early adopted by the Group in 2018 (continued)

- HKFRS 17, “Insurance Contracts”. HKFRS 17 aims at replacing the current insurance contracts standard HKFRS 4, an interim standard that leads to highly divergent accounting practices that exist in the insurers’ local jurisdictions. The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts, with an objective to ensure that an entity provides relevant information that faithfully represents insurance contracts. Early application of the standard is permitted but only if the entity also applies HKFRS 9 and HKFRS 15. The Group is considering the financial impact of the standard and the timing of its application.
- HK(IFRIC) – Int 23, “Uncertainty over Income Tax Treatments”. The interpretation specifies how an entity should reflect and measure the effects of uncertainty in accounting for income taxes by determining how probable that a taxation authority will accept an uncertain tax treatment. The interpretation can either be applied on a fully retrospective basis or on a modified retrospective basis. Earlier application is permitted. The application of this interpretation will not have a material impact on the Group’s financial statements.

(c) Improvements to HKFRSs

“Improvements to HKFRSs” contains a number of 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. These improvements will not have a material impact on the Group’s financial statements.

2. Significant accounting policies (continued)

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries for the year ended 31 December 2018.

(1) Subsidiaries

Subsidiaries are entities (including structured entities), directly or indirectly, controlled by the Group. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee (i.e. existing rights that give the Group the current ability to direct the relevant activities of the investee). When the Company has, directly or indirectly, less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including: (a) the contractual arrangement with the other vote holders of the investee; (b) rights arising from other contractual arrangements; and (c) the Group's voting rights and potential voting rights. 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.

If the Group loses control over a subsidiary, it derecognises (i) the assets (including goodwill) and liabilities of the subsidiary, (ii) the carrying amount of any non-controlling interests; and recognises (i) the fair value of the consideration received, (ii) the fair value of any investment in that former subsidiary retained; reclassifies the amounts previously recognised in other comprehensive income to the income statement or retained earnings, as appropriate, on the same basis as directly disposed of the related assets or liabilities; recognises any resulting differences as gain or loss in the income statement.

If the Group is committed by the Board to a sale plan involving loss of control of a subsidiary (a disposal group) that is unlikely to be withdrawn or changed significantly, the Group shall classify all the assets and liabilities of that subsidiary as held for sale only when the following criteria are met on or before the end of the reporting period: (i) the carrying amount will be recovered principally through a sale transaction rather than through continuing use; (ii) the subsidiary is available for immediate sale in its present condition subject only to terms that are usual and customary for the sale of its kind and its sale must be highly probable, including a high probability of shareholders' approval, if needed; (iii) an active programme to locate a buyer at a reasonable price has been initiated and to complete the sale within one year, regardless of whether the Group will or will not retain a non-controlling interest after the sale. Disposal group (other than investment properties and financial instruments) is initially recognised and subsequently remeasured at the lower of its carrying amount and fair value less costs to sell. Properties, plant and equipment classified as held for sale are not depreciated.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.2 Consolidation (continued)

(1) Subsidiaries (continued)

(i) Business combinations not under common control

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

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

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. The measurement period does not exceed one year from the acquisition date.

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

2. Significant accounting policies (continued)

2.2 Consolidation (continued)

(1) Subsidiaries (continued)

(ii) Business combinations under common control

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

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

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

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.2 Consolidation (continued)

(3) Associates and joint ventures

An associate is the entity over which the Group has significant influence but not control or joint control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

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

Investments in associates and joint ventures are accounted for using the equity method of accounting and are initially recognised at cost, unless it is classified as held for sale (or included in a disposal group that is classified as held for sale). The Group's investments in associates and joint ventures include goodwill, net of accumulated impairment loss and any related accumulated foreign currency translation difference.

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

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

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

2.3 Segmental reporting

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

2. 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 or 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 fair value through other comprehensive income 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 fair value through other comprehensive income 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, borrowings and other currency instruments designated as hedges of such investments are taken to other comprehensive income and are accumulated separately in equity in the translation reserve. When a foreign entity is disposed, such exchange differences are reclassified from equity to the income statement, as part of the gain or loss on sale.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting

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

Certain derivatives embedded in financial liabilities 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 flow attributable to a recognised asset or liability, or a highly probable forecast transaction (cash flow hedge).

2. Significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting (continued)

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 the economic relationship, credit risks, the hedge ratio and an evaluation of the effectiveness of the hedging instruments 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. Hedge accounting may become ineffective if the hedging instrument and the hedged item lose economic relationship, or a significant change of the counterparties' credit risks that dominates the fair value change of the hedging instruments or the hedged items.

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as effective fair value hedges are recognised 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.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting (continued)

(c) Net investment hedge

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

2.6 Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is 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.

2.7 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.

2. Significant accounting policies (continued)

2.7 Interest income and expense and fee and commission income and expense (continued)

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 applicable to the other participants.

2.8 Financial assets

The Group classifies its financial assets into one of the following measurement categories at initial recognition as subsequently measured at: fair value through profit or loss ("FVPL"), amortised cost and fair value through other comprehensive income ("FVOCI"). The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instruments, or the election of fair value option. All financial assets are recognised initially at fair value. Except for financial assets carried at FVPL, all transaction costs of financial assets are included in their initial carrying amounts.

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

This category has two sub-categories: financial assets designated at fair value through profit or loss at inception, or financial assets mandatorily required to be measured at fair value through profit or loss, including those held for trading.

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 hedging instruments.

A financial asset, other than those held for trading or mandatorily measured at fair value, will be designated as a financial asset at FVPL, if it 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, and is so designated by the Management.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.8 Financial assets (continued)

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

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 FVPL. The interest component is reported as part of the 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 FVPL when the Group's right to receive payment is established.

(2) Financial assets at amortised cost

Financial assets are classified as subsequently measured at amortised cost if both of the following conditions are met: (i) the financial assets are held within a business model with the objective to hold financial assets in order to collect contractual cash flows ("hold-to-collect" business model), and (ii) the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding on specified dates. They are initially recognised 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. Interest income which includes the amortisation of premium or discount is calculated using the effective interest method and is recognised in the income statement, gains or losses are recognised in profit or loss when the asset is derecognised, modified or impaired.

(3) Financial assets at fair value through other comprehensive income

Debt instruments are classified as subsequently measured at FVOCI if both of the following conditions are met: (i) the financial assets are held within a business model with the objective of both holding to collect contractual cash flows and selling, and (ii) the contractual terms of the financial assets give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding on specified dates.

2. Significant accounting policies (continued)

2.8 Financial assets (continued)

(3) Financial assets at fair value through other comprehensive income (continued)

Financial assets at FVOCI are initially recognised at fair value plus any directly attributable transaction costs, and are subsequently measured at fair value. Unrealised gains or losses arising from changes in the fair value of the financial assets 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.

For equity investments, an irrevocable election can be made at initial recognition to recognise unrealised and realised fair value gains or losses in other comprehensive income without subsequent reclassification of fair value gains or losses to the income statement even upon disposal. Dividends on equity instruments classified as FVOCI are recognised in other operating income when the Group's right to receive payment is established. Equity instruments designated at FVOCI are not subject to impairment assessment.

The treatment of translation differences on FVOCI securities is dealt with in Note 2.4.

Policy prior to 1 January 2018

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 initial carrying amounts.

(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.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.8 Financial assets (continued)

Policy prior to 1 January 2018 (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.

2. Significant accounting policies (continued)

2.8 Financial assets (continued)

Policy prior to 1 January 2018 (continued)

(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.

(4) Available-for-sale

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

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

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

Notes to the Financial Statements

2. Significant accounting policies (continued)

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 and certificates of deposit in issue, subordinated liabilities, and other liabilities. All financial liabilities are classified at inception and recognised initially at fair value, and in the case of financial liability not at fair value through profit or loss, plus or minus transaction costs.

(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 in issue 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 derivatives that significantly modify the cash flows 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, except for fair value changes arising from own credit risks are recognised as other comprehensive income and subsequently reclassified to the retained earnings upon derecognition.

2. Significant accounting policies (continued)

2.9 Financial liabilities (continued)

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

Deposits and debt securities and certificates of deposit 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.

Policy prior to 1 January 2018

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 and certificates of deposit in issue, subordinated liabilities, and other liabilities. All financial liabilities are classified at inception and recognised initially at fair value.

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, including own credit risks, are recognised in the income statement.

2.10 Financial guarantee contracts

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

Financial guarantee contracts are initially recognised as financial liabilities and reported under "Other accounts and provisions" in the financial statements at fair value on the date the guarantees were given. Subsequent to initial recognition, the Group's liabilities under such guarantees are measured at the higher of (i) an ECL provision as set out in Note 2.14 and (ii) the amount initially recognised less, where appropriate, accumulated amortisation recognised over the life of the guarantee on a straight-line basis. Any changes in the liability relating to financial guarantee contracts are taken to the income statement.

Policy prior to 1 January 2018

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

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.11 Recognition and derecognition of financial instruments

Purchases and sales of financial assets subsequently measured at FVPL, securities measured at FVOCI and amortised costs are recognised on the trade date, the date on which the Group purchases or sells the assets. Loans and advances and other financial assets (except investment securities without an active market) are recognised when cash is advanced to the counterparties. 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 FVPL and debt securities and certificates of deposit in issue are recognised on the trade date. Deposits that are not designated at FVPL are recognised when money is received from customers, other liabilities are recognised when such obligations arise. Financial liabilities are derecognised from the balance sheet when and only when the obligation specified in the contract is discharged, cancelled or expires. If the Group purchases its own debt, it is removed from the balance sheet, and the difference between the carrying amount of a liability and the consideration paid is included in profit or loss, except for the portion arising from the change of own credit risk in the case of liabilities designated at FVPL, if any.

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 recognised as due to banks, placements from banks and other financial institutions, as appropriate, at the actual amount of cash received from the counterparty. Financial assets given as collateral for repurchase agreements are not derecognised and are recorded as investment in securities or financial assets at FVPL. Reverse repos or securities borrowings with a “hold-to-collect” business model and contractual cash flow of solely payments of principal and interest on the principal outstanding are initially recognised 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 the sale and the repurchase price is recognised as interest income or interest expense over the life of the agreements using the effective interest method.

2.12 Fair value measurement

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

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

2. Significant accounting policies (continued)

2.12 Fair value measurement (continued)

The Group uses the price within the bid-offer spread that is most representative of the fair value of financial instruments, where appropriate, includes using on the residual of the net offsetting risk position of portfolios of financial assets and financial liabilities in cases the Group manages such groups of financial assets and liabilities according to their net market risk exposures. Despite the Group measures the fair value of these groups of financial instruments on a net basis, the underlying financial assets and financial liabilities are separately presented in the financial statements unless the offsetting criteria stated in Note 2.6 are fulfilled.

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

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

2.13 Precious metals

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

2.14 Impairment of financial assets

The Group recognises a loss allowance for expected credit losses (ECLs) on the following items:

- financial assets measured at amortised cost;
- debt securities measured at FVOCI; and
- loan commitments and financial guarantees issued, which are not measured at FVPL.

Financial assets measured at fair value, including units in bond funds, equity securities measured at FVPL, equity securities designated at FVOCI (non-recycling) and derivative financial assets, are not subject to the ECL assessment.

ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all expected cash shortfalls (i.e. the difference between the cash flows due to the Group in accordance with the contract and the cash flows that the Group expects to receive).

For undrawn loan commitments and financial guarantees outstanding, expected cash shortfalls are measured as the difference between (i) the contractual cash flows that would be due to the Group if the holder/beneficiary of the loan commitment/financial guarantee draws down/claims on the loan/financial guarantee and (ii) the cash flows that the Group expects to receive if the loan is drawn down/financial guarantee is claimed.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

The expected cash shortfalls are discounted where the effect of discounting is material. The maximum period considered when estimating ECLs is the maximum contractual period over which the Group is exposed to credit risk.

In measuring ECLs, the Group takes into account reasonable and supportable information that is available. This includes information about past events, current conditions and forecasts of future economic conditions.

ECLs are measured on either of the following bases:

- 12-month ECLs: these are losses that are expected to result from possible default events within 12 months after the reporting date; or
- lifetime ECLs: these are losses that are expected to result from all possible default events over the expected lives of the items to which the ECL model applies.

The Group will account for expected credit losses within the next 12 months as Stage 1 when those financial instruments are initially recognised; and to recognise lifetime expected credit losses as Stage 2 when there has been significant increases in credit risk since initial recognition. Lifetime expected credit losses will be recognised for credit-impaired financial instruments as Stage 3 if one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred and interest will then be accrued net of the impairment amount of the respective Stage 3 financial assets.

In assessing whether the credit risk of a financial instrument (including a loan commitment and financial guarantee) has increased significantly since initial recognition, the Group compares the risk of default occurring on the financial instrument assessed at the reporting date with that assessed at the date of initial recognition. In making this reassessment, the Group considers that a default event occurs when (i) the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realising securities (if any is held); or (ii) the financial asset is 90 days past due. The Group considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort.

In particular, the following information is taken into account when assessing whether credit risk has increased significantly since initial recognition:

- failure to make payments of principal or interest on their contractually due dates;
- an actual or expected significant deterioration in a financial instrument's external or internal credit rating (if available);
- an actual or expected significant deterioration in the operating results of the debtor; and
- existing or forecast changes in the technological, market, economic or legal environment that have a significant adverse effect on the debtor's ability to meet its obligation to the Group.

2. Significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

For loan commitments and financial guarantees, the date of initial recognition for the purpose of assessing ECLs is considered to be the date that the Group becomes a party to the irrevocable commitment. In assessing whether there has been a significant increase in credit risk since initial recognition of a loan commitment or a financial guarantee, the Group considers changes in the risk of default occurring on the loan and advances to which the loan commitment/financial guarantee relates.

Depending on the nature of the financial instruments, the assessment of a significant increase in credit risk is performed on either an individual basis or a collective basis. When the assessment is performed on a collective basis, the financial instruments are grouped based on shared credit risk characteristics, such as past due status and credit risk ratings.

ECLs are remeasured at each reporting date to reflect changes in the financial instrument's credit risk since initial recognition. Any change in the ECL amount is recognised as an impairment gain or loss in profit or loss. The Group recognises an impairment gain or loss for all financial instruments with a corresponding adjustment to their carrying amount through a loss allowance account, except for investments in debt securities that are measured at FVOCI, for which the loss allowance is recorded in the fair value reserve.

Interest income recognised in accordance with Note 2.7 is calculated based on the gross carrying amount of the financial asset unless the financial asset is credit-impaired (Stage 3), in which case interest income is calculated based on the amortised cost (i.e. the gross carrying amount less loss allowance) of the financial asset.

When a financial asset is uncollectible, it is written off against the related allowance for impairment losses. Such assets are written off after all the necessary procedures have been completed and the amount of the loss has been determined. The assets written off are still subject to enforcement activity. 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.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

Policy prior to 1 January 2018

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 reliably estimated future cash flows of the financial asset or group of financial assets. Objective evidence that a financial asset or group of financial assets may be impaired includes observable data that comes to the attention of the Group about the following probable loss events:

- (i) significant financial difficulty of the issuer or obligor;
- (ii) a breach of contract, such as a default or delinquency in interest or principal payment;
- (iii) the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- (iv) it becoming probable that the borrower will enter into bankruptcy or other financial reorganisation;
- (v) the disappearance of an active market or downgrading below investment grade level for that financial asset because of financial difficulties; or
- (vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
 - adverse changes in the payment status of borrowers in the group; or
 - national or local economic conditions that correlate with defaults on the assets in the group.

(1) Assets carried at amortised cost

The Group first assesses whether objective evidence of impairment exists individually for financial assets. If the Group determines that no individually assessed impairment is provided, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. 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.

2. Significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

Policy prior to 1 January 2018 (continued)

(1) Assets carried at amortised cost (continued)

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

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.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.14 Impairment of financial assets (continued)

Policy prior to 1 January 2018 (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 investments in subsidiaries, associates, joint ventures 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. "Significant" is evaluated against the original cost of the investment and "prolonged" against the period in which the fair value has been below its original 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). Impaired assets are reviewed for possible reversal of the impairment at each reporting date.

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

2. Significant accounting policies (continued)

2.16 Investment properties

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

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

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 stated at fair value based on periodic, at least annually, valuations by external independent valuers less any subsequent accumulated depreciation and 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.

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.

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

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.17 Properties, plant and equipment (continued)

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.

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 2 to 15 years

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

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

Gains or losses on disposals are determined as the difference between the net disposal proceeds and the carrying amount, relevant taxes and expenses. These are recognised in the income statement on the date of disposal. Any related revaluation surplus is transferred from the revaluation reserve to retained earnings and is not reclassified to 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. Contingent rental payable is recognised as an expense in the accounting period in which it is incurred.

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

2. Significant accounting policies (continued)

2.18 Leases (continued)

(2) Finance leases

Leases of assets where lessee has 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 commencement of the lease 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 periodic rate of interest on the remaining balance of the liability. 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 the net investment method, which reflects a constant periodic rate of return.

2.19 Insurance and investment contracts

(1) Insurance and investment contract classification, recognition and measurement

The Group follows the local regulatory requirements to measure the liabilities of its insurance contracts and investment contracts with the discretionary participation feature ("DPF").

The Group issues insurance contracts, which are contracts that transfer significant insurance risk and may also transfer financial 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. In addition, the Group issues investment contracts. Investment contracts transfer financial risk with no significant insurance risk. They contain a DPF which entitles the holders to receive additional benefits (supplement to guaranteed benefits) that are likely to be significant based on the performance and return of a specified pool or type of contracts.

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.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.19 Insurance and investment contracts (continued)

(1) Insurance and investment contract classification, recognition and measurement (continued)

Retirement scheme management category I contracts are classified as investment contracts. They also include an investment guarantee element in the determination of the credit rate to policyholders' accounts. The liability for these contracts is determined using a retrospective calculation method which represents an account balance based on the premiums received to date plus interest or bonus credited to the policyholders less policy charges.

Retirement scheme management category III insurance contracts, as defined in the Insurance 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 and are gross of any taxes or duties levied on the premium. Benefits and claims are recorded as an expense when they are incurred.

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

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

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

(2) Liability adequacy tests

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 administrative 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 tests.

2. Significant accounting policies (continued)

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

(3) Bonus plans

The expected cost of bonus payments is 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 discounted if the amounts are significant.

Notes to the Financial Statements

2. Significant accounting policies (continued)

2.23 Current and deferred income taxes

Tax expenses for the period comprise 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 its subsidiaries, associates and joint ventures 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, and revaluation of certain assets including securities at FVOCI and premises. 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. Deferred income tax assets are recognised on deductible temporary differences, the carry forward of any unused tax credits and unused tax losses to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences, the carry forward of unused tax credits and unused tax losses 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 securities at FVOCI 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 an 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. Significant accounting policies (continued)

2.24 Repossessed assets

Reposessed 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, reposessed assets are measured at the lower of their cost and fair values less costs to sell and are reported as “non-current assets held for sale” included in “Other assets”.

2.25 Fiduciary activities

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

2.26 Contingent liabilities and contingent assets

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

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

A contingent asset is a possible asset that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future 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 (i) controls, jointly controls or has significant influence over the Group; (ii) is a member of the same financial reporting group, such as parents, subsidiaries and fellow subsidiaries; (iii) is an associate or a joint venture of the Group or parent reporting group; (iv) is a key management personnel of the Group or parents; (v) is subject to common control with the Group; (vi) is an entity in which a person identified in (iv) controls; and (vii) provides key management personnel services to the Group or its parent. Related parties may be individuals or entities.

Notes to the Financial Statements

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 reporting period. Estimates and judgements are continually evaluated and 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 effects of changes to either the key assumptions or other estimation uncertainties are presented below if it is practicable to determine. It is possible that actual results may require material adjustments to the estimates referred to below.

3.1 Impairment of financial assets

The Group reviews its credit portfolios to assess impairment at least on a quarterly basis. Under HKFRS 9, the measurement of impairment losses across all categories of financial asset requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes of which can result in different levels of allowances.

The Group's ECL calculations are outputs of complex models. The choice of variable inputs and their interdependencies involves a series of assumptions. ECL models are developed by leveraging on the parameters implemented under Basel II Internal Ratings-Based ("IRB") models and internal models, where feasible and available. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Group's internal credit rating models, which assign Probability of Defaults to the individual ratings. Please refer to CRE of section 7 of the Group's Regulatory Disclosures for 2018 for a description of the Group's internal models;
- The Group's significant credit deterioration criteria (including internal credit rating downgrade, days past due, drop in Mark-to-Market and qualitative assessment) for assessing whether the financial assets' impairment allowances should be measured on a lifetime ECL basis;
- The segmentation of financial assets according to similar risk and default characteristics (portfolios including Sovereign, Bank, Corporates, Retail Small Medium-sized Enterprise, Residential Mortgage Loan and Credit Card) when their ECLs are assessed on a collective basis;
- Development of ECL models, including the determination of macroeconomic factor forecasts (including Gross Domestic Product, Consumer Price Index, Property Price Index and Unemployment Rate) and the effect on Probability of Defaults, Loss Given Defaults and Exposure at Defaults; and
- Selection of forward-looking macroeconomic scenarios (including three independent scenarios i.e. good, baseline and bad) and their probability weightings.

It has been the Group's policy to regularly review its models in the context of actual loss experience and adjust when necessary.

Carrying amounts of loans and advances and investment in securities as at 31 December 2018 are shown in Notes 25 and 26 respectively.

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

3.2 Fair values of derivative financial instruments

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

Carrying amounts of derivative financial instruments as at 31 December 2018 are shown in Note 24.

3.3 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 (Determination of Long Term Liabilities) Rules 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 population statistics or reinsurance information, adjusted where appropriate to reflect the Group's own experience and relevant reinsurance arrangements. 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 and morbidity in future years to differ by 10% (2017: 10%) from the Management's estimate, the long term business fund liability would increase by approximately HK\$163 million (2017: approximately HK\$193 million), which accounts for 0.24% (2017: 0.29%) 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 (2017: 50 basis points) from the Management's estimates, the long term business fund liability would increase by approximately HK\$1,189 million (2017: approximately HK\$1,660 million). In this case, it is assumed there is no relief arising from reinsurance contracts held.

Notes to the Financial Statements

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

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

The Group has also assessed whether a provision for expense is necessary in accordance with the Insurance 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. As at 31 December 2018, no provision for maintenance expenses was provided (2017: Nil).

A resilience reserve was set up and included in long term business fund liabilities in accordance with the Insurance (Determination of Long Term Liabilities) Rules 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 31 basis points (2017: 30 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.

3.4 Deferred tax assets

Deferred tax assets on unused tax losses and unused tax credits are recognised and the determination of the amount to be recognised requires significant management judgement. Deferred tax asset on unused tax losses are recognised to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits. For deferred tax assets on unused tax credits, judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the estimation of available tax credits and the possibility to recover such deferred tax assets recognised.

4. Financial risk management

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

Financial risk management framework

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

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

The RMC, a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, approving Level I risk management policies and monitoring their implementation, and approving significant or high risk exposures or transactions. 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, and approving material risk exposures or transactions within his authority delegated by the Board of Directors. The Deputy Chief Executives ("DCEs") assist the CE in fulfilling his responsibilities on the day-to-day management of various types of risk, and are responsible for approving material risk exposures or transactions within their authorities delegated by the CE. 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 in response to regulatory changes that will enable the Group to better monitor and manage any risks that may arise from time to time from new businesses, products and changes in the operating environment. The CRO is also responsible for reviewing material risk exposures or transactions within his delegated authority. In accordance with the principle of setting the hierarchy of risk management policies approved by the Board, senior management is also responsible for approving the detailed risk management policies of their responsible areas.

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 responsibility for drafting, reviewing and updating various risk management policies and procedures.

The Group's principal banking subsidiaries are subject to risk management 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.

Notes to the Financial Statements

4. Financial risk management (continued)

Financial risk management framework (continued)

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

Product development and risk monitoring

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

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

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

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

4.1 Credit risk

Credit risk is the risk of loss that a customer or counterparty is unable to or unwilling to meet its contractual obligations. Credit risk exists in the trading book and banking book, as well as from on- and off-balance sheet transactions of the Group. It arises principally from lending, trade finance and treasury businesses.

Credit risk management framework

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

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

4. Financial risk management (continued)

4.1 Credit risk (continued)

Credit risk management framework (continued)

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 exposures of subsidiaries in line with the credit risk management principles and requirements set by the Group. 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, development and maintenance of the Group's internal rating system and ensures the system complies with the relevant regulatory requirements. Back offices are responsible for credit administration, providing operations support and supervision on the implementation of prerequisite terms and conditions of credit facilities.

In accordance with the Group's operating principle, the Group's principal subsidiaries have to formulate their own credit risk policies that are consistent with those of the Group's core principle. These subsidiaries are required to submit their risk management reports 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 credit 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.

Advances

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

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

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

Credit risk measurement and control (continued)

Advances (continued)

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

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

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

The Group adopts loan grading criteria which divides credit assets into five categories with reference to the HKMA's guidelines, as below:

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

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

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

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

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

4. Financial risk management (continued)

4.1 Credit risk (continued)

Credit risk measurement and control (continued)

Debt securities and derivatives

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

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

Expected Credit Loss ("ECL") Methodology

HKFRS 9 introduces a new impairment model that requires the recognition of ECL for financial instrument held at amortised cost and fair value through other comprehensive income. Under HKFRS 9, ECL is assessed in three stages and the financial assets and loan commitments are classified in one of the three stages.

Stage 1: if the financial instrument is not credit-impaired upon origination and the credit risk on the financial instrument has not increased significantly since initial recognition, the loss allowance is measured at an amount up to 12-month ECL;

Stage 2: if the financial instrument is not credit-impaired upon origination but the credit risk on the financial instrument has increased significantly since initial recognition, the loss allowance is measured at an amount equal to the lifetime ECL;

Stage 3: if the financial instrument is credit-impaired, with one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred, the loss allowance is also measured at an amount equal to the lifetime ECL.

The Group leverages the parameters implemented under Basel II Internal Ratings-Based ("IRB") models and internal models where feasible and available to assess ECL. For the portfolios without models, all other reasonable and supportable information such as historical information, relevant loss experience or proxies are utilised. The measurement of ECL is the product of the financial instrument's probability of default ("PD"), loss given default ("LGD") and exposure at default ("EAD") discounted at the effective interest rate to the reporting date.

ECL is measured at an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes, the time value of money and reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. The Group adopts three economic scenarios in the ECL measurement to meet the requirements of HKFRS 9. The "Baseline" scenario represents a most likely outcome and the other two scenarios, referred to as "Good" scenario and "Bad" scenario, represent less likely outcomes which are more optimistic or more pessimistic compared to Baseline scenario.

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

Expected Credit Loss (“ECL”) Methodology (continued)

The Baseline scenario is prepared by our Economics & Strategic Planning Department. Historical data, economic trend, external forecast from governmental and non-governmental organisation, etc. are also used as benchmarks to ensure the scenario is reasonable and supportable. For the Good and Bad scenarios, the Group makes reference to the historical macroeconomics data.

The macroeconomic factors in the major countries/regions the Group operates such as Gross Domestic Product growth, Consumer Price Index, Property Price Index and Unemployment Rate are applied in the economic scenarios. These macroeconomic factors are considered to be important to the Group's ECL in statistical analysis and business opinion.

The probability assigned for each scenario reflects the Group's view for the economic environment, which implements the Group's prudent and consistent credit strategy of ensuring the adequacy of impairment allowance. A higher probability is assigned to the Baseline scenario to reflect the most likely outcome and a lower probability is assigned to the Good and Bad scenarios to reflect the less likely outcomes. The probabilities assigned are updated in each quarter.

The ECL methodology has been validated by independent Model Validation Unit and approved by the RMC. The Management is responsible to the ECL model application, if there is any required change in ECL methodology, the Group will follow the proper approval process.

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, property collateral including 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, cash deposits and securities. In the commercial and industrial sector, the types of collateral include real estate, securities, cash deposits, vessels, etc.

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 2018, the fair value of collateral held by the Group that was permitted to sell or re-pledge in the absence of default by the borrower amounted to HK\$5,322 million (2017: HK\$11,826 million). The Group had not sold or re-pledged such collateral (2017: Nil). These transactions are conducted under terms that are usual and customary to reverse repurchase and securities borrowing agreements.

4. Financial risk management (continued)

4.1 Credit risk (continued)

(A) Credit exposures

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

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

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 Master Agreement published by the International Swaps and Derivatives Association, Inc. ("ISDA Master Agreement") is the preferred agreement for documenting derivative activities of the Group. It provides the contractual framework under which dealing activities of over-the-counter ("OTC") transactions are conducted, and sets out close-out netting provisions upon termination following the occurrence of an event of default or a termination event. In addition, if deemed necessary, Credit Support Annex ("CSA") will be included to form part of the Schedule to the ISDA Master Agreement. Under a CSA, collateral is passed from one counterparty to another, as appropriate, to mitigate the credit exposures.

Advances and other accounts, contingent liabilities and commitments

The general types of collateral are disclosed on page 192. 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 201 to 202. The components and nature of contingent liabilities and commitments are disclosed in Note 43. 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, 13.37% (2017: 12.77%) were covered by collateral as at 31 December 2018.

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts

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

	2018 HK\$'m	2017 HK\$'m
Advances to customers		
Personal		
– Mortgages	256,723	245,951
– Credit cards	15,640	14,648
– Others	82,256	67,228
Corporate		
– Commercial loans	846,649	740,403
– Trade finance	65,437	78,196
	1,266,705	1,146,426
Trade bills	17,361	42,975
Advances to banks and other financial institutions	3,822	6,259
	1,287,888	1,195,660

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 to exceed the approved limit that was advised to the borrower.

Advances are credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows have occurred. Credit-impaired advances are classified as Stage 3 and lifetime expected credit losses will be recognised.

The Group identifies the advances as credit-impaired if the exposure is past due for more than 90 days or the borrower is unlikely to pay in full for the credit obligations to the Group.

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

Evidence that an advance is credit-impaired include observable data about the following events:

- Significant financial difficulty incurred by the borrower;
- A breach of contract, such as a default or delinquency in principal or interest payment;
- For economic or legal reasons related to the borrower's financial difficulty, the Group has granted to the borrower a concession that it would not otherwise consider;
- Probable that the borrower will become bankrupt or undergo other financial reorganisation; or
- Other observable data indicating that there is a measurable decrease in the estimated future cash flows from such advances.

Advances classified as Stage 3 may not necessarily result in impairment loss where the advances are fully collateralised.

Gross advances and other accounts before impairment allowances are analysed by internal credit grade and stage classification as follows:

	2018				2017
	Stage 1 HK\$'m	Stage 2 HK\$'m	Stage 3 HK\$'m	Total HK\$'m	Total HK\$'m
Advances to customers					
Pass	1,254,236	5,019	–	1,259,255	1,140,711
Special mention	1,934	3,133	–	5,067	3,636
Substandard or below	–	–	2,383	2,383	2,079
	1,256,170	8,152	2,383	1,266,705	1,146,426
Trade bills					
Pass	17,357	–	–	17,357	42,975
Special mention	–	–	–	–	–
Substandard or below	–	–	4	4	–
	17,357	–	4	17,361	42,975
Advances to banks and other financial institutions					
Pass	3,822	–	–	3,822	6,259
Special mention	–	–	–	–	–
Substandard or below	–	–	–	–	–
	3,822	–	–	3,822	6,259
	1,277,349	8,152	2,387	1,287,888	1,195,660
Impairment allowances	(3,740)	(546)	(1,130)	(5,416)	(4,106)
	1,273,609	7,606	1,257	1,282,472	1,191,554

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

Reconciliation of impairment allowances and gross amount for advances and other accounts is as follows:

	2018			
	Stage 1 HK\$'m	Stage 2 HK\$'m	Stage 3 HK\$'m	Total HK\$'m
Impairment allowances				
At 1 January 2018	3,689	651	618	4,958
Transfer to Stage 1	267	(253)	(14)	–
Transfer to Stage 2	(38)	53	(15)	–
Transfer to Stage 3	(7)	(240)	247	–
Changes arising from transfer of stage	(241)	293	815	867
Other changes (including new assets and derecognised assets)	74	43	194	311
Write-offs	–	–	(834)	(834)
Recoveries	–	–	120	120
Unwind of discount on impairment allowances	–	–	(1)	(1)
Exchange difference	(4)	(1)	–	(5)
At 31 December 2018	3,740	546	1,130	5,416
Charged to income statement (Note 13)				1,178

	2018			
	Stage 1 HK\$'m	Stage 2 HK\$'m	Stage 3 HK\$'m	Total HK\$'m
Gross amount				
At 1 January 2018	1,189,595	3,958	2,107	1,195,660
Transfer to Stage 1	1,477	(1,449)	(28)	–
Transfer to Stage 2	(4,868)	4,884	(16)	–
Transfer to Stage 3	(599)	(275)	874	–
New assets, further lending, derecognised assets and repayments	94,514	1,071	285	95,870
Write-offs	–	–	(834)	(834)
Exchange difference	(2,770)	(37)	(1)	(2,808)
At 31 December 2018	1,277,349	8,152	2,387	1,287,888

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

	2017		Total HK\$'m
	Collectively assessed HK\$'m	Individually assessed HK\$'m	
Impairment allowances			
At 1 January 2017, as previously reported	2,779	650	3,429
Effect of merger of entities under common control	43	29	72
At 1 January 2017, as restated	2,822	679	3,501
Charged/(credited) to income statement (Note 13)	1,117	(71)	1,046
Write-offs	(399)	(197)	(596)
Recoveries	58	73	131
Unwind of discount on impairment allowances	–	(3)	(3)
Exchange difference	17	10	27
At 31 December 2017	3,615	491	4,106

(a) Impaired advances

Impaired advances to customers are analysed as follows:

	2018 HK\$'m	2017 HK\$'m
Gross impaired advances to customers	2,383	1,371
Impairment allowances made in respect of such advances		
– Stage 3	1,126	N/A
– Individually assessed	N/A	491
Current market value of collateral held against the covered portion of such advances to customers	2,988	1,523
Covered portion of such advances to customers	1,511	1,083
Uncovered portion of such advances to customers	872	288

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

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

(a) Impaired advances (continued)

As at 31 December 2018, gross impaired trade bills amounted to HK\$4 million (2017: Nil), and there were no impaired advances to banks and other financial institutions (2017: Nil).

Classified or impaired advances to customers are analysed as follows:

	2018 HK\$'m	2017 HK\$'m
Gross classified or impaired advances to customers	2,383	2,079
Gross classified or impaired advances to customers as a percentage of gross advances to customers	0.19%	0.18%
Impairment allowances made in respect of such advances		
– Stages 1 to 3	1,126	N/A
– Collectively and individually assessed	N/A	540

Classified or impaired advances to customers represent advances which are either classified as “substandard”, “doubtful” or “loss” under the Group’s classification of loan quality, or classified as stage 3/individually assessed to be impaired.

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

(b) Advances overdue for more than three months

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

	2018		2017	
	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	443	0.04%	117	0.01%
– one year or less but over six months	309	0.02%	123	0.01%
– over one year	310	0.02%	313	0.03%
Advances overdue for over three months	1,062	0.08%	553	0.05%
Impairment allowances made in respect of such advances				
– Stage 3	828		N/A	
– Individually assessed	N/A		309	

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

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

	2018 HK\$'m	2017 HK\$'m
Current market value of collateral held against the covered portion of such advances to customers	849	520
Covered portion of such advances to customers	349	289
Uncovered portion of such advances to customers	713	264

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

As at 31 December 2018, gross trade bills overdue for more than three months amounted to HK\$4 million (2017: Nil) and there were no advances to banks and other financial institutions overdue for more than three months (2017: Nil).

(c) Rescheduled advances

	2018		2017	
	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"	280	0.02%	238	0.02%

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) Advances and other accounts (continued)

(d) Concentration of advances to customers

(i) Sectoral analysis of gross advances to customers

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

	2018					
	Gross advances to customers HK\$'m	% covered by collateral or other security	Classified or impaired HK\$'m	Overdue HK\$'m	Impairment allowances – Stage 3 HK\$'m	Impairment allowances – Stages 1 and 2 HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development	126,328	20.51%	–	–	–	543
– Property investment	50,223	80.51%	37	117	–	44
– Financial concerns	21,239	0.91%	–	–	–	37
– Stockbrokers	1,171	95.73%	–	–	–	1
– Wholesale and retail trade	38,147	34.46%	21	127	3	179
– Manufacturing	51,093	10.57%	136	148	134	87
– Transport and transport equipment	66,256	27.37%	867	17	9	150
– Recreational activities	1,675	1.90%	–	–	–	2
– Information technology	18,006	1.27%	1	220	1	107
– Others	118,574	38.43%	9	166	7	269
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	11,150	99.80%	18	166	–	4
– Loans for purchase of other residential properties	243,963	99.92%	65	1,534	–	58
– Credit card advances	15,613	–	135	558	118	150
– Others	78,282	86.84%	60	634	52	397
Total loans for use in Hong Kong	841,720	56.20%	1,349	3,687	324	2,028
Trade finance	65,437	19.37%	206	232	194	124
Loans for use outside Hong Kong	359,548	8.78%	828	970	608	2,133
Gross advances to customers	1,266,705	40.84%	2,383	4,889	1,126	4,285

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

(d) Concentration of advances to customers (continued)

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

	2017					
	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	99,987	24.22%	–	5	–	336
– Property investment	53,581	78.47%	19	68	–	180
– Financial concerns	13,461	2.42%	–	–	–	68
– Stockbrokers	1,027	89.86%	–	1	–	3
– Wholesale and retail trade	34,931	38.23%	26	160	20	131
– Manufacturing	45,075	13.93%	32	25	4	159
– Transport and transport equipment	61,786	28.44%	1,062	27	44	213
– Recreational activities	2,040	1.47%	–	–	–	6
– Information technology	23,900	1.07%	–	–	–	79
– Others	100,966	41.99%	18	132	5	336
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	9,874	99.75%	12	147	–	6
– Loans for purchase of other residential properties	234,434	99.93%	75	1,520	1	128
– Credit card advances	14,620	–	39	549	–	124
– Others	63,356	80.57%	53	508	20	429
Total loans for use in Hong Kong	759,038	58.31%	1,336	3,142	94	2,198
Trade finance	78,196	14.13%	55	25	32	287
Loans for use outside Hong Kong	309,192	9.19%	688	1,003	365	1,130
Gross advances to customers	1,146,426	42.05%	2,079	4,170	491	3,615

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

(d) Concentration of advances to customers (continued)

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

For those industry sectors constitute not less than 10% of the Group's gross advances to customers, the amounts of new impairment allowances charged to the income statement, and classified or impaired loans written off during the year are shown below:

	2018		2017	
	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	337	–	80	–
Individuals – Loans for purchase of other residential properties	27	–	26	–

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

(d) 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 locations of the counterparties, after taking into account the transfer of risk. For an advance to customer guaranteed by a party situated in a location different from the customer, the risk will be transferred to the location of the guarantor.

Gross advances to customers

	2018 HK\$'m	2017 HK\$'m
Hong Kong	1,008,102	911,691
Mainland of China	126,960	135,990
Others	131,643	98,745
	1,266,705	1,146,426
Impairment allowances made in respect of the gross advances to customers – Stages 1 and 2		
Hong Kong	2,798	N/A
Mainland of China	527	N/A
Others	960	N/A
	4,285	N/A
Impairment allowances made in respect of the gross advances to customers – Collectively assessed		
Hong Kong	N/A	2,741
Mainland of China	N/A	453
Others	N/A	421
	N/A	3,615

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

(d) Concentration of advances to customers (continued)

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

Overdue advances

	2018 HK\$'m	2017 HK\$'m
Hong Kong	3,752	3,061
Mainland of China	257	181
Others	880	928
	4,889	4,170
Impairment allowances made in respect of the overdue advances – Stage 3		
Hong Kong	407	N/A
Mainland of China	84	N/A
Others	445	N/A
	936	N/A
Impairment allowances made in respect of the overdue advances – Individually assessed		
Hong Kong	N/A	65
Mainland of China	N/A	53
Others	N/A	220
	N/A	338

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

(B) Advances and other accounts (continued)

(d) Concentration of advances to customers (continued)

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

Classified or impaired advances

	2018 HK\$'m	2017 HK\$'m
Hong Kong	1,485	1,379
Mainland of China	197	111
Others	701	589
	2,383	2,079
Impairment allowances made in respect of the classified or impaired advances – Stage 3		
Hong Kong	490	N/A
Mainland of China	107	N/A
Others	529	N/A
	1,126	N/A
Impairment allowances made in respect of the classified or impaired advances – Individually assessed		
Hong Kong	N/A	113
Mainland of China	N/A	70
Others	N/A	308
	N/A	491

(C) Repossessed assets

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

	2018 HK\$'m	2017 HK\$'m
Commercial properties	–	8
Industrial properties	–	1
Residential properties	10	21
	10	30

4. Financial risk management (continued)

4.1 Credit risk (continued)

(C) Repossessed assets (continued)

The estimated market value of repossessed assets held by the Group as at 31 December 2018 amounted to HK\$23 million (2017: HK\$77 million). The repossessed assets 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

(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 as at 31 December by rating agency designation and stage classification.

	2018				2017
	Stage 1 HK\$'m	Stage 2 HK\$'m	Stage 3 HK\$'m	Total HK\$'m	Total HK\$'m
Central banks					
Aaa to A3	153,697	–	–	153,697	84,559
Lower than A3	1,680	–	–	1,680	6,674
Unrated	14,781	–	–	14,781	8,830
	170,158	–	–	170,158	100,063
Other banks and other financial institutions					
Aaa to A3	226,755	–	–	226,755	267,873
Lower than A3	10,579	–	–	10,579	40,997
Unrated	2,079	–	–	2,079	3,428
	239,413	–	–	239,413	312,298
	409,571	–	–	409,571	412,361
Impairment allowances	(15)	–	–	(15)	–
	409,556	–	–	409,556	412,361

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 (continued)

Reconciliation of impairment allowances for balances and placements with banks and other financial institutions is as follows:

	2018			Total HK\$'m
	Stage 1 HK\$'m	Stage 2 HK\$'m	Stage 3 HK\$'m	
At 1 January 2018	83	–	–	83
Changes arising from transfer of stage	–	–	–	–
Other changes (including new assets and derecognised assets)	(70)	–	–	(70)
Exchange difference	2	–	–	2
At 31 December 2018	15	–	–	15
Credited to income statement (Note 13)				(70)

As at 31 December 2018, there were no overdue or impaired balances and placements with banks and other financial institutions (2017: Nil).

4. Financial risk management (continued)

4.1 Credit risk (continued)

(E) Debt securities and certificates of deposit

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

	2018			Total HK\$m
	Stage 1 HK\$m	Stage 2 HK\$m	Stage 3 HK\$m	
Investment in securities at fair value through other comprehensive income				
Aaa	87,036	–	–	87,036
Aa1 to Aa3	148,944	–	–	148,944
A1 to A3	206,957	–	–	206,957
Lower than A3	28,482	–	–	28,482
Unrated	14,195	–	–	14,195
	485,614	–	–	485,614
Of which: impairment allowances	(140)	–	–	(140)
Investment in securities at amortised cost				
Aaa	55,745	–	–	55,745
Aa1 to Aa3	4,628	–	–	4,628
A1 to A3	29,833	–	–	29,833
Lower than A3	12,271	–	–	12,271
Unrated	6,257	–	–	6,257
	108,734	–	–	108,734
Impairment allowances	(29)	–	–	(29)
	108,705	–	–	108,705

	2018 HK\$m
Financial assets at fair value through profit or loss	
Aaa	3,846
Aa1 to Aa3	24,326
A1 to A3	17,538
Lower than A3	7,514
Unrated	1,850
	55,074

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

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

	2017					Total HK\$'m
	Financial assets at fair value through profit or loss HK\$'m	Available-for-sale securities HK\$'m	Held-to-maturity securities HK\$'m	Loans and receivables HK\$'m		
Aaa	18,003	169,826	16,909	–		204,738
Aa1 to Aa3	13,639	135,479	1,581	–		150,699
A1 to A3	29,692	205,403	20,933	499		256,527
Lower than A3	9,662	35,848	6,192	–		51,702
Unrated	2,593	15,145	4,962	–		22,700
	<u>73,589</u>	<u>561,701</u>	<u>50,577</u>	<u>499</u>		<u>686,366</u>
Impairment allowances		–	45	–		

4. Financial risk management (continued)

4.1 Credit risk (continued)

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

Reconciliation of impairment allowances for debt securities and certificates of deposit is as follows:

	2018			Total HK\$'m
	Stage 1 HK\$'m	Stage 2 HK\$'m	Stage 3 HK\$'m	
Investment in securities at fair value through other comprehensive income				
At 1 January 2018	127	–	–	127
Changes arising from transfer of stage	–	–	–	–
Other changes (including new assets and derecognised assets)	14	–	–	14
Exchange difference	(1)	–	–	(1)
At 31 December 2018	140	–	–	140
Charged to income statement (Note 13)				14
Investment in securities at amortised cost				
At 1 January 2018	17	–	45	62
Changes arising from transfer of stage	–	–	–	–
Other changes (including new assets and derecognised assets)	12	–	–	12
Write-offs	–	–	(45)	(45)
At 31 December 2018	29	–	–	29
Charged to income statement (Note 13)				12

Notes to the Financial Statements

4. Financial risk management (continued)

4.1 Credit risk (continued)

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

The gross impaired or overdue debt securities and certificates of deposit are analysed as follows:

	2018 HK\$'m	2017 HK\$'m
Impaired and overdue for over one year		
– Investment in securities at amortised cost	–	N/A
– Held-to-maturity securities	N/A	45
	–	45

(F) Loan commitments and financial guarantee contracts

Loan commitments and financial guarantee contracts are analysed by internal credit grade and stage classification as follows:

	2018			Total HK\$'m
	Stage 1 HK\$'m	Stage 2 HK\$'m	Stage 3 HK\$'m	
Loan commitments and financial guarantee contracts				
Pass	603,513	2,900	–	606,413
Special mention	1,017	367	–	1,384
Substandard or below	–	–	91	91
	604,530	3,267	91	607,888

4. Financial risk management (continued)

4.1 Credit risk (continued)

(F) Loan commitments and financial guarantee contracts (continued)

Reconciliation of impairment allowances for loan commitments and financial guarantee contracts is as follows:

	2018			Total HK\$'m
	Stage 1 HK\$'m	Stage 2 HK\$'m	Stage 3 HK\$'m	
At 1 January 2018	331	21	–	352
Transfer to Stage 1	14	(14)	–	–
Transfer to Stage 2	(1)	1	–	–
Transfer to Stage 3	(1)	–	1	–
Changes arising from transfer of stage	(12)	12	22	22
Other changes (including new assets and derecognised assets)	49	–	20	69
Exchange difference	(5)	–	–	(5)
At 31 December 2018	375	20	43	438
Charged to income statement (Note 13)				91

Notes to the Financial Statements

4. Financial risk management (continued)

4.2 Market risk

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

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

The Group's market risk management covers BOCHK and its subsidiaries. The Group establishes market risk management policies to regulate BOCHK's and its subsidiaries' market risk management; meanwhile, the Group sets up the Group's VAR and stress test limits, which are allocated and monitored across the Group according to the business requirements and risk tolerance levels. In line with the requirements set in the Group's policy, the subsidiaries formulate the detailed policies and procedures and are responsible for managing their daily market risk.

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's requirements, major risk indicators and limits are classified into four levels, and are approved by the RMC, MC, CRO and the DCE in charge of the treasury business or the head of the respective business unit respectively. The treasury business units of BOCHK and subsidiaries (as for Group Limit) are required to conduct their business within approved market risk indicators and limits.

(A) VAR

The Group uses the VAR to measure and report general market risks to the RMC and senior management on a periodic basis. The Group adopts a uniformed VAR calculation model, using a historical simulation approach and two years of historical market data, to calculate the VAR of the Group and its subsidiaries over a one-day holding period with a 99% confidence level, and sets up the VAR limit of the Group and its 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 exposures¹ 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	2018	26.0	24.1	45.8	33.0
	2017	28.3	27.1	80.9	49.7
VAR for foreign exchange risk	2018	15.9	10.7	27.1	18.0
	2017	13.1	12.5	54.1	31.2
VAR for interest rate risk in the trading book	2018	13.0	12.9	43.0	26.4
	2017	25.1	19.3	82.4	44.4
VAR for equity risk in the trading book	2018	0.3	0.2	7.0	1.6
	2017	2.1	0.7	5.9	2.6
VAR for commodity risk	2018	9.6	0.8	9.7	3.1
	2017	1.1	0.5	2.0	1.3

Note:

1. Structural FX positions have been excluded.

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

- the use of historical market data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk 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.

Notes to the Financial Statements

4. Financial risk management (continued)

4.2 Market risk (continued)

(B) Currency risk

The Group's assets and liabilities are denominated in major currencies, particularly HK Dollar, 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.

The following is a summary of the Group's major foreign currency exposures arising from trading, non-trading and structural positions and is prepared with reference to the completion instructions for the HKMA return of foreign currency position. The net options position is calculated based on the basis of delta-weighted positions of all foreign exchange options contracts.

	2018							
	Equivalent in million of HK\$							
	US Dollars	Pound Sterling	Japanese Yen	Euro	Renminbi	Australian Dollars	Other foreign currencies	Total foreign currencies
Spot assets	867,526	26,486	23,821	33,069	560,809	38,679	63,410	1,613,800
Spot liabilities	(879,874)	(16,358)	(7,125)	(17,729)	(320,961)	(23,991)	(63,990)	(1,330,028)
Forward purchases	1,121,467	22,996	54,990	55,338	454,667	14,107	74,958	1,798,523
Forward sales	(1,107,713)	(33,076)	(71,582)	(70,369)	(693,728)	(28,786)	(73,864)	(2,079,118)
Net options position	1,312	(9)	(66)	(217)	(696)	(33)	4	295
Net long/(short) position	2,718	39	38	92	91	(24)	518	3,472

	2017							
	Equivalent in million of HK\$							
	US Dollars	Pound Sterling	Japanese Yen	Euro	Renminbi	Australian Dollars	Other foreign currencies	Total foreign currencies
Spot assets	850,639	23,799	90,147	52,557	365,422	42,746	47,941	1,473,251
Spot liabilities	(742,593)	(15,363)	(11,352)	(25,620)	(288,947)	(19,414)	(50,633)	(1,153,922)
Forward purchases	909,676	16,490	30,145	61,278	356,964	21,391	86,722	1,482,666
Forward sales	(1,014,314)	(25,073)	(108,992)	(88,054)	(433,565)	(44,640)	(83,140)	(1,797,778)
Net options position	(684)	6	(6)	(48)	44	(14)	10	(692)
Net long/(short) position	2,724	(141)	(58)	113	(82)	69	900	3,525

4. Financial risk management (continued)

4.2 Market risk (continued)

(B) Currency risk (continued)

	2018					
	Equivalent in million of HK\$					
	US Dollars	Baht	Malaysian Ringgit	Philippine Peso	Other foreign currencies	Total foreign currencies
Net structural position	28,122	2,301	2,769	1,608	1,812	36,612

	2017					
	Equivalent in million of HK\$					
	US Dollars	Baht	Malaysian Ringgit	Philippine Peso	Other foreign currencies	Total foreign currencies
Net structural position	3,531	2,350	2,651	–	1,015	9,547

(C) Interest rate risk

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

- Repricing risk: mismatches in the maturity or repricing periods of assets and liabilities that may affect net interest income;
- Basis risk: different pricing basis for different transactions resulting that the yield on assets and cost of liabilities may change by different amounts within the same repricing period;
- Yield curve risk: non-parallel shifts in the yield curve that may have an adverse impact on net interest income or economic value; and
- Option risk: exercise of the options embedded in assets, liabilities or off-balance sheet items that can cause a change in the cash flows of assets and liabilities.

Notes to the Financial Statements

4. Financial risk management (continued)

4.2 Market risk (continued)

(C) Interest rate risk (continued)

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

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

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

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

4. Financial risk management (continued)

4.2 Market risk (continued)

(C) Interest rate risk (continued)

The Group is principally exposed to HK Dollar, US Dollar and Renminbi in terms of interest rate risk. As at 31 December 2018, if market interest rates had a 100 basis point parallel shift of the yield curve with other variables held constant, the sensitivities on net interest income over a twelve-month period and on reserves for the Group would have been as follows:

	Impact on net interest income over the next twelve months at 31 December		Impact on reserves at 31 December	
	2018 HK\$'m	2017 HK\$'m	2018 HK\$'m	2017 HK\$'m
100 basis point parallel up of yield curve				
Total	1,416	961	(5,138)	(6,750)
Of which:				
HK Dollar	2,226	2,326	(358)	(388)
US Dollar	(382)	(947)	(3,022)	(4,787)
Renminbi	(336)	(241)	(1,441)	(836)
100 basis point parallel down of yield curve				
Total	(1,416)	(961)	5,138	6,750
Of which:				
HK Dollar	(2,226)	(2,326)	358	388
US Dollar	382	947	3,022	4,787
Renminbi	336	241	1,441	836

Notes to the Financial Statements

4. Financial risk management (continued)

4.2 Market risk (continued)

(C) Interest rate risk (continued)

In a parallel shift up of 100 basis points of yield curve, the overall impact on net interest income of the above currencies is positive in 2018. Reserves of the Group would have been reduced because of the expected reduction in valuation of the debt securities portfolio and relevant interest rate derivatives under hedge accounting due to a parallel shift up of 100 basis points in the yield curve. The reduction of reserves is decreased compared with 2017 because the duration of the debt securities portfolio in capital market is decreased.

In a parallel shift down of 100 basis points of yield curve, the overall impact on net interest income of the above currencies is negative in 2018. Reserves of the Group would have been increased because of the expected increase in valuation of the debt securities portfolio and relevant interest rate derivatives under hedge accounting due to a parallel shift down of 100 basis points in the yield curve. The increase of reserves is decreased compared with 2017 because the duration of the debt securities portfolio in capital market is decreased.

The sensitivities above are for illustration only and are based on several assumptions, including, but not limited to, the change in the correlation between interest rates of relevant currencies, parallel movement of interest rates, the absence of actions that would be taken to mitigate the impact of interest rate risk, the effectiveness of hedge accounting, all positions being assumed to run to maturity, behavioural assumptions of products in which the actual repricing date differs from the contractual repricing date or products without contractual maturity. The above exposures form only a part of the Group's overall 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 on-balance sheet 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 date and maturity date.

	2018						Total HK\$'m
	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	Non- interest bearing HK\$'m	
Assets							
Cash and balances and placements with banks and other financial institutions	304,795	36,223	20,457	-	-	70,049	431,524
Financial assets at fair value through profit or loss	245,659	11,264	8,178	12,187	15,897	7,744	300,929
Derivative financial instruments	-	-	-	-	-	34,912	34,912
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	156,300	156,300
Advances and other accounts	1,041,818	165,176	27,273	34,562	5,208	8,435	1,282,472
Investment in securities							
– At FVOCI	53,051	81,555	110,700	159,917	80,391	3,928	489,542
– At amortised cost	751	1,676	10,308	58,406	37,564	-	108,705
Interests in associates and joint ventures	-	-	-	-	-	483	483
Investment properties	-	-	-	-	-	19,684	19,684
Properties, plant and equipment	-	-	-	-	-	49,430	49,430
Other assets (including current and deferred tax assets)	7,491	-	-	-	-	71,431	78,922
Total assets	1,653,565	295,894	176,916	265,072	139,060	422,396	2,952,903
Liabilities							
Hong Kong SAR currency notes in circulation	-	-	-	-	-	156,300	156,300
Deposits and balances from banks and other financial institutions	356,105	6,178	118	460	-	13,946	376,807
Financial liabilities at fair value through profit or loss	3,274	8,820	1,761	1,160	520	-	15,535
Derivative financial instruments	-	-	-	-	-	30,880	30,880
Deposits from customers	1,321,385	235,761	166,442	5,187	-	164,582	1,893,357
Debt securities and certificates of deposit in issue	3,480	4,813	1,160	-	-	-	9,453
Other accounts and provisions (including current and deferred tax liabilities)	9,406	-	-	-	-	58,289	67,695
Insurance contract liabilities	-	-	-	-	-	104,723	104,723
Subordinated liabilities	-	-	-	13,246	-	-	13,246
Total liabilities	1,693,650	255,572	169,481	20,053	520	528,720	2,667,996
Interest sensitivity gap	(40,085)	40,322	7,435	245,019	138,540	(106,324)	284,907

Notes to the Financial Statements

4. Financial risk management (continued)

4.2 Market risk (continued)

(C) Interest rate risk (continued)

	2017						Total HK\$'m
	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	Non- interest bearing HK\$'m	
Assets							
Cash and balances and placements with banks and other financial institutions	344,533	37,363	21,864	-	-	22,844	426,604
Financial assets at fair value through profit or loss	10,940	9,239	17,242	13,824	29,203	12,746	93,194
Derivative financial instruments	-	-	-	-	-	33,543	33,543
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	146,200	146,200
Advances and other accounts	954,709	139,053	55,031	28,574	6,374	7,813	1,191,554
Investment in securities							
– Available-for-sale securities	73,072	102,698	116,481	164,179	105,271	5,414	567,115
– Held-to-maturity securities	1,231	2,467	7,989	24,092	14,798	-	50,577
– Loans and receivables	-	499	-	-	-	-	499
Interests in associates and joint ventures	-	-	-	-	-	417	417
Investment properties	-	-	-	-	-	19,669	19,669
Properties, plant and equipment	-	-	-	-	-	47,268	47,268
Other assets (including deferred tax assets)	4,338	-	-	-	-	70,108	74,446
Total assets	1,388,823	291,319	218,607	230,669	155,646	366,022	2,651,086
Liabilities							
Hong Kong SAR currency notes in circulation	-	-	-	-	-	146,200	146,200
Deposits and balances from banks and other financial institutions	184,793	7,177	380	825	-	30,252	223,427
Financial liabilities at fair value through profit or loss	7,102	4,116	7,068	955	479	-	19,720
Derivative financial instruments	-	-	-	-	-	31,046	31,046
Deposits from customers	1,336,481	160,670	140,524	1,263	-	136,152	1,775,090
Debt securities and certificates of deposit in issue	7,091	1,971	12,579	-	-	-	21,641
Other accounts and provisions (including current and deferred tax liabilities)	13,703	-	-	-	-	49,427	63,130
Insurance contract liabilities	-	-	-	-	-	103,229	103,229
Subordinated liabilities	-	-	63	18,917	-	-	18,980
Total liabilities	1,549,170	173,934	160,614	21,960	479	496,306	2,402,463
Interest sensitivity gap	(160,347)	117,385	57,993	208,709	155,167	(130,284)	248,623

4. Financial risk management (continued)

4.3 Liquidity risk

Liquidity risk is the risk that banks may not be able to obtain sufficient and timely funding at a reasonable cost to meet their obligations as they fall due. The Group maintains a sound liquidity risk appetite to provide stable, reliable and adequate sources of cash to meet liquidity needs under normal circumstances or stressed scenarios; and to survive with net positive cumulative cash flow in extreme scenarios, without requesting the HKMA to act as the lender of last resort.

In accordance with the Group's corporate governance principles in respect of risk management, the Board and the RMC, senior management and functional departments/units perform their duties and responsibilities to manage the Group's liquidity risk. The RMC is the decision-making authority of liquidity risk management, and assumes the ultimate responsibility of liquidity risk management. As authorised by the RMC, ALCO exercises its oversight of liquidity risk and ensures the daily operations of the Group are in accordance with the risk appetite and policies as set by the RMC. RMD is responsible for overseeing the Group's liquidity risk. It cooperates with the Asset and Liability Management Division of the Financial Management Department, Treasury, and Investment Management, etc. to assist the ALCO to perform liquidity management functions according to their specific responsibilities.

The Group's liquidity risk management objective is to effectively manage the liquidity of on- and off-balance sheet items with a reasonable cost based on the liquidity risk appetite to achieve sound operation and sustainable profitability. Deposits from customers are the Group's primary source of funds. To ensure stable and sufficient sources of funds are in place, the Group actively attracts new deposits, keeps the core deposit and obtains supplementary funding from the interbank market and by issuing bills in the capital market. According to different term maturities and the results of funding needs estimated from stressed scenarios, the Group adjusts its asset structure (including loans, bonds investment, interbank placement, etc.) to maintain sufficient liquid assets which provides adequate funds in support of normal business needs and ensure its ability to raise funds at a reasonable cost to serve external claims in case of emergency. The Group is committed to diversify the sources and tenors of funding 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 problems occurred in one concentrated funding source. In order to manage such risk, the Group sets concentration limits on collateral pools and sources of funding such as Tier 1 high-quality readily liquefiable assets to total high-quality readily liquefiable assets ratio, top ten depositors ratio and large depositors ratio. Whenever necessary, the Group could improve the liquidity position by taking mitigation actions including, but not limited to obtaining funding through interbank borrowings or repos in the money market, selling bonds in the secondary market or retaining existing and attracting new customer deposits. Apart from increasing the funding, the Group would maintain good communication with the counterparties, the parent and the regulators to enhance mutual confidence.

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

The Group established liquidity risk management indicators and limits to identify, measure, monitor and control liquidity risk on a daily basis. These indicators and limits include, but are not limited to liquidity coverage ratio ("LCR"), net stable funding ratio ("NSFR"), loan-to-deposit ratio, Maximum Cumulative Cash Outflow ("MCO") and liquidity cushion. The Group applies a cash flow analysis to assess the Group's liquidity condition under normal conditions and also performs a liquidity stress test (including institution specific, general market crisis and combined crisis) and other methods at least on a monthly basis to assess the Group's capability to withstand various severe liquidity crises. Also, relevant management information systems such as the Assets and Liabilities Management System and the Basel Liquidity Ratio Management System are developed to provide data and to prepare for regular management reports to facilitate liquidity risk management duties.

Notes to the Financial Statements

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, the Group has implemented a behaviour model and assumptions of 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 have been made relating to on-balance sheet items (such as deposits from customers) and off-balance sheet items (such as loan commitments). According to various characteristics of the assets, liabilities and off-balance sheet items, the Group forecasts the future cash flow based on the contractual maturity date and the assumptions of customer behaviour and balance sheet changes. The Group establishes the MCO indicator which predicts the future 30 days maximum cumulative net cash outflow in normal situations based on the above assumptions, to assess if the Group has sufficient financing capacity to meet the cash flow gap in order to achieve the objective of continuing operations. As at 31 December 2018, before taking the cash inflow through the sale of outstanding marketable securities into consideration, BOCHK’s 30-day cumulative cash flow was a net cash inflow, amounting to HK\$93,439 million (2017: HK\$85,602 million) and was in compliance with the internal limit requirements.

In the liquidity stress test, institution specific, general market crisis and combined crisis scenarios have been set up, a combined crisis scenario is a combination of institution specific and general market crisis to assess the Group’s capability to withstand a more severe liquidity crisis, with a more stringent set of assumptions being adopted. Stress test assumptions include the run-off rate of retail, wholesale and interbank deposits; the drawdown rate of loan commitments and trade-related contingent liabilities; the delinquency ratio and rollover rate of customer loans; and haircut of interbank placement and marketable securities. As at 31 December 2018, the Group was able to maintain a net cash inflow under the three stressed scenarios, indicating the Group has the ability to meet financing needs under stressed conditions. In addition, the Group has a policy in place to maintain a liquidity cushion which includes high quality or comparable quality marketable securities issued or guaranteed by sovereigns, central banks, public sector entities or multilateral development banks with 0% or 20% risk weight or marketable securities issued by non-financial corporate with a corresponding external credit rating of A- or above to ensure funding needs even under stressed scenarios. As at 31 December 2018, the liquidity cushion (before haircut) of BOCHK was HK\$447,175 million (2017: HK\$420,770 million). A contingency plan is being established which details the conditions to trigger the plan based on stress test results and early warning indicators, the action plans and relevant procedures and responsibility of relevant departments.

The LCR is calculated in accordance with the Banking (Liquidity) Rules effective from 1 January 2015. The Group, being classified as a category 1 authorised institution by the HKMA, is required to calculate the LCR on a consolidated basis. During the year of 2018, the Group is required to maintain a LCR not less than 90%.

The NSFR is calculated in accordance with the Banking (Liquidity) (Amendment) Rules 2017 effective from 1 January 2018. The Group, being classified as a category 1 authorised institution by the HKMA, is required to calculate NSFR on consolidated basis and maintain a NSFR not less than 100%.

In certain derivative contracts, the counterparties have the right to request from the Group additional collateral if they have concerns about the Group’s creditworthiness.

The Group’s liquidity risk management also covers new products or business developments. 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 the RMC for approval.

4. Financial risk management (continued)

4.3 Liquidity risk (continued)

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, and assumes its own liquidity risk management responsibility. Subsidiaries are required to report their respective liquidity positions with relevant liquidity ratios on a regular basis to the RMD of BOCHK, which consolidates this information and evaluates group-wide liquidity risk to ensure relevant requirements are satisfied.

(A) Liquidity coverage ratio and net stable funding ratio

	2018	2017
Average value of liquidity coverage ratio		
– First quarter	134.33%	121.41%
– Second quarter	146.39%	123.88%
– Third quarter	141.44%	121.12%
– Fourth quarter	160.23%	135.64%

Average value of liquidity coverage ratio is calculated based on the arithmetic mean of the liquidity coverage ratio as at the end of each working day in the quarter and the calculation methodology and instructions set out in the HKMA return of liquidity position.

	2018
Quarter-end value of net stable funding ratio	
– First quarter	118.98%
– Second quarter	118.82%
– Third quarter	122.24%
– Fourth quarter	124.41%

Quarter-end value of net stable funding ratio is calculated based on the calculation methodology and instructions set out in the HKMA return of stable funding position.

Liquidity coverage ratio and net stable funding ratio are computed on the consolidated basis which comprise the positions of BOCHK and certain subsidiaries specified by the HKMA in accordance with the Banking (Liquidity) Rules.

The additional information of liquidity coverage ratio and net stable funding ratio disclosures is available under the section "Regulatory Disclosures" on BOCHK's website at www.bochk.com.

Notes to the Financial Statements

4. Financial risk management (continued)

4.3 Liquidity risk (continued)

(B) Maturity analysis

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

	2018							Total HK\$'m
	On demand HK\$'m	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	Indefinite HK\$'m	
Assets								
Cash and balances and placements with banks and other financial institutions	299,464	75,380	36,223	20,457	-	-	-	431,524
Financial assets at fair value through profit or loss	-	243,201	8,448	8,495	15,956	16,323	8,506	300,929
Derivative financial instruments	11,303	3,282	4,025	5,909	6,965	3,428	-	34,912
Hong Kong SAR Government certificates of indebtedness	156,300	-	-	-	-	-	-	156,300
Advances and other accounts	178,403	53,549	51,928	158,754	578,964	259,523	1,351	1,282,472
Investment in securities								
– At FVOCI	-	44,818	52,143	115,304	192,058	81,110	4,109	489,542
– At amortised cost	-	508	1,921	10,493	57,984	37,292	507	108,705
Interests in associates and joint ventures	-	-	-	-	-	-	483	483
Investment properties	-	-	-	-	-	-	19,684	19,684
Properties, plant and equipment	-	-	-	-	-	-	49,430	49,430
Other assets (including current and deferred tax assets)	32,102	17,389	446	1,595	13,181	14,195	14	78,922
Total assets	677,572	438,127	155,134	321,007	865,108	411,871	84,084	2,952,903
Liabilities								
Hong Kong SAR currency notes in circulation	156,300	-	-	-	-	-	-	156,300
Deposits and balances from banks and other financial institutions	241,706	128,345	6,178	118	460	-	-	376,807
Financial liabilities at fair value through profit or loss	-	3,274	8,823	1,762	1,159	517	-	15,535
Derivative financial instruments	8,260	4,081	3,181	5,836	6,560	2,962	-	30,880
Deposits from customers	1,060,354	425,613	235,761	166,442	5,187	-	-	1,893,357
Debt securities and certificates of deposit in issue	-	3,480	4,813	1,160	-	-	-	9,453
Other accounts and provisions (including current and deferred tax liabilities)	39,028	18,436	1,892	1,276	7,056	7	-	67,695
Insurance contract liabilities	36,873	566	686	1,994	17,692	46,912	-	104,723
Subordinated liabilities	-	-	275	-	12,971	-	-	13,246
Total liabilities	1,542,521	583,795	261,609	178,588	51,085	50,398	-	2,667,996
Net liquidity gap	(864,949)	(145,668)	(106,475)	142,419	814,023	361,473	84,084	284,907

4. Financial risk management (continued)

4.3 Liquidity risk (continued)

(B) Maturity analysis (continued)

	2017							Total HK\$'m
	On demand HK\$'m	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	Indefinite HK\$'m	
Assets								
Cash and balances and placements with banks and other financial institutions	248,821	111,143	37,363	21,864	-	-	7,413	426,604
Financial assets at fair value through profit or loss	-	10,622	8,561	17,828	14,364	28,912	12,907	93,194
Derivative financial instruments	10,492	4,134	4,097	6,697	5,523	2,600	-	33,543
Hong Kong SAR Government certificates of indebtedness	146,200	-	-	-	-	-	-	146,200
Advances and other accounts	131,113	35,145	68,476	184,172	525,761	244,761	2,126	1,191,554
Investment in securities								
– Available-for-sale securities	-	61,106	72,443	121,513	199,007	107,428	5,618	567,115
– Held-to-maturity securities	-	1,312	2,616	8,162	23,830	14,657	-	50,577
– Loans and receivables	-	-	499	-	-	-	-	499
Interests in associates and joint ventures	-	-	-	-	-	-	417	417
Investment properties	-	-	-	-	-	-	19,669	19,669
Properties, plant and equipment	-	-	-	-	-	-	47,268	47,268
Other assets (including deferred tax assets)	28,492	18,185	777	1,183	9,472	16,300	37	74,446
Total assets	565,118	241,647	194,832	361,419	777,957	414,658	95,455	2,651,086
Liabilities								
Hong Kong SAR currency notes in circulation	146,200	-	-	-	-	-	-	146,200
Deposits and balances from banks and other financial institutions	173,065	41,044	8,113	380	825	-	-	223,427
Financial liabilities at fair value through profit or loss	-	7,102	4,118	7,070	954	476	-	19,720
Derivative financial instruments	6,668	5,600	5,033	6,800	4,636	2,309	-	31,046
Deposits from customers	1,117,254	355,379	160,670	140,524	1,263	-	-	1,775,090
Debt securities and certificates of deposit in issue	-	7,091	1,971	12,579	-	-	-	21,641
Other accounts and provisions (including current and deferred tax liabilities)	35,878	15,299	2,103	3,011	6,831	8	-	63,130
Insurance contract liabilities	35,707	418	890	3,781	14,214	48,219	-	103,229
Subordinated liabilities	-	-	422	16	18,542	-	-	18,980
Total liabilities	1,514,772	431,933	183,320	174,161	47,265	51,012	-	2,402,463
Net liquidity gap	(949,654)	(190,286)	11,512	187,258	730,692	363,646	95,455	248,623

Notes to the Financial Statements

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 based on contractual maturity date. The disclosure does not imply that the securities will be held to maturity.

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

4. Financial risk management (continued)

4.3 Liquidity risk (continued)

(C) Analysis of undiscounted cash flows by contractual maturities

(a) Non-derivative cash flows

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

	2018					Total HK\$'m
	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	
Financial liabilities						
Hong Kong SAR currency notes in circulation	156,300	-	-	-	-	156,300
Deposits and balances from banks and other financial institutions	370,198	6,198	154	556	-	377,106
Financial liabilities at fair value through profit or loss	3,279	8,850	1,801	1,238	560	15,728
Deposits from customers	1,486,269	236,699	168,740	5,320	-	1,897,028
Debt securities and certificates of deposit in issue	3,485	4,837	1,179	-	-	9,501
Subordinated liabilities	-	353	353	13,064	-	13,770
Other financial liabilities	48,078	172	107	6	7	48,370
Total financial liabilities	2,067,609	257,109	172,334	20,184	567	2,517,803

	2017					Total HK\$'m
	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	
Financial liabilities						
Hong Kong SAR currency notes in circulation	146,200	-	-	-	-	146,200
Deposits and balances from banks and other financial institutions	214,147	8,147	411	900	-	223,605
Financial liabilities at fair value through profit or loss	7,107	4,132	7,121	1,020	500	19,880
Deposits from customers	1,472,836	161,157	142,310	1,307	-	1,777,610
Debt securities and certificates of deposit in issue	7,096	1,976	12,962	-	-	22,034
Subordinated liabilities	-	542	558	21,209	-	22,309
Other financial liabilities	40,824	486	834	-	-	42,144
Total financial liabilities	1,888,210	176,440	164,196	24,436	500	2,253,782

Notes to the Financial Statements

4. Financial risk management (continued)

4.3 Liquidity risk (continued)

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

(b) Derivative cash flows

The tables below summarise the cash flows of the Group by remaining contractual maturity as at 31 December for derivative financial liabilities that will be settled on a net basis, together with all derivative financial instruments that will be settled on a gross basis regardless of whether the contract is in an asset or liability position. The amounts disclosed in the tables are the contractual undiscounted cash flows, except for certain derivatives which are disclosed at fair value.

The Group's derivative financial instruments that will be settled on a net basis mainly include interest rate swaps whereas derivative financial instruments that will be settled on a gross basis mainly include currency forwards and currency swaps.

	2018					Total HK\$'m
	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	
Derivative financial liabilities settled on a net basis	(8,983)	(884)	(2,338)	(5,061)	(1,002)	(18,268)
Derivative financial instruments settled on a gross basis						
Total inflow	792,296	383,269	643,870	133,033	4,683	1,957,151
Total outflow	(793,145)	(382,112)	(641,036)	(133,384)	(4,660)	(1,954,337)

	2017					Total HK\$'m
	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	
Derivative financial liabilities settled on a net basis	(7,463)	(720)	(1,127)	(3,580)	(856)	(13,746)
Derivative financial instruments settled on a gross basis						
Total inflow	635,704	462,071	492,297	125,606	5,181	1,720,859
Total outflow	(636,212)	(462,229)	(491,628)	(125,756)	(5,192)	(1,721,017)

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 2018 that the Group commits to extend credit to customers and other facilities amounted to HK\$545,794 million (2017: HK\$569,658 million). Those loan commitments can be drawn within one year.

Financial guarantee contracts

Financial guarantees and other financial facilities of the Group as at 31 December 2018 amounting to HK\$62,094 million (2017: HK\$66,800 million) are maturing no later than one year.

4.4 Insurance risk

The Group is in the business of insuring against the risk of mortality, morbidity, disability, critical illness, accidents and related risks. The Group manages these risks through the application of its underwriting strategy 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 and the Group's underwriting procedures include the screening processes, such as the review of health condition and family medical history to ensure alignment with the underwriting strategy.

Within the insurance process, concentrations of risk may arise where a particular event or a 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, universal life, annuity, 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, the Group has entered into reinsurance arrangements that reinsure most of the 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. In this regard, the Group has conducted relevant experience studies. The results of such studies are considered in determining the assumptions of insurance liability which include an appropriate level of prudential margins.

Notes to the Financial Statements

4. Financial risk management (continued)

4.4 Insurance risk (continued)

(A) Process used to decide on assumptions

In determining the long term business fund liabilities, the Group follows the Insurance (Determination of Long Term Liabilities) Rules and makes prudent assumptions which include appropriate margins for adverse deviation of the relevant factors. It takes account of all prospective liabilities as determined by the policy terms and conditions for each existing contract, taking credit for premiums payable after the valuation date. The determination of liability is based on current assumptions made as at the valuation date as to mortality rates and morbidity rates, and takes into account of various appropriate discount rates, and with due regard to the reasonable expectation of policyholders. A prudent margin for adverse deviations is included in the assumptions.

The assumptions adopted for the insurance liabilities disclosed in this note are summarised as follows:

Mortality and morbidity

The amount of liability in respect of any category of contract shall, where relevant, be determined on the basis of prudent rates of mortality and morbidity, plus a margin for adverse deviation. The assumptions used for the determination of future liabilities are based on population statistics or reinsurance information, adjusted where appropriate to reflect the Group's own experience and relevant reinsurance arrangements.

Interest rates adopted for valuation purposes

Homogeneous life insurance policies are grouped into segments and are matched by specific assets. The duration of liabilities under each segment is calculated for valuation purposes.

Investment guarantee of investment contract with discretionary participating feature

The amount of the liability in respect of the investment guarantee provided by the investment contract with discretionary participation feature is determined by stochastic analysis based on historical economic data to reflect the value-at-risk at 99% confidence level.

Acquisition expense

The acquisition expense assumptions used for determination of future liabilities are based on the Group's own experience. The Group has changed the acquisition expense assumptions for new business written based on updated expense experience of the Group.

(B) Change in assumptions

The Group has changed the interest rates adopted for the valuation purposes to reflect the changes in the market interest rates and the yields of investment portfolio backing the policy liabilities. The valuation interest rate assumptions used for the year end valuation purpose were in the range of 0% to 3.72% in 2018 (2017: 0% to 3.57%).

4. Financial risk management (continued)

4.4 Insurance risk (continued)

(C) Sensitivity analysis

The following table presents the sensitivity of the long-term business fund liabilities to movements in the key assumptions used in the estimation of insurance liabilities:

Sensitivity analysis – life and annuity insurance contracts:

Scenario	Change in variable	Decrease in profit after tax due to changes in insurance liabilities	
		2018 HK\$'m	2017 HK\$'m
Worsening of mortality and morbidity	10%	(136)	(129)
Lowering of interest rate	50 basis points	(993)	(1,158)

The above analyses are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated – for example, changes in interest rate and in market values; and changes in lapses and in future mortality and morbidity.

Sensitivity analysis – linked long term insurance contracts, retirement scheme management category III insurance contracts, and retirement scheme management category I investment contracts with “DPF”:

The reserves on retirement scheme management category III insurance contracts, retirement scheme management category I investment contracts with “DPF” and non-unitised reserve on linked long term insurance contracts are insignificant to the whole portfolio, and no sensitivity analysis has been performed. The insurance liabilities for these three components contributed to less than 0.10% of the total insurance liabilities at the balance sheet date.

For unit-linked fund liabilities (unitised reserve), the liabilities are backed by the unit-linked fund asset values.

Among linked long term insurance contracts, there are contracts with minimum guaranteed death benefits that expose the Group to the risk arising from declines in the value of underlying investments. This may increase the Group’s net exposure to mortality risk.

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.

Notes to the Financial Statements

4. Financial risk management (continued)

4.5 Capital management (continued)

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 the majority of its non-securitisation exposures. Small residual credit exposures which include the credit exposures of overseas subsidiaries and branches are remained under the standardised (credit risk) ("STC") approach. The Group has adopted the standardised credit valuation adjustment ("CVA") method to calculate the capital charge for the CVA risk of the counterparty.

The Group continues to adopt the internal models ("IMM") approach to calculate the general market risk capital charge for foreign exchange and interest rate exposures and, with the approval from the HKMA, exclude its structural FX positions 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 the remaining exposures.

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

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 2018. Based on the HKMA's guidelines on Pillar II, ICAAP has been initiated to assess the extra capital needed to cover the material risks not captured or not adequately captured under Pillar I, and therefore minimum Common Equity Tier 1 capital ratio, minimum Tier 1 capital ratio and minimum Total capital ratio are determined. Meanwhile, operating ranges for the aforementioned capital ratios have also been established which enable the flexibility for future business growth and efficiency of capital utilisation. The Group considers this ICAAP 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 maintains adequate capital and appropriate capital structure which align with its business development needs, thereby achieving an optimal balance among risk, return and capital adequacy.

(A) Basis of regulatory consolidation

The consolidation basis for regulatory purposes comprises the positions of BOCHK and certain subsidiaries specified by the HKMA in accordance with the Banking (Capital) Rules. For accounting purposes, subsidiaries are consolidated in accordance with HKFRSs and the list of subsidiaries is set out in "Appendix – Subsidiaries of the Company".

4. Financial risk management (continued)

4.5 Capital management (continued)

(A) Basis of regulatory consolidation (continued)

The Company, its subsidiaries of BOC Group Life Assurance Company Limited, BOCHK Asset Management (Cayman) Limited and BOC Insurance (International) Holdings Company Limited (including their subsidiaries), and certain subsidiaries of BOCHK are included within the accounting scope of consolidation but not included within the regulatory scope of consolidation.

The particulars of the above-mentioned subsidiaries of BOCHK are as follows:

Name	2018		2017	
	Total assets HK\$'m	Total equity HK\$'m	Total assets HK\$'m	Total equity HK\$'m
BOC Group Trustee Company Limited	200	200	200	200
BOCI-Prudential Trustee Limited	506	464	506	464
China Bridge (Malaysia) Sdn. Bhd.	38	31	37	31
Bank of China (Hong Kong) Nominees Limited	–	–	–	–
Bank of China (Hong Kong) Trustees Limited	15	15	15	15
BOCHK Information Technology (Shenzhen) Co., Ltd.	377	242	355	238
BOCHK Information Technology Services (Shenzhen) Co., Ltd.	377	336	366	312
Che Hsing (Nominees) Limited	1	1	1	1
Po Sang Financial Investment Services Company Limited	364	346	363	346
Po Sang Securities and Futures Limited	657	553	990	511
Sin Chiao Enterprises Corporation, Limited	6	6	7	7
Sin Hua Trustee Limited	7	6	4	4
Billion Express Development Inc.	–	–	–	–
Billion Orient Holdings Ltd.	–	–	–	–
Elite Bond Investments Ltd.	–	–	–	–
Express Capital Enterprise Inc.	–	–	–	–
Express Charm Holdings Corp.	–	–	–	–
Express Shine Assets Holdings Corp.	–	–	–	–
Express Talent Investment Ltd.	–	–	–	–
Gold Medal Capital Inc.	–	–	–	–
Gold Tap Enterprises Inc.	–	–	–	–
Maxi Success Holdings Ltd.	–	–	–	–
Smart Linkage Holdings Inc.	–	–	–	–
Smart Union Capital Investments Ltd.	–	–	–	–
Success Trend Development Ltd.	–	–	–	–
Wise Key Enterprises Corp.	–	–	–	–

Notes to the Financial Statements

4. Financial risk management (continued)

4.5 Capital management (continued)

(A) Basis of regulatory consolidation (continued)

The principal activities of the above subsidiaries are set out in "Appendix – Subsidiaries of the Company".

There were no subsidiaries which are included within the regulatory scope of consolidation but not included within the accounting scope of consolidation as at 31 December 2018 (2017: Nil).

There were also no subsidiaries which are included within both the accounting scope of consolidation and the regulatory scope of consolidation where the methods of consolidation differ as at 31 December 2018 (2017: Nil).

The Group operates subsidiaries in different countries/regions where capital is governed by local rules and there may be restrictions on the transfer of funds or regulatory capital between the members of the Group.

(B) Capital ratio

The capital ratios are analysed as follows:

	2018	2017
CET1 capital ratio	17.48%	16.52%
Tier 1 capital ratio	19.76%	16.52%
Total capital ratio	23.10%	20.39%

4. Financial risk management (continued)

4.5 Capital management (continued)

(B) Capital ratio (continued)

The consolidated capital base after deductions used in the calculation of the above capital ratios is analysed as follows:

	2018 HK\$'m	2017 HK\$'m
CET1 capital: instruments and reserves		
Directly issued qualifying CET1 capital instruments	43,043	43,043
Retained earnings	153,501	142,208
Disclosed reserves	45,367	43,673
CET1 capital before regulatory adjustments	241,911	228,924
CET1 capital: regulatory deductions		
Valuation adjustments	(9)	(12)
Deferred tax assets (net of associated deferred tax liabilities)	(82)	(51)
Gains and losses due to changes in own credit risk on fair valued liabilities	141	(69)
Cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties)	(51,263)	(48,556)
Regulatory reserve for general banking risks	(10,496)	(10,224)
Total regulatory deductions to CET1 capital	(61,709)	(58,912)
CET1 capital	180,202	170,012
AT1 capital: instruments		
Qualifying AT1 capital instruments classified as equity under applicable accounting standards	23,476	–
AT1 capital	23,476	–
Tier 1 capital	203,678	170,012

Notes to the Financial Statements

4. Financial risk management (continued)

4.5 Capital management (continued)

(B) Capital ratio (continued)

	2018 HK\$m	2017 HK\$m
Tier 2 capital: instruments and provisions		
Capital instruments subject to phase-out arrangements from Tier 2 capital	5,010	11,576
Collective provisions and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital	6,315	6,390
Tier 2 capital before regulatory deductions	11,325	17,966
Tier 2 capital: regulatory deductions		
Add back of cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) eligible for inclusion in Tier 2 capital	23,068	21,850
Total regulatory adjustments to Tier 2 capital	23,068	21,850
Tier 2 capital	34,393	39,816
Total regulatory capital	238,071	209,828

The capital buffer ratios are analysed as follows:

	2018	2017
Capital conservation buffer ratio	1.875%	1.250%
Higher loss absorbency ratio	1.125%	0.750%
Countercyclical capital buffer ratio	1.418%	0.934%

The additional information of capital ratio disclosures is available under the section "Regulatory Disclosures" on BOCHK's website at www.bochk.com.

(C) Leverage ratio

The leverage ratio is analysed as follows:

	2018 HK\$m	2017 HK\$m
Tier 1 capital	203,678	170,012
Leverage ratio exposure	2,733,653	2,461,068
Leverage ratio	7.45%	6.91%

The additional information of leverage ratio disclosures is available under the section "Regulatory Disclosures" on BOCHK's website at www.bochk.com.

5. Fair values of assets and liabilities

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

- Level 1: based on quoted prices (unadjusted) in active markets for identical assets or liabilities. This category includes equity securities listed on exchange, debt instruments issued by certain governments, certain exchange-traded derivative contracts and precious metals.
- Level 2: based on valuation techniques for which the lowest level input that is significant to the fair value measurement is observable, either directly or indirectly. This category includes majority of the OTC derivative contracts, debt securities and certificates of deposit with quote from pricing services vendors, issued structured deposits and other debt instruments. It also includes precious metals and properties with insignificant adjustments made to observable market inputs.
- Level 3: based on valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable. This category includes equity investment, debt instruments and certain OTC derivative contracts with significant unobservable components. It also includes properties with significant adjustments made to observable market inputs.

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

5.1 Financial instruments measured at fair value

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

Generally, the unit of account for a financial instrument is the individual instrument. HKFRS 13 permits a portfolio exception, through an accounting policy election, to measure the fair value of a portfolio of financial assets and financial liabilities on the basis of the net open risk position when certain criteria are met. The Group applies valuation adjustments at an individual instrument level, consistent with that unit of account. According to its risk management policies and systems to manage derivative financial instruments, the fair value of certain derivative portfolios that meet those criteria is measured on the basis of the price to be received or paid for net open risk. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative size of each of the individual instruments in the portfolio.

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.

Notes to the Financial Statements

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

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, commodity prices, volatilities and correlations, counterparty credit spreads and others, which are mostly observable and obtainable from open market.

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

Debt securities and certificates of deposit and other debt instruments

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

Asset backed securities

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

Derivatives

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

Credit valuation adjustments ("CVAs") and debit valuation adjustments ("DVAs") are applied to the Group's OTC derivatives. These adjustments reflect market factors movement, expectations of counterparty creditworthiness and the Group's own credit spread respectively. They are mainly determined for each counterparty and are dependent on expected future values of exposures, default probabilities and recovery rates.

Financial liabilities designated at fair value through profit or loss

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

Subordinated liabilities

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

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(A) Fair value hierarchy

	2018			Total HK\$'m
	Level 1 HK\$'m	Level 2 HK\$'m	Level 3 HK\$'m	
Financial assets				
Trading assets (Note 23)				
– Debt securities and certificates of deposit	334	31,783	–	32,117
– Equity securities	2	–	–	2
– Fund	3	–	–	3
– Other debt instruments	–	4,634	–	4,634
Other financial assets mandatorily classified at fair value through profit or loss (Note 23)				
– Debt securities and certificates of deposit	–	17,877	1,909	19,786
– Equity securities	1,010	–	–	1,010
– Fund	3,477	2,337	915	6,729
Financial assets designated at fair value through profit or loss (Note 23)				
– Debt securities and certificates of deposit	691	2,480	–	3,171
– Other debt instruments	–	233,477	–	233,477
Derivative financial instruments (Note 24)	11,356	23,549	7	34,912
Investment in securities at FVOCI (Note 26)				
– Debt securities and certificates of deposit	68,013	415,983	1,618	485,614
– Equity securities	2,599	185	1,144	3,928
Financial liabilities				
Financial liabilities at fair value through profit or loss (Note 32)				
– Trading liabilities	–	13,336	–	13,336
– Financial liabilities designated at fair value through profit or loss	–	2,199	–	2,199
Derivative financial instruments (Note 24)	8,417	22,463	–	30,880
Subordinated liabilities (Note 38)				
– Subordinated notes	–	13,246	–	13,246

Notes to the Financial Statements

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(A) Fair value hierarchy (continued)

	2017			Total HK\$'m
	Level 1 HK\$'m	Level 2 HK\$'m	Level 3 HK\$'m	
Financial assets				
Trading assets (Note 23)				
– Debt securities and certificates of deposit	1,947	41,978	–	43,925
– Equity securities	203	–	–	203
– Other debt instruments	–	6,859	–	6,859
Financial assets designated at fair value through profit or loss (Note 23)				
– Debt securities and certificates of deposit	–	26,552	3,112	29,664
– Equity securities	3,481	–	–	3,481
– Fund	6,969	1,580	513	9,062
Derivative financial instruments (Note 24)	10,510	23,033	–	33,543
Available-for-sale securities (Note 26)				
– Debt securities and certificates of deposit	111,552	449,139	1,010	561,701
– Equity securities	4,468	134	812	5,414
Financial liabilities				
Financial liabilities at fair value through profit or loss (Note 32)				
– Trading liabilities	–	16,936	–	16,936
– Financial liabilities designated at fair value through profit or loss	–	2,784	–	2,784
Derivative financial instruments (Note 24)	6,703	24,343	–	31,046

There were no financial asset and liability transfers between level 1 and level 2 for the Group during the year (2017: Nil).

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items

	2018				
	Financial assets				
	Other financial assets mandatorily classified at FVPL			Investment in securities at FVOCI	
	Debt securities and certificates of deposit HK\$'m	Fund HK\$'m	Derivative financial instruments HK\$'m	Debt securities and certificates of deposit HK\$'m	Equity securities HK\$'m
At 1 January 2018, after adoption of HKFRS 9	1,982	513	–	1,674	812
Gains/(losses)					
– Income statement					
– Net trading gain	–	–	7	–	–
– Net (loss)/gain on other financial instruments at fair value through profit or loss	(73)	37	–	–	–
– Other comprehensive income					
– Change in fair value	–	–	–	(56)	296
Additions	–	489	–	–	36
Disposals, redemptions and maturity	–	(124)	–	–	–
Transfer out of level 3	–	–	–	–	–
Reclassification	–	–	–	–	–
At 31 December 2018	1,909	915	7	1,618	1,144
Total unrealised gains/(losses) for the year included in income statement for financial assets held as at 31 December 2018					
– Net trading gain	–	–	7	–	–
– Net (loss)/gain on other financial instruments at fair value through profit or loss	(73)	37	–	–	–
	(73)	37	7	–	–

Notes to the Financial Statements

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items (continued)

	2017				
	Financial assets				
	Trading assets	Financial assets designated at fair value through profit or loss		Available-for-sale securities	
	Debt securities and certificates of deposit HK\$'m	Debt securities and certificates of deposit HK\$'m	Fund HK\$'m	Debt securities and certificates of deposit HK\$'m	Equity securities HK\$'m
At 1 January 2017, as previously reported	162	2,878	–	1,735	718
Effect of merger of entities under common control	–	–	–	–	1
At 1 January 2017, as restated	162	2,878	–	1,735	719
Gains					
– Income statement					
– Net trading gain	–	–	–	–	–
– Net gain on other financial instruments at fair value through profit or loss	–	234	43	–	–
– Other comprehensive income					
– Change in fair value	–	–	–	157	88
Additions	–	–	470	–	5
Disposals, redemptions and maturity	(157)	–	–	(287)	–
Transfer out of level 3	(5)	–	–	(238)	–
Reclassification	–	–	–	(357)	–
At 31 December 2017	–	3,112	513	1,010	812
Total unrealised gains for the year included in income statement for financial assets held as at 31 December 2017					
– Net trading gain	–	–	–	–	–
– Net gain on other financial instruments at fair value through profit or loss	–	234	43	–	–
	–	234	43	–	–

5. Fair values of assets and liabilities (continued)

5.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items (continued)

As at 31 December 2018 and 2017, financial instruments categorised as level 3 are mainly comprised of debt securities and certificates of deposit, fund, unlisted equity shares and certain OTC derivative contracts.

Certain debt securities and certificates of deposit were transferred out of level 3 during 2017 due to change of valuation observability. For certain illiquid debt securities and certificates of deposit and fund, the Group obtains valuation quotations from counterparties which may be based on unobservable inputs with significant impact on the valuation. For certain OTC derivative contracts, the counterparty credit spreads used in valuation techniques are unobservable inputs with significant impact on valuation. Therefore, these instruments have been classified by the Group as level 3. The Group has established internal control procedures to control the Group's exposure to such financial instruments.

The fair values of unlisted FVOCI/available-for-sale equity shares are determined with reference to multiples of comparable listed companies, such as average of the price/earning ratios of comparables, or net asset value, if appropriate comparables are not available. The fair value is positively correlated to the price/earning ratios of appropriate comparables or net asset values. Had the net asset value of the underlying equity investments increased/decreased by 5%, the Group's other comprehensive income would have increased/decreased by HK\$57 million (2017: HK\$41 million).

Notes to the Financial Statements

5. Fair values of assets and liabilities (continued)

5.2 Financial instruments not measured at fair value

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

Balances with/from banks and other financial institutions and trade bills

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

Advances to customers and banks and other financial institutions

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

Investment in securities at amortised cost

The fair value of securities at amortised cost is determined by using the same approach as those debt securities and certificates of deposit and asset backed securities measured at fair value as described in Note 5.1. Besides, a discounted cash flow model is used for certain securities at amortised cost based on a current yield curve appropriate for the remaining term to maturity.

Held-to-maturity securities

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

Loans and receivables

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

Deposits from customers

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

Debt securities and certificates of deposit in issue

The fair value of these instruments is determined by using the same approach as those debt securities and certificates of deposit measured at fair value as described in Note 5.1.

Subordinated liabilities

Fair value for subordinated notes is based on market prices or broker/dealer price quotations. The subordinated loan is on floating rate terms, bears interest at prevailing market interest rates and its carrying value approximates fair value.

5. Fair values of assets and liabilities (continued)

5.2 Financial instruments not measured at fair value (continued)

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

	2018		2017	
	Carrying value HK\$'m	Fair value HK\$'m	Carrying value HK\$'m	Fair value HK\$'m
Financial assets				
Investment in securities at amortised cost (Note 26)	108,705	107,561	N/A	N/A
Held-to-maturity securities (Note 26)	N/A	N/A	50,577	50,998
Loans and receivables (Note 26)	N/A	N/A	499	498
Financial liabilities				
Debt securities and certificates of deposit in issue (Note 34)	9,453	9,454	21,641	21,578
Subordinated liabilities (Note 38) – Subordinated notes	N/A	N/A	18,917	20,985

The following tables show the fair value hierarchy for financial instruments with fair values disclosed.

	2018			
	Level 1 HK\$'m	Level 2 HK\$'m	Level 3 HK\$'m	Total HK\$'m
Financial assets				
Investment in securities at amortised cost	2,475	104,296	790	107,561
Financial liabilities				
Debt securities and certificates of deposit in issue	–	9,454	–	9,454

	2017			
	Level 1 HK\$'m	Level 2 HK\$'m	Level 3 HK\$'m	Total HK\$'m
Financial assets				
Held-to-maturity securities	991	49,653	354	50,998
Loans and receivables	–	498	–	498
Financial liabilities				
Debt securities and certificates of deposit in issue	–	21,578	–	21,578
Subordinated liabilities – Subordinated notes	–	20,985	–	20,985

Notes to the Financial Statements

5. Fair values of assets and liabilities (continued)

5.3 Non-financial instruments measured at fair value

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

Investment properties and premises

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

(i) Valuation methods and inputs used in Level 2 fair value measurements

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

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

(ii) Information about Level 3 fair value measurements

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

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

5. Fair values of assets and liabilities (continued)

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

Investment properties and premises (continued)

(ii) Information about Level 3 fair value measurements (continued)

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

	Valuation method	Significant unobservable inputs	Weighted average	Relationship of unobservable inputs to fair value
Bank vault	Depreciated replacement cost approach	Depreciation rate	2% (2017: 2%) per year	The higher the depreciation rate, the lower the fair value.
		Premium on specialised nature of the property	+15% (2017: +15%) to building cost	The higher the premium, the higher the fair value.
Other properties	Market comparison approach or income capitalisation approach	Premium/(discount) on features of the property compared to comparable properties	-6% (2017: -11%)	The higher the premium, the higher the fair value. The higher the discount, the lower the fair value.

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

Precious metals

The fair values of precious metals are determined by obtaining quoted market prices in active market or market quote with certain adjustments.

Notes to the Financial Statements

5. Fair values of assets and liabilities (continued)

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

(A) Fair value hierarchy

	2018			
	Level 1 HK\$'m	Level 2 HK\$'m	Level 3 HK\$'m	Total HK\$'m
Non-financial assets				
Investment properties (Note 28)	–	368	19,316	19,684
Properties, plant and equipment (Note 29)				
– Premises	–	1,041	45,349	46,390
Other assets (Note 30)				
– Precious metals	3,012	3,590	–	6,602
	2017			
	Level 1 HK\$'m	Level 2 HK\$'m	Level 3 HK\$'m	Total HK\$'m
Non-financial assets				
Investment properties (Note 28)	–	359	19,310	19,669
Properties, plant and equipment (Note 29)				
– Premises	–	1,215	43,114	44,329
Other assets (Note 30)				
– Precious metals	5,501	790	–	6,291

There were no non-financial asset transfers between level 1 and level 2 for the Group during the year (2017: Nil).

5. Fair values of assets and liabilities (continued)

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

(B) Reconciliation of level 3 items

	2018	
	Non-financial assets	
	Investment properties HK\$'m	Properties, plant and equipment Premises HK\$'m
At 1 January 2018	19,310	43,114
Gains		
– Income statement		
– Net gain from fair value adjustments on investment properties	881	–
– Net gain from revaluation of premises	–	21
– Other comprehensive income		
– Revaluation of premises	–	2,068
Depreciation	–	(1,065)
Additions	13	90
Disposals	–	–
Transfer into level 3	–	234
Transfer out of level 3	–	–
Reclassification	(888)	888
Exchange difference	–	(1)
At 31 December 2018	19,316	45,349
Total unrealised gains for the year included in income statement for non-financial assets held as at 31 December 2018		
– Net gain from fair value adjustments on investment properties	881	–
– Net gain from revaluation of premises	–	21
	881	21

Notes to the Financial Statements

5. Fair values of assets and liabilities (continued)

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

(B) Reconciliation of level 3 items (continued)

	2017	
	Non-financial assets	
	Investment properties HK\$'m	Properties, plant and equipment Premises HK\$'m
At 1 January 2017	17,365	41,698
Gains		
– Income statement		
– Net gain from fair value adjustments on investment properties	1,133	–
– Net gain from revaluation of premises	–	4
– Other comprehensive income		
– Revaluation of premises	–	1,999
Depreciation	–	(999)
Additions	10	102
Disposals	–	(1)
Transfer into level 3	500	857
Transfer out of level 3	–	(251)
Reclassification	302	(302)
Exchange difference	–	7
At 31 December 2017	19,310	43,114
Total unrealised gains for the year included in income statement for non-financial assets held as at 31 December 2017		
– Net gain from fair value adjustments on investment properties	1,133	–
– Net gain from revaluation of premises	–	4
	1,133	4

The transfer of properties into and out of level 3 is due to change in the premium/(discount) on features applied between the subject and comparable properties during the year. Premium/(discount) on features is determined with reference to differences in features between the subject properties and the comparable properties recently transacted in the market. As comparable properties that come from recent market transactions may be different in each year, the premium/(discount) on features applied between the subject and comparable properties would change from year to year accordingly. As a result, the significance of adjustments made to observable market inputs may vary and lead to the transfer of properties into and out of level 3.

6. Net interest income

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Interest income		
Advances to customers, due from banks and other financial institutions	42,661	35,592
Investment in securities and financial assets at fair value through profit or loss	18,701	13,270
Others	374	215
	61,736	49,077
Interest expense		
Deposits from customers, due to banks and other financial institutions	(20,279)	(12,653)
Debt securities and certificates of deposit in issue	(517)	(289)
Subordinated liabilities	(992)	(932)
Others	(554)	(385)
	(22,342)	(14,259)
Net interest income	39,394	34,818

Included within interest income are HK\$46,414 million and HK\$11,434 million, before hedging effect, for financial assets measured at amortised cost and at fair value through other comprehensive income respectively (2017: HK\$47,285 million that are not measured at fair value through profit or loss).

Included within interest expense are HK\$21,103 million (2017: HK\$14,586 million), before hedging effect, for financial liabilities that are not measured at fair value through profit or loss.

Notes to the Financial Statements

7. Net fee and commission income

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Fee and commission income		
Credit card business	3,441	3,202
Securities brokerage	2,769	2,625
Loan commissions	2,613	3,608
Insurance	1,546	1,326
Funds distribution	929	985
Bills commissions	738	816
Payment services	679	649
Trust and custody services	633	555
Currency exchange	590	433
Safe deposit box	285	291
Others	1,290	1,010
	15,513	15,500
Fee and commission expense		
Credit card business	(2,545)	(2,327)
Insurance	(344)	(311)
Securities brokerage	(323)	(312)
Others	(994)	(949)
	(4,206)	(3,899)
Net fee and commission income	11,307	11,601
Of which arise from:		
Financial assets or financial liabilities not at fair value through profit or loss		
– Fee and commission income	3,123	3,913
– Fee and commission expense	(23)	(50)
	3,100	3,863
Trust and other fiduciary activities		
– Fee and commission income	818	739
– Fee and commission expense	(27)	(23)
	791	716

8. Net trading gain

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Net gain from:		
Foreign exchange and foreign exchange products	2,704	197
Interest rate instruments and items under fair value hedge	50	741
Commodities	184	205
Equity and credit derivative instruments	140	225
	3,078	1,368

9. Net (loss)/gain on other financial instruments at fair value through profit or loss

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Net loss on other financial instruments mandatorily classified at fair value through profit or loss	(1,839)	N/A
Net gain on financial instruments designated at fair value through profit or loss	557	2,181
	(1,282)	2,181

10. Net gain on other financial assets

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Net gain on disposal/redemption of investment in securities at FVOCI	26	N/A
Net loss on disposal/redemption of investment in securities at amortised cost	(4)	N/A
Net gain on available-for-sale securities	N/A	1,107
Net gain on held-to-maturity securities	N/A	26
Others	(3)	30
	19	1,163

Gain on disposal of investment in securities at amortised cost due to credit deterioration amounted to HK\$27 million.

Notes to the Financial Statements

11. Other operating income

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Dividend income		
– From investment in securities at FVOCI derecognised during the year	22	N/A
– From investment in securities at FVOCI held at the end of the year	191	N/A
– From available-for-sale securities	N/A	177
Gross rental income from investment properties	654	594
Less: Outgoings in respect of investment properties	(73)	(100)
Others	187	260
	981	931

Included in the “Outgoings in respect of investment properties” is HK\$1 million (2017: HK\$1 million) of direct operating expenses related to investment properties that were not let during the year.

12. Net insurance benefits and claims and movement in liabilities

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Gross insurance benefits and claims and movement in liabilities		
Claims, benefits and surrenders paid	(18,292)	(11,624)
Movement in liabilities	(2,944)	(14,257)
	(21,236)	(25,881)
Reinsurers' share of benefits and claims and movement in liabilities		
Reinsurers' share of claims, benefits and surrenders paid	6,867	5,392
Reinsurers' share of movement in liabilities	1,160	2,768
	8,027	8,160
Net insurance benefits and claims and movement in liabilities	(13,209)	(17,721)

13. Net charge of impairment allowances

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Net (charge)/reversal of impairment allowances on:		
Advances and other accounts	(1,178)	(1,046)
Balances and placements with banks and other financial institutions	70	–
Investment in securities		
– At FVOCI	(14)	N/A
– At amortised cost	(12)	N/A
– Held-to-maturity securities	N/A	–
	(26)	–
Loan commitments and financial guarantee contracts	(91)	–
Others	(12)	(9)
Net charge of impairment allowances	(1,237)	(1,055)

14. Operating expenses

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Staff costs (including directors' emoluments)		
– Salaries and other costs	8,158	7,457
– Pension cost	469	444
	8,627	7,901
Premises and equipment expenses (excluding depreciation)		
– Rental of premises	770	710
– Information technology	631	551
– Others	458	460
	1,859	1,721
Depreciation (Note 29)	2,063	1,951
Auditor's remuneration		
– Audit services	28	28
– Non-audit services	20	9
Other operating expenses	2,583	2,238
	15,180	13,848

Contingent rent included in the "Rental of premises" amounted to HK\$51 million during the year (2017: HK\$16 million).

Notes to the Financial Statements

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

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Net gain from fair value adjustments on investment properties (Note 28)	906	1,197

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

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Net loss from disposal of equipment, fixtures and fittings	(6)	(15)
Net gain/(loss) from revaluation of premises (Note 29)	24	(10)
	18	(25)

17. Taxation

Taxation in the income statement represents:

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Current tax		
Hong Kong profits tax		
– Current year taxation	5,630	5,507
– Over-provision in prior years	(65)	(82)
	5,565	5,425
Overseas taxation		
– Current year taxation	783	889
– Over-provision in prior years	(27)	–
	6,321	6,314
Deferred tax		
Origination and reversal of temporary differences and unused tax credits (Note 36)	83	(246)
	6,404	6,068

Hong Kong profits tax has been provided at the rate of 16.5% (2017: 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/regions 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:

	2018 HK\$'m	2017 HK\$'m
CONTINUING OPERATIONS		
Profit before taxation	38,988	35,375
Calculated at a taxation rate of 16.5% (2017: 16.5%)	6,433	5,837
Effect of different taxation rates in other countries/regions	123	93
Income not subject to taxation	(691)	(460)
Expenses not deductible for taxation purposes	335	262
Tax losses not recognised	–	2
Over-provision in prior years	(92)	(82)
Foreign withholding tax	296	416
Taxation charge	6,404	6,068
Effective tax rate	16.4%	17.2%

Notes to the Financial Statements

18. Dividends

	2018		2017	
	Per share HK\$	Total HK\$m	Per share HK\$	Total HK\$m
Interim dividend paid	0.545	5,762	0.545	5,762
Special dividend paid	–	–	0.095	1,005
Proposed final dividend	0.923	9,759	0.758	8,014
	1.468	15,521	1.398	14,781

At a meeting held on 28 August 2018, the Board declared an interim dividend of HK\$0.545 per ordinary share for the first half of 2018 amounting to approximately HK\$5,762 million.

At a meeting held on 29 March 2019, the Board proposed to recommend to the Annual General Meeting on 16 May 2019 a final dividend of HK\$0.923 per ordinary share for the year ended 31 December 2018 amounting to approximately HK\$9,759 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 2019.

19. Earnings per share

The calculation of basic earnings per share for the year ended 31 December 2018 is based on the consolidated profit for the year and profit from continuing operations attributable to equity holders of the Company of approximately HK\$32,000 million and HK\$32,000 million (2017: HK\$31,163 million and HK\$28,574 million) respectively and on the ordinary shares in issue of 10,572,780,266 shares (2017: 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 2018 (2017: Nil).

20. Retirement benefit costs

Retirement benefits are provided to eligible employees of the Group. In Hong Kong, 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 retirement, early retirement or termination of employment after completing 10 years of service. Employees with 3 to 9 years of service are entitled to receive the employer's contributions at a scale ranging from 30% to 90% upon termination of employment for other reasons other than summary dismissal. All employer's contributions received by employee are subject to MPF Schemes Ordinance.

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

The Group's total contributions made to the ORSO schemes for the year ended 31 December 2018 amounted to approximately HK\$343 million (2017: approximately HK\$337 million), after a deduction of forfeited contributions of approximately HK\$10 million (2017: approximately HK\$10 million). For the MPF Scheme, the Group contributed approximately HK\$93 million (2017: approximately HK\$83 million) for the year ended 31 December 2018.

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:

	2018			
	Directors' fee HK\$'000	Basic salaries, allowances and benefits in kind HK\$'000	Bonus HK\$'000	Total HK\$'000
Executive Directors				
GAO Yingxin (Chief Executive)	–	6,530	4,018	10,548
LI Jiuzhong	–	4,846	2,490	7,336
	–	11,376	6,508	17,884
Non-executive Directors				
CHEN Siqing	–	–	–	–
LIU Liange ^{Note 1}	–	–	–	–
LIN Jingzhen ^{Note 1}	–	–	–	–
CHENG Eva*	500	–	–	500
CHOI Koon Shum*	592	–	–	592
KOH Beng Seng*	642	–	–	642
TUNG Savio Wai-Hok*	692	–	–	692
REN Deqi ^{Note 2}	–	–	–	–
LIU Qiang ^{Note 1, 2}	–	–	–	–
	2,426	–	–	2,426
	2,426	11,376	6,508	20,310

Note 1: Appointed during the year.

Note 2: Resigned during the year.

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

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

(i) Directors' emoluments (continued)

	2017			
	Directors' fee HK\$'000	Basic salaries, allowances and benefits in kind HK\$'000	Bonus HK\$'000	Total HK\$'000
Executive Directors				
YUE Yi (Chief Executive)	–	7,140	4,166	11,306
LI Jiuzhong	–	4,664	2,394	7,058
	–	11,804	6,560	18,364
Non-executive Directors				
CHEN Siqing	–	–	–	–
GAO Yingxin	–	–	–	–
CHENG Eva*	500	–	–	500
CHOI Koon Shum*	588	–	–	588
KOH Beng Seng*	650	–	–	650
TUNG Savio Wai-Hok*	712	–	–	712
REN Deqi	–	–	–	–
TIAN Guoli	–	–	–	–
XU Luode	–	–	–	–
	2,450	–	–	2,450
	2,450	11,804	6,560	20,814

* Independent Non-executive Directors

There were no directors waived emoluments for the year ended 31 December 2018 (2017: Nil).

Notes to the Financial Statements

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 (2017: two) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining three (2017: three) individuals during the year are as follows:

	2018 HK\$m	2017 HK\$m
Basic salaries and allowances	12	11
Bonus	9	9
Contributions to pension schemes	1	1
	22	21

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

	Number of individuals	
	2018	2017
HK\$6,500,001 to HK\$7,000,000	1	2
HK\$7,000,001 to HK\$7,500,000	1	1
HK\$7,500,001 to HK\$8,000,000	1	–

(iii) Senior management's emoluments

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

	Number of individuals	
	2018	2017
HK\$0 to HK\$500,000	2	–
HK\$500,001 to HK\$1,000,000	1	–
HK\$4,500,001 to HK\$5,000,000	–	1
HK\$5,000,001 to HK\$5,500,000	2	2
HK\$5,500,001 to HK\$6,000,000	1	1
HK\$6,500,001 to HK\$7,000,000	–	1
HK\$7,000,001 to HK\$7,500,000	2	1
HK\$10,500,001 to HK\$11,000,000	1	–
HK\$11,000,001 to HK\$11,500,000	–	1

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

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

For the purpose of disclosure, Senior Management and Key Personnel are defined as follows:

- Senior Management: The senior executives designated by the Board who are responsible for oversight of the firm-wide strategy or material business lines, including the Chief Executive, Deputy Chief Executives, Chief Financial Officer, Chief Risk Officer, Chief Operating Officer, Board Secretary and General Manager 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, senior executives of Southeast Asian entities, head of trading, as well as heads of risk control functions.

Details of the remuneration for Senior Management and Key Personnel of the Group during the year are as follows:

(i) Remuneration awarded during financial year

	2018		2017	
	Senior Management HK\$m	Key Personnel HK\$m	Senior Management HK\$m	Key Personnel HK\$m
Fixed remuneration				
Cash-based	36	133	38	64
<i>Of which: deferred</i>	–	–	–	–
Variable remuneration				
Cash-based	16	81	17	45
<i>Of which: deferred</i>	5	21	5	14
Total remuneration	52	214	55	109
Number of employees				
Fixed remuneration	11	52	9	25
Variable remuneration	11	52	9	24

(ii) Special payments

There were no guaranteed bonuses, sign-on awards and severance payments to Senior Management and Key Personnel for the year ended 31 December 2018 (2017: Nil).

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)

(iii) Deferred remuneration

	2018				
	Total amount of outstanding deferred remuneration HK\$'m	Of which: Total amount of outstanding deferred and retained remuneration exposed to ex post explicit and/or implicit adjustment HK\$'m	Total amount of amendment during the year due to ex post explicit adjustments HK\$'m	Total amount of amendment during the year due to ex post implicit adjustments HK\$'m	Total amount of deferred remuneration paid out in the financial year HK\$'m
Senior Management					
Cash	10	10	-	-	(5)
Key Personnel					
Cash	33	33	-	-	(12)
Total	43	43	-	-	(17)

	2017				
	Total amount of outstanding deferred remuneration HK\$'m	Of which: Total amount of outstanding deferred and retained remuneration exposed to ex post explicit and/or implicit adjustment HK\$'m	Total amount of amendment during the year due to ex post explicit adjustments HK\$'m	Total amount of amendment during the year due to ex post implicit adjustments HK\$'m	Total amount of deferred remuneration paid out in the financial year HK\$'m
Senior Management					
Cash	10	10	-	-	(4)
Key Personnel					
Cash	24	24	-	-	(8)
Total	34	34	-	-	(12)

22. Cash and balances and placements with banks and other financial institutions

	2018 HK\$'m	2017 HK\$'m
Cash	21,968	14,243
Balances with central banks	157,889	88,886
Placements with central banks maturing within one month	9,572	9,691
Placements with central banks maturing between one and twelve months	2,697	1,486
	170,158	100,063
Balances with other banks and other financial institutions	119,611	153,105
Placements with other banks and other financial institutions maturing within one month	65,810	101,452
Placements with other banks and other financial institutions maturing between one and twelve months	53,992	57,741
	239,413	312,298
	431,539	426,604
Impairment allowances		
– Stage 1	(15)	N/A
– Stage 2	–	N/A
– Stage 3	–	N/A
	431,524	426,604

Notes to the Financial Statements

23. Financial assets at fair value through profit or loss

	2018 HK\$'m	2017 HK\$'m
Securities		
Trading assets		
– Treasury bills	16,301	17,780
– Certificates of deposit	623	1,483
– Other debt securities	15,193	24,662
	32,117	43,925
– Equity securities	2	203
– Fund	3	–
	32,122	44,128
Other financial assets mandatorily classified at fair value through profit or loss		
– Certificates of deposit	2	N/A
– Other debt securities	19,784	N/A
	19,786	N/A
– Equity securities	1,010	N/A
– Fund	6,729	N/A
	27,525	N/A
Financial assets designated at fair value through profit or loss		
– Certificates of deposit	–	159
– Other debt securities	3,171	29,505
	3,171	29,664
– Equity securities	–	3,481
– Fund	–	9,062
	3,171	42,207
Total securities	62,818	86,335
Other debt instruments		
Trading assets	4,634	6,859
Financial assets designated at fair value through profit or loss	233,477	–
Total other debt instruments	238,111	6,859
	300,929	93,194

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

Total securities are analysed by place of listing as follows:

	2018 HK\$'m	2017 HK\$'m
Debt securities and certificates of deposit		
– Listed in Hong Kong	13,556	18,203
– Listed outside Hong Kong	14,436	17,870
– Unlisted	27,082	37,516
	55,074	73,589
Equity securities		
– Listed in Hong Kong	468	2,578
– Listed outside Hong Kong	544	1,106
	1,012	3,684
Fund		
– Listed in Hong Kong	339	–
– Unlisted	6,393	9,062
	6,732	9,062
Total securities	62,818	86,335

Total securities are analysed by type of issuer as follows:

	2018 HK\$'m	2017 HK\$'m
Sovereigns	26,397	28,929
Public sector entities	1,720	703
Banks and other financial institutions	26,385	39,844
Corporate entities	8,316	16,859
Total securities	62,818	86,335

Notes to the Financial Statements

24. Derivative financial instruments and hedge accounting

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

(a) Derivative financial instruments

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

24. Derivative financial instruments and hedge accounting (continued)

(a) Derivative financial instruments (continued)

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

	2018		
	Contract/ notional amounts HK\$'m	Fair values	
		Assets HK\$'m	Liabilities HK\$'m
Exchange rate contracts			
Spot, forwards and futures	363,070	12,711	(8,901)
Swaps	1,721,302	12,373	(12,143)
Options	29,715	158	(64)
	2,114,087	25,242	(21,108)
Interest rate contracts			
Futures	20,242	1	(39)
Swaps	1,047,515	9,312	(8,428)
Options	1,566	1	(1)
	1,069,323	9,314	(8,468)
Commodity contracts	28,782	239	(1,184)
Equity contracts	2,998	117	(119)
Credit derivative contracts	392	–	(1)
	3,215,582	34,912	(30,880)

	2017		
	Contract/ notional amounts HK\$'m	Fair values	
		Assets HK\$'m	Liabilities HK\$'m
Exchange rate contracts			
Spot, forwards and futures	354,350	12,043	(9,238)
Swaps	1,460,316	13,923	(15,641)
Options	59,734	138	(107)
	1,874,400	26,104	(24,986)
Interest rate contracts			
Futures	17,306	8	(1)
Swaps	932,611	6,788	(5,405)
	949,917	6,796	(5,406)
Commodity contracts	28,001	559	(570)
Equity contracts	6,655	78	(81)
Credit derivative contracts	586	6	(3)
	2,859,559	33,543	(31,046)

Notes to the Financial Statements

24. Derivative financial instruments and hedge accounting (continued)

(b) Hedge accounting

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.

The table below summarises the contract/notional amounts of the hedging instruments as at 31 December 2018 by remaining contractual maturity.

	2018					Total HK\$'m
	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	
Interest rate swaps	235	78	10,808	70,258	34,845	116,224

The amounts relating to items designated as hedging instruments are as follows:

	2018			Change in fair value used for recognising hedge ineffectiveness HK\$'m
	Contract/ notional amounts HK\$'m	Fair values		
		Assets HK\$'m	Liabilities HK\$'m	
Derivative financial instruments				
Interest rate swaps	116,224	2,038	(477)	612

The amounts relating to hedged items are as follows:

	2018		Change in value used for recognising hedge ineffectiveness HK\$'m
	Carrying amounts HK\$'m	Accumulated amount of fair value hedge adjustment included in the carrying amounts HK\$'m	
Investment in securities			
Debt securities and certificates of deposit	115,598	(2,233)	(273)

24. Derivative financial instruments and hedge accounting (continued)

(b) Hedge accounting (continued)

Fair value hedges (continued)

Hedge ineffectiveness recognised is as follows:

	2018 HK\$'m
Net trading gain	339

The fair values of derivative financial instruments designated as hedging instruments as at 31 December 2017 are as follows:

	2017	
	Assets HK\$'m	Liabilities HK\$'m
Fair value hedges	2,339	(555)

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

	2017	
	Hedged assets HK\$'m	Hedged liabilities HK\$'m
Net gain/(loss)		
– Hedging instruments	591	(464)
– Hedged items	(271)	563
	320	99

Notes to the Financial Statements

25. Advances and other accounts

	2018 HK\$'m	2017 HK\$'m
Personal loans and advances	354,619	327,827
Corporate loans and advances	912,086	818,599
Advances to customers	1,266,705	1,146,426
Impairment allowances		
– Stage 1	(3,739)	N/A
– Stage 2	(546)	N/A
– Stage 3	(1,126)	N/A
– Collectively assessed	N/A	(3,615)
– Individually assessed	N/A	(491)
	1,261,294	1,142,320
Trade bills	17,361	42,975
Impairment allowances		
– Stage 1	(1)	N/A
– Stage 2	–	N/A
– Stage 3	(4)	N/A
	17,356	42,975
Advances to banks and other financial institutions	3,822	6,259
	1,282,472	1,191,554

As at 31 December 2018, advances to customers included accrued interest of HK\$2,336 million (2017: HK\$1,729 million).

26. Investment in securities

	2018 HK\$'m	2017 HK\$'m
Investment in securities at fair value through other comprehensive income		
– Treasury bills	122,462	N/A
– Certificates of deposit	34,849	N/A
– Other debt securities	328,303	N/A
	485,614	N/A
– Equity securities	3,928	N/A
	489,542	N/A
Investment in securities at amortised cost		
– Certificates of deposit	18	N/A
– Other debt securities	108,716	N/A
	108,734	N/A
– Impairment allowances		
Stage 1	(29)	N/A
Stage 2	–	N/A
Stage 3	–	N/A
	108,705	N/A
Available-for-sale securities at fair value		
– Treasury bills	N/A	180,160
– Certificates of deposit	N/A	26,762
– Other debt securities	N/A	354,779
	N/A	561,701
– Equity securities	N/A	5,414
	N/A	567,115
Held-to-maturity securities at amortised cost		
– Certificates of deposit	N/A	18
– Other debt securities	N/A	50,604
	N/A	50,622
– Impairment allowances	N/A	(45)
	N/A	50,577
Loans and receivables at amortised cost		
– Certificates of deposit	N/A	–
– Other debt securities	N/A	499
	N/A	499
	598,247	618,191

Notes to the Financial Statements

26. Investment in securities (continued)

Investment in securities is analysed by place of listing as follows:

	2018 HK\$'m	2017 HK\$'m
Debt securities and certificates of deposit		
– Listed in Hong Kong	87,137	80,808
– Listed outside Hong Kong	242,128	210,804
– Unlisted	265,054	321,165
	594,319	612,777
Equity securities		
– Listed in Hong Kong	2,599	4,468
– Listed outside Hong Kong	185	134
– Unlisted	1,144	812
	3,928	5,414
	598,247	618,191

	2018		2017	
	Carrying value HK\$'m	Market value HK\$'m	Carrying value HK\$'m	Market value HK\$'m
Listed securities at amortised cost				
– Listed in Hong Kong	19,249	19,077	N/A	N/A
– Listed outside Hong Kong	54,225	54,009	N/A	N/A
	73,474	73,086	N/A	N/A
Listed held-to-maturity securities				
– Listed in Hong Kong	N/A	N/A	10,355	10,662
– Listed outside Hong Kong	N/A	N/A	19,646	19,781
	N/A	N/A	30,001	30,443

26. Investment in securities (continued)

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

	2018 HK\$'m	2017 HK\$'m
Sovereigns	184,540	234,032
Public sector entities	44,984	45,374
Banks and other financial institutions	208,060	213,826
Corporate entities	160,663	124,959
	598,247	618,191

The movements in investment in securities are summarised as follows:

	2018	
	At fair value through other comprehensive income HK\$'m	At amortised cost HK\$'m
At 1 January 2018, after adoption of HKFRS 9	542,706	76,230
Additions	727,971	46,371
Disposals, redemptions and maturity	(772,469)	(13,674)
Amortisation	1,357	239
Change in fair value/fair value hedge adjustment	(3,674)	(26)
Net charge of impairment allowances	-	(12)
Reclassification	-	-
Exchange difference	(6,349)	(423)
At 31 December 2018	489,542	108,705

Notes to the Financial Statements

26. Investment in securities (continued)

	2017		
	Available-for-sale securities HK\$'m	Held-to-maturity securities HK\$'m	Loans and receivables HK\$'m
At 1 January 2017, as previously reported	531,847	60,868	935
Effect of merger of entities under common control	1	22	–
At 1 January 2017, as restated	531,848	60,890	935
Additions	541,193	4,915	3,864
Disposals, redemptions and maturity	(511,733)	(22,845)	(4,320)
Amortisation	65	(76)	20
Change in fair value	1,663	–	–
Reclassification	(6,097)	6,097	–
Exchange difference	10,176	1,596	–
At 31 December 2017	567,115	50,577	499

In 2017, the Group reclassified certain debt securities with fair value of HK\$6,097 million out of available-for-sale category into held-to-maturity category during the year. The Group had the intention and ability to hold these reclassified debt securities until maturity at the date of reclassification.

In 2018, the Group has designated certain equity securities, which previously classified as available-for-sale, as equity securities at fair value through other comprehensive income. The fair value through other comprehensive income designation was made because these are held for strategic investments. Investments include subordinated Additional Tier 1 securities, listed and unlisted equity shares.

The Group sold certain equity securities at fair value through other comprehensive income with fair value of HK\$3,149 million during the year. These sales were made because of portfolio rebalancing.

27. Interests in associates and joint ventures

	2018 HK\$'m	2017 HK\$'m
At 1 January	417	319
Share of results	103	132
Share of tax	(33)	(32)
Dividend received	(4)	(2)
At 31 December	483	417

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

Name	Place of incorporation and operation	Issued share capital	Interest held	Principal activities
Associates:				
BOC Services Company Limited	PRC	Registered capital RMB50,000,000	45%	Credit card back-end service support
FutureX Innovation Limited	Cayman Islands	US\$1	20%	Investment holding
Joint Ventures:				
Joint Electronic Teller Services Limited	Hong Kong	HK\$10,026,000	19.96%	Operation of a private inter-bank message switching network in respect of ATM services
Golden Harvest (Cayman) Limited	Cayman Islands	US\$100	49%	Investment holding

FutureX Innovation Limited became an associate of the Group on 31 July 2018.

	Associates		Joint ventures	
	2018 HK\$'m	2017 HK\$'m	2018 HK\$'m	2017 HK\$'m
Interests in associates/joint ventures	421	350	62	67
Share of profit/total comprehensive income for the year of associates/joint ventures	71	94	(1)	6

Notes to the Financial Statements

28. Investment properties

	2018 HK\$'m	2017 HK\$'m
At 1 January	19,669	18,227
Additions	13	13
Disposals	–	(2)
Fair value gains (Note 15)	906	1,197
Reclassification (to)/from properties, plant and equipment (Note 29)	(904)	234
At 31 December	19,684	19,669

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

	2018 HK\$'m	2017 HK\$'m
Held in Hong Kong		
On long-term lease (over 50 years)	4,691	4,526
On medium-term lease (10 to 50 years)	14,635	14,835
Held outside Hong Kong		
On long-term lease (over 50 years)	86	77
On medium-term lease (10 to 50 years)	244	203
On short-term lease (less than 10 years)	28	28
	19,684	19,669

As at 31 December 2018, investment properties were included in the balance sheet at valuation carried out at 31 December 2018 on the basis of their fair value by an independent firm of chartered surveyors, Knight Frank Petty Limited. The fair value represents the price that would be received to sell each investment property in an orderly transaction with market participants at the measurement date.

29. Properties, plant and equipment

	Premises HK\$'m	Equipment, fixtures and fittings HK\$'m	Total HK\$'m
Net book value at 1 January 2018, as previously reported	44,329	2,932	47,261
Effect of merger of entities under common control	–	7	7
Net book value at 1 January 2018, as restated	44,329	2,939	47,268
Additions	94	1,080	1,174
Disposals	(4)	(8)	(12)
Revaluation	2,160	–	2,160
Depreciation for the year (Note 14)	(1,092)	(971)	(2,063)
Reclassification from investment properties (Note 28)	904	–	904
Exchange difference	(1)	–	(1)
Net book value at 31 December 2018	46,390	3,040	49,430
At 31 December 2018			
Cost or valuation	46,390	10,495	56,885
Accumulated depreciation and impairment	–	(7,455)	(7,455)
Net book value at 31 December 2018	46,390	3,040	49,430
The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2018			
At cost	–	10,495	10,495
At valuation	46,390	–	46,390
	46,390	10,495	56,885
Net book value at 1 January 2017, as previously reported	43,357	2,455	45,812
Effect of merger of entities under common control	–	6	6
Net book value at 1 January 2017, as restated	43,357	2,461	45,818
Additions	112	1,411	1,523
Disposals	(8)	(20)	(28)
Revaluation	2,119	–	2,119
Depreciation for the year (Note 14)	(1,024)	(927)	(1,951)
Reclassification to investment properties (Note 28)	(234)	–	(234)
Exchange difference	7	14	21
Net book value at 31 December 2017	44,329	2,939	47,268
At 31 December 2017			
Cost or valuation	44,329	9,616	53,945
Accumulated depreciation and impairment	–	(6,677)	(6,677)
Net book value at 31 December 2017	44,329	2,939	47,268
The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2017			
At cost	–	9,616	9,616
At valuation	44,329	–	44,329
	44,329	9,616	53,945

Notes to the Financial Statements

29. Properties, plant and equipment (continued)

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

	2018 HK\$'m	2017 HK\$'m
Held in Hong Kong		
On long-term lease (over 50 years)	13,774	13,734
On medium-term lease (10 to 50 years)	32,267	30,221
Held outside Hong Kong		
On long-term lease (over 50 years)	6	5
On medium-term lease (10 to 50 years)	266	290
On short-term lease (less than 10 years)	77	79
	46,390	44,329

As at 31 December 2018, premises were included in the balance sheet at valuation carried out at 31 December 2018 on the basis of their fair value by an independent firm of chartered surveyors, Knight Frank Petty Limited. The fair value represents the price that would be received to sell each premises in an orderly transaction with market participants at the measurement date.

As a result of the above-mentioned revaluations, changes in value of the premises were recognised as follows:

	2018 HK\$'m	2017 HK\$'m
Increase/(decrease) in valuation credited/(charged) to income statement (Note 16)	24	(10)
Increase in valuation credited to other comprehensive income	2,136	2,129
	2,160	2,119

As at 31 December 2018, the net book value of premises that would have been included in the Group's balance sheet had the premises been carried at cost less accumulated depreciation and impairment losses was HK\$8,598 million (2017: HK\$7,295 million).

30. Other assets

	2018 HK\$'m	2017 HK\$'m
Reposessed assets	10	30
Precious metals	6,602	6,291
Reinsurance assets	45,898	43,717
Accounts receivable and prepayments	26,077	24,350
	78,587	74,388

31. 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.

32. Financial liabilities at fair value through profit or loss

	2018 HK\$'m	2017 HK\$'m
Trading liabilities		
– Short positions in Exchange Fund Bills and Notes	13,336	16,936
Financial liabilities designated at fair value through profit or loss		
– Structured deposits (Note 33)	2,199	2,784
	15,535	19,720

The carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2018 was less than the amount that the Group would be contractually required to pay at maturity to the holders by HK\$7 million (2017: HK\$3 million).

Notes to the Financial Statements

33. Deposits from customers

	2018 HK\$'m	2017 HK\$'m
Current, savings and other deposit accounts (per balance sheet)	1,893,357	1,775,090
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 32)	2,199	2,784
	1,895,556	1,777,874
Analysed by:		
Demand deposits and current accounts		
– Corporate	144,985	145,029
– Personal	62,812	58,808
	207,797	203,837
Savings deposits		
– Corporate	336,333	372,909
– Personal	516,006	540,283
	852,339	913,192
Time, call and notice deposits		
– Corporate	487,433	409,151
– Personal	347,987	251,694
	835,420	660,845
	1,895,556	1,777,874

34. Debt securities and certificates of deposit in issue

	2018 HK\$'m	2017 HK\$'m
Debt securities, at amortised cost	9,453	21,641

35. Other accounts and provisions

	2018 HK\$'m	2017 HK\$'m
Other accounts payable	58,982	53,088
Impairment allowances on loan commitments and financial guarantee contracts		
– Stage 1	375	N/A
– Stage 2	20	N/A
– Stage 3	43	N/A
	59,420	53,088

36. 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 and unused tax credits in accordance with HKAS 12 "Income Taxes".

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

	2018				
	Accelerated tax depreciation HK\$'m	Property revaluation HK\$'m	Impairment allowances HK\$'m	Others HK\$'m	Total HK\$'m
At 1 January 2018, as previously reported	693	6,649	(549)	(1,147)	5,646
Effect of adoption of HKFRS 9	–	–	(190)	170	(20)
At 1 January 2018, after adoption of HKFRS 9	693	6,649	(739)	(977)	5,626
Charged to income statement (Note 17)	13	44	15	11	83
Charged/(credited) to other comprehensive income	–	298	–	(519)	(221)
Release upon disposal of equity instruments at fair value through other comprehensive income	–	–	–	7	7
At 31 December 2018	706	6,991	(724)	(1,478)	5,495

	2017				
	Accelerated tax depreciation HK\$'m	Property revaluation HK\$'m	Impairment allowances HK\$'m	Others HK\$'m	Total HK\$'m
At 1 January 2017	611	6,467	(426)	(1,139)	5,513
Charged/(credited) to income statement (Note 17)	82	(116)	(123)	(89)	(246)
Charged to other comprehensive income	–	298	–	81	379
At 31 December 2017	693	6,649	(549)	(1,147)	5,646

Notes to the Financial Statements

36. Deferred taxation (continued)

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

	2018 HK\$'m	2017 HK\$'m
Deferred tax assets	(270)	(58)
Deferred tax liabilities	5,765	5,704
	5,495	5,646

	2018 HK\$'m	2017 HK\$'m
Deferred tax assets to be recovered after more than twelve months	(60)	(38)
Deferred tax liabilities to be settled after more than twelve months	7,011	6,794
	6,951	6,756

As at 31 December 2018, the Group has not recognised deferred tax assets in respect of tax losses amounting to HK\$23 million (2017: HK\$25 million). Of the amount, HK\$9 million (2017: HK\$9 million) for the Group has no expiry date and HK\$14 million (2017: HK\$16 million) for the Group is scheduled to expire within six years under the current tax legislation in different countries/regions.

37. Insurance contract liabilities

	2018 HK\$'m	2017 HK\$'m
At 1 January	103,229	86,534
Benefits paid	(17,479)	(10,815)
Claims incurred and movement in liabilities	18,973	27,510
At 31 December	104,723	103,229

The insurance contract liabilities that are covered by reinsurance arrangements amounted to HK\$37,940 million (2017: HK\$38,074 million) and the associated reinsurance assets of HK\$45,898 million (2017: HK\$43,717 million) are included in "Other assets" (Note 30).

38. Subordinated liabilities

	2018 HK\$'m	2017 HK\$'m
Subordinated notes		
– designated at fair value through profit or loss	13,246	N/A
– at amortised cost with fair value hedge adjustment	N/A	18,917
Subordinated loan		
– at amortised cost	–	63
	13,246	18,980

In 2010, BOCHK issued listed subordinated notes with an aggregate amount of USD2,500 million, interest rate at 5.55% per annum payable semi-annually, due February 2020. In September 2018, USD877 million in principal amount of subordinated notes were purchased and redeemed by BOCHK and cancelled pursuant to the terms and conditions of the notes. USD1,623 million of the aggregate principal amount of subordinated notes remain outstanding. Amounts qualified as Tier 2 capital instruments for regulatory purposes are shown in Note 4.5(B). The carrying amount of subordinated notes designated at fair value through profit or loss as at 31 December 2018 was more than the amount that the Group would be contractually required to pay at maturity to the holders by HK\$260 million (2017: N/A).

The subordinated loan was from BOC, the intermediate holding company, with interest rate at 12-month LIBOR plus 1.50% per annum payable annually. It has been fully repaid during the year.

39. Discontinued operations

On 22 December 2016, BOCHK (as seller) entered into a sale and purchase agreement with Xiamen International Investment Limited and the Committee of Jimei Schools (each as a buyer) in relation to the disposal of a total of 2,114,773 ordinary shares of Chiyu. The completion of the disposal was conditional upon the satisfaction of all the conditions precedent set out in the sale and purchase agreement.

All the conditions precedent set out in the sale and purchase agreement were satisfied, and completion of the disposal took place on 27 March 2017 in accordance with the terms and conditions of the sale and purchase agreement. Upon completion, Chiyu ceased to be a subsidiary of BOCHK.

Notes to the Financial Statements

39. Discontinued operations (continued)

The results of discontinued operations for the year are as follows:

DISCONTINUED OPERATIONS	2018 HK\$'m	2017 HK\$'m
Interest income	–	268
Interest expense	–	(75)
Net interest income	–	193
Fee and commission income	–	39
Fee and commission expense	–	–
Net fee and commission income	–	39
Net trading gain	–	2
Net gain on other financial instruments at fair value through profit or loss	–	1
Net operating income before impairment allowances	–	235
Net charge of impairment allowances	–	(7)
Net operating income	–	228
Operating expenses	–	(87)
Operating profit	–	141
Taxation	–	(22)
Profit after taxation	–	119
Gain on disposal of discontinued operations	–	2,504
Profit from discontinued operations	–	2,623
Profit attributable to:		
Equity holders of the Company	–	2,589
Non-controlling interests	–	34
	–	2,623
	HK\$	HK\$
Earnings per share		
Basic and diluted		
– profit from discontinued operations	–	0.2449

39. Discontinued operations (continued)

The net cash flows incurred by discontinued operations are as follows:

	2018 HK\$'m	2017 HK\$'m
Operating activities	–	2,000
Investing activities	–	(3)
Financing activities	–	–
Net cash inflow incurred by discontinued operations	–	1,997

The gain on disposal of discontinued operations is analysed as follows:

	2017 HK\$'m
Total consideration	7,685
Net assets disposed	(7,044)
Non-controlling interests	2,078
Cumulative translation reserve and reserve for fair value changes of available-for-sale securities reclassified to income statement	(48)
Transaction costs incurred in connection with the disposal	(167)
Gain on disposal of discontinued operations	2,504

Notes to the Financial Statements

39. Discontinued operations (continued)

The net assets of discontinued operations at the date of disposal are as follows:

	At the date of disposal HK\$'m
Cash and balances and placements with banks and other financial institutions	8,244
Financial assets at fair value through profit or loss	351
Derivative financial instruments	95
Advances and other accounts	31,411
Investment in securities	14,541
Investment properties	204
Properties, plant and equipment	1,537
Deferred tax assets	63
Other assets	582
Deposits and balances from banks and other financial institutions	(2,765)
Derivative financial instruments	(8)
Deposits from customers	(46,277)
Other accounts and provisions	(725)
Current tax liabilities	(45)
Deferred tax liabilities	(164)
Net assets disposed	7,044

39. Discontinued operations (continued)

The net cash inflow from disposal of discontinued operations is analysed as follows:

	2017 HK\$'m
Total consideration received, satisfied by cash	7,685
Transaction costs incurred in connection with the disposal	(167)
Cash and cash equivalents disposed	(6,708)
Net cash inflow from disposal of discontinued operations	810

40. Share capital

	2018 HK\$'m	2017 HK\$'m
Issued and fully paid:		
10,572,780,266 ordinary shares	52,864	52,864

41. Other equity instruments

	2018 HK\$'m	2017 HK\$'m
Undated non-cumulative subordinated Additional Tier 1 capital securities	23,476	–

In September 2018, BOCHK issued USD3,000 million undated non-cumulative subordinated Additional Tier 1 capital securities. The capital securities are perpetual securities in respect of which there is no fixed redemption date and are not callable within the first 5 years. They have an initial rate of distribution of 5.90% per annum payable semi-annually.

Notes to the Financial Statements

42. Notes to consolidated cash flow statement

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

	2018 HK\$'m	2017 HK\$'m
Operating profit		
– from continuing operations	37,994	34,103
– from discontinued operations	–	141
	37,994	34,244
Depreciation	2,063	1,951
Net charge of impairment allowances	1,237	1,062
Unwind of discount on impairment allowances	(1)	(3)
Advances written off net of recoveries	(714)	(465)
Investment in securities written off	(45)	–
Change in subordinated liabilities	521	498
Change in balances and placements with banks and other financial institutions with original maturity over three months	7,103	21,878
Change in financial assets at fair value through profit or loss	29,801	(24,597)
Change in derivative financial instruments	(1,535)	12,530
Change in advances and other accounts	(92,117)	(183,091)
Change in investment in securities	11,053	(28,687)
Change in other assets	(4,220)	(3,397)
Change in deposits and balances from banks and other financial institutions	153,380	24,995
Change in financial liabilities at fair value through profit or loss	(4,185)	6,349
Change in deposits from customers	118,267	252,023
Change in debt securities and certificates of deposit in issue	(12,188)	20,520
Change in other accounts and provisions	5,894	364
Change in insurance contract liabilities	1,494	16,695
Effect of changes in exchange rates	20,095	(15,936)
Operating cash inflow before taxation	273,897	136,933
Cash flows from operating activities included		
– interest received	59,305	48,444
– interest paid	19,896	12,613
– dividend received	213	177

42. Notes to consolidated cash flow statement (continued)

(b) Reconciliation of liabilities arising from financing activities

	2018 HK\$'m	2017 HK\$'m
Subordinated liabilities		
At 1 January, as previously reported	18,980	19,093
Effect of adoption of HKFRS 9	2,068	N/A
At 1 January, after adoption of HKFRS 9	21,048	19,093
Cash flows:		
Payment for redemption/repayment of subordinated liabilities	(7,211)	(16)
Interest paid for subordinated liabilities	(1,087)	(595)
	(8,298)	(611)
Non-cash changes:		
Change in fair value of own credit risk credited to other comprehensive income	(25)	N/A
Exchange difference	59	145
Other changes	462	353
At 31 December	13,246	18,980

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

	2018 HK\$'m	2017 HK\$'m
Cash and balances and placements with banks and other financial institutions with original maturity within three months	378,703	366,665
Treasury bills, certificates of deposit and other debt instruments with original maturity within three months		
– financial assets at fair value through profit or loss	239,020	1,000
– investment in securities	7,024	13,257
	624,747	380,922

Notes to the Financial Statements

43. Contingent liabilities and commitments

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

	2018 HK\$'m	2017 HK\$'m
Direct credit substitutes	6,533	8,414
Transaction-related contingencies	29,292	30,092
Trade-related contingencies	26,269	28,294
Commitments that are unconditionally cancellable without prior notice	404,337	397,100
Other commitments with an original maturity of		
– up to one year	10,189	17,976
– over one year	131,268	154,582
	607,888	636,458
Credit risk-weighted amount	68,508	74,844

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.

44. Capital commitments

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

	2018 HK\$'m	2017 HK\$'m
Authorised and contracted for but not provided for	215	146
Authorised but not contracted for	35	3
	250	149

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

45. Operating lease commitments

(a) As lessee

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

	2018 HK\$'m	2017 HK\$'m
Land and buildings		
– Not later than one year	641	607
– Later than one year but not later than five years	739	634
– Later than five years	48	14
	1,428	1,255

Certain non-cancellable operating leases included in the table above, in the event that there is such special conditions stipulated thereto, 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) As lessor

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

	2018 HK\$'m	2017 HK\$'m
Land and buildings		
– Not later than one year	540	543
– Later than one year but not later than five years	415	502
	955	1,045

The Group leases its investment properties 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 upon the lease renewal.

Notes to the Financial Statements

46. 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.

47. 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: 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. Personal Banking mainly serves retail customers and small enterprises, while Corporate Banking mainly deals with corporate customers. Treasury manages the funding and liquidity, and the interest rate and foreign exchange positions of the Group in addition to proprietary trades. The Insurance segment represents business mainly relating to life insurance products, including individual life insurance and group life insurance products. "Others" mainly represents the Group's holdings of premises, investment properties, equity investments, certain interests in associates and joint ventures and the businesses of the Southeast Asian entities.

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

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

Several products/businesses have been reclassified among operating segments in accordance with the latest management model of the Group. Comparative amounts have been restated to conform with current year presentation.

47. Segmental reporting (continued)

	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
Year ended 31 December 2018								
CONTINUING OPERATIONS								
Net interest income/(expense)								
– External	1,362	15,735	17,074	3,055	2,168	39,394	–	39,394
– Inter-segment	10,030	(2,664)	(6,105)	(31)	(1,230)	–	–	–
	11,392	13,071	10,969	3,024	938	39,394	–	39,394
Net fee and commission income/(expense)	6,846	3,364	995	(667)	1,140	11,678	(371)	11,307
Net insurance premium income	–	–	–	14,142	–	14,142	(19)	14,123
Net trading gain/(loss)	784	1,438	740	(244)	302	3,020	58	3,078
Net gain/(loss) on other financial instruments at fair value through profit or loss	10	–	512	(1,811)	(1)	(1,290)	8	(1,282)
Net (loss)/gain on other financial assets	–	(3)	4	18	–	19	–	19
Other operating income	48	2	16	155	2,075	2,296	(1,315)	981
Total operating income	19,080	17,872	13,236	14,617	4,454	69,259	(1,639)	67,620
Net insurance benefits and claims and movement in liabilities	–	–	–	(13,209)	–	(13,209)	–	(13,209)
Net operating income before impairment allowances	19,080	17,872	13,236	1,408	4,454	56,050	(1,639)	54,411
Net charge of impairment allowances	(123)	(784)	(3)	(5)	(322)	(1,237)	–	(1,237)
Net operating income	18,957	17,088	13,233	1,403	4,132	54,813	(1,639)	53,174
Operating expenses	(8,756)	(3,001)	(1,350)	(465)	(3,247)	(16,819)	1,639	(15,180)
Operating profit	10,201	14,087	11,883	938	885	37,994	–	37,994
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	906	906	–	906
Net (loss)/gain from disposal/revaluation of properties, plant and equipment	(4)	–	–	(1)	23	18	–	18
Share of profits less losses after tax of associates and joint ventures	72	–	1	–	(3)	70	–	70
Profit before taxation	10,269	14,087	11,884	937	1,811	38,988	–	38,988
At 31 December 2018								
ASSETS								
Segment assets	378,547	887,367	1,439,655	132,417	137,581	2,975,567	(23,147)	2,952,420
Interests in associates and joint ventures	422	–	1	–	60	483	–	483
	378,969	887,367	1,439,656	132,417	137,641	2,976,050	(23,147)	2,952,903
LIABILITIES								
Segment liabilities	1,038,673	839,457	616,617	124,085	72,311	2,691,143	(23,147)	2,667,996
Year ended 31 December 2018								
CONTINUING OPERATIONS								
Other information								
Capital expenditure	26	–	5	10	1,146	1,187	–	1,187
Depreciation	564	140	115	16	1,228	2,063	–	2,063
Amortisation of securities	–	–	1,502	114	(20)	1,596	–	1,596

Notes to the Financial Statements

47. Segmental reporting (continued)

	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
Year ended 31 December 2017								
CONTINUING OPERATIONS								
Net interest income/(expense)								
– External	3,243	12,366	15,385	2,687	1,137	34,818	–	34,818
– Inter-segment	6,467	(635)	(4,906)	(31)	(895)	–	–	–
	9,710	11,731	10,479	2,656	242	34,818	–	34,818
Net fee and commission income/(expense)	6,340	4,264	853	(658)	1,159	11,958	(357)	11,601
Net insurance premium income	–	–	–	14,683	–	14,683	(18)	14,665
Net trading gain/(loss)	876	1,270	(1,182)	100	223	1,287	81	1,368
Net gain/(loss) on other financial instruments at fair value through profit or loss	9	–	(3)	2,168	–	2,174	7	2,181
Net gain on other financial assets	–	30	698	435	–	1,163	–	1,163
Other operating income	82	8	37	165	2,017	2,309	(1,378)	931
Total operating income	17,017	17,303	10,882	19,549	3,641	68,392	(1,665)	66,727
Net insurance benefits and claims and movement in liabilities	–	–	–	(17,721)	–	(17,721)	–	(17,721)
Net operating income before impairment allowances	17,017	17,303	10,882	1,828	3,641	50,671	(1,665)	49,006
Net charge of impairment allowances	(754)	(73)	–	–	(228)	(1,055)	–	(1,055)
Net operating income	16,263	17,230	10,882	1,828	3,413	49,616	(1,665)	47,951
Operating expenses	(7,949)	(2,834)	(1,358)	(427)	(2,945)	(15,513)	1,665	(13,848)
Operating profit	8,314	14,396	9,524	1,401	468	34,103	–	34,103
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	1,197	1,197	–	1,197
Net loss from disposal/revaluation of properties, plant and equipment	(5)	(4)	(1)	–	(15)	(25)	–	(25)
Share of profits less losses after tax of associates and joint ventures	94	–	2	–	4	100	–	100
Profit before taxation	8,403	14,392	9,525	1,401	1,654	35,375	–	35,375
At 31 December 2017								
ASSETS								
Segment assets	355,060	832,946	1,213,510	130,597	130,831	2,662,944	(12,275)	2,650,669
Interests in associates and joint ventures	350	–	2	–	65	417	–	417
	355,410	832,946	1,213,512	130,597	130,896	2,663,361	(12,275)	2,651,086
LIABILITIES								
Segment liabilities	957,439	810,020	457,289	121,752	68,238	2,414,738	(12,275)	2,402,463
Year ended 31 December 2017								
CONTINUING OPERATIONS								
Other information								
Capital expenditure	27	–	4	32	1,473	1,536	–	1,536
Depreciation	522	147	97	18	1,167	1,951	–	1,951
Amortisation of securities	–	–	36	(20)	(7)	9	–	9

48. Offsetting financial instruments

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

	2018					
	Gross amounts of recognised financial assets HK\$'m	Gross amounts of recognised financial liabilities set off in the balance sheet HK\$'m	Net amounts of financial assets presented in the balance sheet HK\$'m	Related amounts not set off in the balance sheet		Net amount HK\$'m
				Financial instruments HK\$'m	Cash collateral received HK\$'m	
Assets						
Derivative financial instruments	34,827	-	34,827	(19,855)	(3,299)	11,673
Reverse repurchase agreements	2,764	-	2,764	(2,764)	-	-
Securities borrowing agreements	2,200	-	2,200	(2,200)	-	-
Other assets	13,384	(9,213)	4,171	-	-	4,171
	53,175	(9,213)	43,962	(24,819)	(3,299)	15,844

	2018					
	Gross amounts of recognised financial liabilities HK\$'m	Gross amounts of recognised financial assets set off in the balance sheet HK\$'m	Net amounts of financial liabilities presented in the balance sheet HK\$'m	Related amounts not set off in the balance sheet		Net amount HK\$'m
				Financial instruments HK\$'m	Cash collateral pledged HK\$'m	
Liabilities						
Derivative financial instruments	30,662	-	30,662	(19,855)	(2,165)	8,642
Repurchase agreements	25,617	-	25,617	(25,617)	-	-
Other liabilities	9,907	(9,213)	694	-	-	694
	66,186	(9,213)	56,973	(45,472)	(2,165)	9,336

Notes to the Financial Statements

48. Offsetting financial instruments (continued)

	2017					
	Gross amounts of recognised financial assets HK\$'m	Gross amounts of recognised financial liabilities set off in the balance sheet HK\$'m	Net amounts of financial assets presented in the balance sheet HK\$'m	Related amounts not set off in the balance sheet		Net amount HK\$'m
				Financial instruments HK\$'m	Cash collateral received HK\$'m	
Assets						
Derivative financial instruments	33,458	–	33,458	(23,094)	(4,427)	5,937
Reverse repurchase agreements	9,012	–	9,012	(9,012)	–	–
Securities borrowing agreements	2,503	–	2,503	(2,503)	–	–
Other assets	17,432	(10,545)	6,887	–	–	6,887
	<u>62,405</u>	<u>(10,545)</u>	<u>51,860</u>	<u>(34,609)</u>	<u>(4,427)</u>	<u>12,824</u>

	2017					
	Gross amounts of recognised financial liabilities HK\$'m	Gross amounts of recognised financial assets set off in the balance sheet HK\$'m	Net amounts of financial liabilities presented in the balance sheet HK\$'m	Related amounts not set off in the balance sheet		Net amount HK\$'m
				Financial instruments HK\$'m	Cash collateral pledged HK\$'m	
Liabilities						
Derivative financial instruments	30,963	–	30,963	(23,094)	(676)	7,193
Repurchase agreements	14,477	–	14,477	(14,477)	–	–
Other liabilities	11,265	(10,545)	720	–	–	720
	<u>56,705</u>	<u>(10,545)</u>	<u>46,160</u>	<u>(37,571)</u>	<u>(676)</u>	<u>7,913</u>

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

49. Assets pledged as security

As at 31 December 2018, the liabilities of the Group amounting to HK\$11,891 million (2017: HK\$11,111 million) were secured by assets deposited with central depositories to facilitate settlement operations. In addition, the liabilities of the Group amounting to HK\$65,617 million (2017: HK\$14,477 million) were secured by debt securities related to sale and repurchase arrangements. The amount of assets pledged by the Group to secure these liabilities was HK\$78,230 million (2017: HK\$26,002 million) mainly included in “Financial assets at fair value through profit or loss” and “Investment in securities”.

50. Transfers of financial assets

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

	2018		2017	
	Carrying amount of transferred assets HK\$'m	Carrying amount of associated liabilities HK\$'m	Carrying amount of transferred assets HK\$'m	Carrying amount of associated liabilities HK\$'m
Repurchase agreements	26,079	25,617	14,767	14,477

51. Loans to directors

Particulars of loans made to directors of the Company pursuant to section 383 of the Hong Kong Companies Ordinance and Part 3 of the Companies (Disclosure of Information about Benefits of Directors) Regulation are as follows:

	2018 HK\$'m	2017 HK\$'m
Aggregate amount of relevant transactions outstanding at year end	–	5
Maximum aggregate amount of relevant transactions outstanding during the year	–	877

52. 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.

Notes to the Financial Statements

52. Significant related party transactions (continued)

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

General information of the parent companies:

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

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

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

The majority of transactions with BOC arise from money market activities. As at 31 December 2018, the related aggregate amounts due from and to BOC of the Group were HK\$158,881 million (2017: HK\$186,565 million) and HK\$137,562 million (2017: HK\$60,385 million) respectively. The aggregate amounts of income and expenses of the Group arising from these transactions with BOC for the year ended 31 December 2018 were HK\$2,878 million (2017: HK\$2,320 million) and HK\$581 million (2017: HK\$459 million) respectively. The related party transactions above constitute connected transactions as defined in Chapter 14A of the Listing Rules but under exemption from its disclosure requirement.

The transactions with BOC disclosed in Note 57 also constitute connected transactions as defined in Chapter 14A of the Listing Rules and announcement had been made by the Group on 6 November 2017 and 29 December 2017.

Transactions with other companies controlled by BOC are not considered material.

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

The Group is subject to the control of the State Council of the PRC Government through CIC and Central Huijin, which also directly or 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, purchases, 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.

52. Significant related party transactions (continued)

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

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

	2018 HK\$'m	2017 HK\$'m
Income statement items		
Associates		
– Fee and commission expenses	11	36
– Other operating expenses	82	72
Other related parties		
– Fee and commission income	11	10
Balance sheet item		
Associates		
– Other accounts and provisions	7	4

The related party transactions in respect of the fee and commission expenses and other operating expenses arising from associates above constitute connected transactions as defined in Chapter 14A of the Listing Rules and the required disclosures are provided in “Connected transactions” on pages 312 to 313.

(d) Key management personnel

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

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

	2018 HK\$'m	2017 HK\$'m
Salaries and other short-term employee benefits	45	48

Notes to the Financial Statements

53. International claims

The below analysis is prepared with reference to the completion instructions for the HKMA return of international banking statistics. International claims are exposures to counterparties on which the ultimate risk lies based on the locations of the counterparties after taking into account the transfer of risk, and represent the sum of cross-border claims in all currencies and local claims in foreign currencies. For a claim guaranteed by a party situated in a location different from the counterparty, the risk will be transferred to the location of the guarantor. For a claim on an overseas branch of a bank whose head office is located in another location, the risk will be transferred to the location where its head office is located.

Claims on individual countries/regions, after risk transfer, amounting to 10% or more of the aggregate international claims of the Group are shown as follows:

	2018				
	Banks HK\$'m	Official sector HK\$'m	Non-bank private sector		Total HK\$'m
			Non-bank financial institutions HK\$'m	Non-financial private sector HK\$'m	
Mainland of China	333,781	362,253	22,430	143,578	862,042
Hong Kong	8,084	–	37,312	315,370	360,766

	2017				
	Banks HK\$'m	Official sector HK\$'m	Non-bank private sector		Total HK\$'m
			Non-bank financial institutions HK\$'m	Non-financial private sector HK\$'m	
Mainland of China	401,249	95,744	25,940	142,557	665,490
Hong Kong	11,186	–	19,529	311,584	342,299

54. Non-bank Mainland exposures

The analysis of non-bank Mainland exposures is based on the categories of non-bank counterparties and the types of direct exposures with reference to the completion instructions for the HKMA return of Mainland activities, which includes the Mainland exposures extended by BOCHK's Hong Kong office only.

	Items in the HKMA return	2018		Total exposure HK\$'m
		On-balance sheet exposure HK\$'m	Off-balance sheet exposure HK\$'m	
Central government, central government-owned entities and their subsidiaries and joint ventures	1	292,682	37,793	330,475
Local governments, local government-owned entities and their subsidiaries and joint ventures	2	60,506	13,060	73,566
PRC nationals residing in Mainland or other entities incorporated in Mainland and their subsidiaries and joint ventures	3	93,286	18,961	112,247
Other entities of central government not reported in item 1 above	4	27,618	630	28,248
Other entities of local governments not reported in item 2 above	5	88	–	88
PRC nationals residing outside Mainland or entities incorporated outside Mainland where the credit is granted for use in Mainland	6	70,926	8,677	79,603
Other counterparties where the exposures are considered to be non-bank Mainland exposures	7	2,214	379	2,593
Total	8	547,320	79,500	626,820
Total assets after provision	9	2,752,643		
On-balance sheet exposures as percentage of total assets	10	19.88%		

Notes to the Financial Statements

54. Non-bank Mainland exposures (continued)

	Items in the HKMA return	2017		Total exposure HK\$'m
		On-balance sheet exposure HK\$'m	Off-balance sheet exposure HK\$'m	
Central government, central government-owned entities and their subsidiaries and joint ventures	1	277,878	46,003	323,881
Local governments, local government-owned entities and their subsidiaries and joint ventures	2	67,154	11,268	78,422
PRC nationals residing in Mainland or other entities incorporated in Mainland and their subsidiaries and joint ventures	3	53,490	11,078	64,568
Other entities of central government not reported in item 1 above	4	29,972	1,029	31,001
Other entities of local governments not reported in item 2 above	5	–	–	–
PRC nationals residing outside Mainland or entities incorporated outside Mainland where the credit is granted for use in Mainland	6	75,825	21,261	97,086
Other counterparties where the exposures are considered to be non-bank Mainland exposures	7	2,624	828	3,452
Total	8	506,943	91,467	598,410
Total assets after provision	9	2,445,769		
On-balance sheet exposures as percentage of total assets	10	20.73%		

55. Balance sheet and statement of changes in equity

(a) Balance sheet

As at 31 December	2018 HK\$'m	2017 HK\$'m
ASSETS		
Bank balances with a subsidiary	1,861	1,798
Investment in securities	2,123	2,886
Investment in subsidiaries	55,322	55,322
Amounts due from a subsidiary	6,026	3,831
Other assets	1	1
Total assets	65,333	63,838
LIABILITIES		
Amounts due to a subsidiary	2	3
Total liabilities	2	3
EQUITY		
Share capital	52,864	52,864
Reserves	12,467	10,971
Total equity	65,331	63,835
Total liabilities and equity	65,333	63,838

Approved by the Board of Directors on 29 March 2019 and signed on behalf of the Board by:



CHEN Siqing

Director



GAO Yingxin

Director

Notes to the Financial Statements

55. Balance sheet and statement of changes in equity (continued)

(b) Statement of changes in equity

	Share capital HK\$'m	Reserves		Total equity HK\$'m
		Reserve for fair value changes/ Reserve for fair value changes of available-for-sale securities HK\$'m	Retained earnings HK\$'m	
At 1 January 2017	52,864	1,276	7,201	61,341
Profit for the year	–	–	15,515	15,515
Other comprehensive income:				
Available-for-sale securities	–	354	–	354
Total comprehensive income	–	354	15,515	15,869
Dividends	–	–	(13,375)	(13,375)
At 31 December 2017	52,864	1,630	9,341	63,835
At 1 January 2018, as previously reported	52,864	1,630	9,341	63,835
Effect of adoption of HKFRS 9	–	(2,730)	2,730	–
At 1 January 2018, after adoption of HKFRS 9	52,864	(1,100)	12,071	63,835
Profit for the year	–	–	16,035	16,035
Other comprehensive income:				
Equity instruments at fair value through other comprehensive income	–	(763)	–	(763)
Total comprehensive income	–	(763)	16,035	15,272
Dividends	–	–	(13,776)	(13,776)
At 31 December 2018	52,864	(1,863)	14,330	65,331

56. Principal subsidiaries

The particulars of all direct and indirect subsidiaries of the Company are set out in "Appendix – Subsidiaries of the Company". The following is a list of principal subsidiaries as at 31 December 2018:

Name	Place of incorporation and operation	Issued share capital	Interest held	Principal activities
Bank of China (Hong Kong) Limited	Hong Kong	HK\$43,042,840,858	*100%	Banking business
BOC Group Life Assurance Company Limited	Hong Kong	HK\$3,538,000,000	*51%	Life insurance business
BOC Credit Card (International) Limited	Hong Kong	HK\$480,000,000	100%	Credit card services
Bank of China (Malaysia) Berhad	Malaysia	RM760,518,480	100%	Banking business
Bank of China (Thai) Public Company Limited	Thailand	Baht10,000,000,000	100%	Banking business
Po Sang Securities and Futures Limited	Hong Kong	HK\$335,000,000	100%	Securities and futures brokerage

* Shares held directly by the Company

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

BOC Group Life Assurance Company Limited

	2018	2017
Proportion of ownership interests and voting rights held by non-controlling interests	49%	49%

	2018 HK\$m	2017 HK\$m
Profit attributable to non-controlling interests	420	586
Accumulated non-controlling interests	4,083	4,334
Summarised financial information:		
– total assets	132,417	130,597
– total liabilities	124,085	121,752
– profit for the year	857	1,196
– total comprehensive income for the year	(182)	1,492

Notes to the Financial Statements

57. Application of merger accounting

On 29 January 2018, the Philippines Business and the Vietnam Business were transferred from BOC to BOCHK for a total consideration of HK\$853 million and HK\$1,315 million in cash respectively. The Philippines Business, the Vietnam Business and BOCHK are all under the common control of BOC before and after the combination. The Group has applied the merger accounting method in accordance with the Accounting Guideline 5 “Merger Accounting for Common Control Combinations” issued by the HKICPA in the preparation of financial statements. The comparative amounts have been restated accordingly as if the Philippines Business and the Vietnam Business had always been carried out by the Group.

The statements of the adjustments to the consolidated equity as at 31 December are as follows:

	2018			
	Before combination HK\$'m	Entities under common control HK\$'m	Adjustment HK\$'m	After combination HK\$'m
Share capital	52,864	1,062	(1,062)	52,864
Merger reserve	–	–	(1,106)	(1,106)
Retained earnings and other reserves	205,033	279	–	205,312
	257,897	1,341	(2,168)	257,070
Other equity instruments	23,476	–	–	23,476
Non-controlling interests	4,361	–	–	4,361
	285,734	1,341	(2,168)	284,907

	2017			
	Before combination HK\$'m	Entities under common control HK\$'m	Adjustment HK\$'m	After combination HK\$'m
Share capital	52,864	1,062	(1,062)	52,864
Merger reserve	–	–	1,062	1,062
Retained earnings and other reserves	189,875	217	–	190,092
	242,739	1,279	–	244,018
Non-controlling interests	4,605	–	–	4,605
	247,344	1,279	–	248,623

58. 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.

59. Comparative amounts

In respect of the transfer of the Philippines Business and the Vietnam Business from BOC on 29 January 2018 as explained in Note 57, the Group has applied merger accounting method for the business combination under common control. Comparative amounts in the financial statements have been restated as if the Philippines Business and the Vietnam Business had always been carried out by the Group.

60. Events after the balance sheet date

As stated in the Company's announcement dated 28 December 2018, all of the conditions precedent set out in the Agreement entered into between BOCHK and BOC were satisfied or, as appropriate, waived and completion of the transfer of the Branch Interests in Bank of China Limited, Vientiane Branch in Laos took place on 21 January 2019 pursuant to the terms and conditions of the Agreement. Upon completion, BOC Vientiane Branch became a branch owned by BOCHK, and all the Branch Interests were held by BOCHK, pursuant to the terms and conditions of the Agreement.

61. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 29 March 2019.

Unaudited Supplementary Financial Information

1. Regulatory Disclosures

The Regulatory Disclosures, together with the disclosures in this Annual Report, contained all the disclosures required by the Banking (Disclosure) Rules issued by the HKMA. The Regulatory Disclosures is available under the section "Regulatory Disclosures" on BOCHK's website at www.bochk.com.

This Annual Report and the Regulatory Disclosures are prepared according to the Group's disclosure policy. The disclosure policy sets out a robust mechanism for the Group's disclosures of financial information on a legitimate and compliant basis. It depicts the principles and internal control measures to ensure the timeliness, fairness, accuracy, integrity, completeness and legitimacy of financial disclosures.

2. Connected transactions

In 2018, BOCHK, a wholly-owned subsidiary of the Company, and its subsidiaries engaged on a regular basis in the usual course of their business in numerous transactions with BOC and its Associates. As BOC is the Company's controlling shareholder and therefore a connected person of the Company, all such transactions constituted connected transactions for the purposes of the Listing Rules. 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. Central Huijin is the ultimate controlling shareholder of the Company. Central Huijin has accepted PRC Government's authorisation in carrying out equity investment in core financial enterprises. For the purposes of this report, therefore, Central Huijin and its Associates have not been treated as connected persons to the Company.

The transactions fell into the following two categories:

1. exempted transactions entered into in the ordinary and usual course of business and under normal commercial terms or better. Such transactions were (1) fully exempted from shareholders' approval, annual review and all disclosure requirements and/or (2) exempted from shareholders' approval requirement by virtue of Rules 14A.76 and 14A.87 to 14A.101 of the Listing Rules;
2. certain continuing connected transactions conducted pursuant to the Services and Relationship Agreement entered into among, inter alia, the Company and BOC dated 6 July 2002 (as amended and supplemented from time to time, which has been amended for a period of three years commencing 1 January 2017), whereas BOC has agreed to, and agreed to procure its Associates to, enter into all future arrangements with the Group on an arm's length basis, on normal commercial terms and at rates no less favourable than those offered to independent third parties, in relation to certain areas including, among others, information technology services, training services, physical bullion agency services, correspondent banking arrangements, treasury transactions, provision of insurance and syndicated loans, and the Company has agreed to, and agreed to procure its subsidiaries to, enter into all future arrangements on the same basis, provided that the rates offered by the Group to BOC and its Associates will be no more favourable than those offered to independent third parties. The Services and Relationship Agreement has also been last amended to allow (i) for the provision of business development, investment products and asset management and referral services between BOC and its Associates and the Group; (ii) the provision of computer systems and information technology services between BOC and its Associates and the Group; and (iii) the provision of support and services by BOC and its Associates to BOCHK's branches and subsidiaries in the Southeast Asian region when they become branches and subsidiaries of BOCHK. On 14 December 2016 the Company made an announcement (the "Announcement") in accordance with Rule 14A.35 of the Listing Rules, and has got the approval from the independent shareholders on 28 June 2017. The Announcement listed those continuing connected transactions that exceeded the de minimus threshold and set out caps in respect of such transactions for 2017-2019. These transactions were conducted in the ordinary and usual course of its business and on normal commercial terms or better. Details of these continuing connected transactions are set out below and are described in the announcements which may be viewed at the Company's website. The Company has complied with the disclosure requirements in accordance with Chapter 14A of the Listing Rules.

2. Connected transactions (continued)

Type of Transaction	2018 Cap (HK\$'m)	2018 Actual Amount (HK\$'m)
Information Technology Services	1,000	89
Property Transactions	1,000	168
Bank-note Delivery	1,000	330
Provision of Insurance Cover	1,000	225
Card Services	1,000	214
Custody Business	1,000	57
Contact Centre Services	1,000	82
Business Development Services	1,000	15
Securities Transactions	7,000	247
Fund Distribution Transactions	7,000	30
Insurance Agency	7,000	1,036
Investment Products Transactions	250,000	1,314
Asset Management and Referral Services	7,000	58
Foreign Exchange Transactions	7,000	384
Derivatives Transactions	7,000	1
Trading of Financial Assets	250,000	13,651
Inter-bank Capital Markets	250,000	7,539

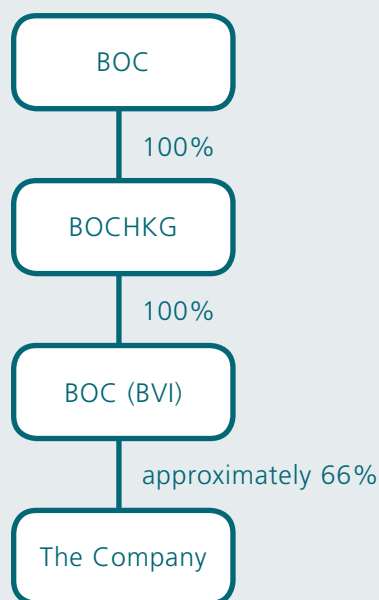
Unaudited Supplementary Financial Information

3. Reconciliation between HKFRSs vs IFRSs/CASs

The Company understands that BOC, an intermediate holding company as well as controlling shareholder of the Company, will prepare and disclose consolidated financial information in accordance with IFRSs and CASs for which the Company and its subsidiaries will form part of the consolidated financial statements. The requirements of CASs have substantially converged with HKFRSs and IFRSs.

The consolidated financial information of “BOC Hong Kong Group” for the periods disclosed by BOC in its consolidated financial statements is not the same as the consolidated financial information of the Group for the periods published by the Company pursuant to applicable laws and regulations in Hong Kong. There are two reasons for this.

First, the definitions of “BOC Hong Kong Group” (as adopted by BOC for the purpose of its own financial disclosure) and “Group” (as adopted by the Company in preparing and presenting its consolidated financial information) are different: “BOC Hong Kong Group” refers to BOCHKG and its subsidiaries, whereas “Group” refers to the Company and its subsidiaries (see the below organisation chart). Though there is difference in definitions between “BOC Hong Kong Group” and “Group”, their financial results for the periods presented are substantially the same. This is because BOCHKG and BOC (BVI) are holding companies only and have no substantive operations of their own.



Second, the Group has prepared its consolidated financial statements in accordance with HKFRSs; whereas the consolidated financial information reported to BOC is prepared in accordance with IFRSs and CASs respectively. There is a difference in the election of subsequent measurement basis of bank premises by the Group and by BOC respectively.

3. Reconciliation between HKFRSs vs IFRSs/CASs (continued)

The Board considers that the best way to ensure that shareholders and the investing public understand the material differences between the consolidated financial information of the Group published by the Company on the one hand, and the consolidated financial information of BOC Hong Kong Group disclosed by BOC in its consolidated financial statements on the other hand, is to present reconciliations of the profit after tax/net assets of the Group prepared under HKFRSs to the profit after tax/net assets of the Group prepared under IFRSs/CASs respectively for the periods presented.

The major differences which arise from the difference in measurement basis relate to the following:

(a) Restatement of carrying value of bank premises

The Company has elected for a revaluation model rather than cost model to account for bank premises and investment properties under HKFRSs. On the contrary, BOC has elected for the cost model for bank premises and revaluation model for investment properties under IFRSs and CASs. Therefore, adjustments have been made to the carrying value of bank premises as well as to re-calculate the depreciation charge and disposal gain/loss under IFRSs and CASs, including the gain on disposal of discontinued operations.

(b) Deferred tax adjustments

These represent the deferred tax effect of the aforesaid adjustments.

Profit after tax/net assets reconciliation

HKFRSs vs IFRSs/CASs

	Profit after tax		Net assets	
	2018 HK\$'m	2017 HK\$'m	2018 HK\$'m	2017 HK\$'m
Profit after tax/net assets of BOC Hong Kong (Holdings) Limited prepared under HKFRSs	32,584	31,930	284,907	248,623
Add: IFRSs/CASs adjustments				
Restatement of carrying value of bank premises	825	1,507	(35,082)	(34,213)
Deferred tax adjustments	(132)	(120)	5,965	5,827
Profit after tax/net assets of BOC Hong Kong (Holdings) Limited prepared under IFRSs/CASs	33,277	33,317	255,790	220,237

Appendix

Subsidiaries of the Company

The particulars of subsidiaries are as follows:

Name	Place and date of incorporation/operation	Issued share capital	Interest held	Principal activities
Directly held:				
Bank of China (Hong Kong) Limited	Hong Kong 16 October 1964	HK\$43,042,840,858	100.00%	Banking business
BOC Group Life Assurance Company Limited	Hong Kong 12 March 1997	HK\$3,538,000,000	51.00%	Life insurance business
BOCHK Asset Management (Cayman) Limited	Cayman Islands 7 October 2010	HK\$283,000,000	100.00%	Investment holding
BOC Insurance (International) Holdings Company Limited	Hong Kong 6 June 2017	HK\$100	100.00%	Investment holding
Indirectly held:				
BOC Credit Card (International) Limited	Hong Kong 9 September 1980	HK\$480,000,000	100.00%	Credit card services
BOC Group Trustee Company Limited	Hong Kong 1 December 1997	HK\$200,000,000	66.00%	Trustee services
BOCI-Prudential Trustee Limited	Hong Kong 11 October 1999	HK\$300,000,000	42.24%*	Trustee services
Bank of China (Malaysia) Berhad	Malaysia 14 April 2000	RM760,518,480	100.00%	Banking business
China Bridge (Malaysia) Sdn. Bhd.	Malaysia 24 April 2009	RM1,000,000	100.00%	China visa application
Bank of China (Thai) Public Company Limited	Thailand 1 April 2014	Baht10,000,000,000	100.00%	Banking business
Bank of China (Hong Kong) Nominees Limited	Hong Kong 1 October 1985	HK\$2	100.00%	Nominee services
Bank of China (Hong Kong) Trustees Limited	Hong Kong 6 November 1987	HK\$3,000,000	100.00%	Trustee and agency services
BOCHK Financial Products (Cayman) Ltd.	Cayman Islands 10 November 2006	US\$50,000	100.00%	Issuing structured notes
BOCHK Information Technology (Shenzhen) Co., Ltd.	PRC 16 April 1990	Registered capital HK\$70,000,000	100.00%	Property holding and investment
BOCHK Information Technology Services (Shenzhen) Co., Ltd.	PRC 26 May 1993	Registered capital HK\$40,000,000	100.00%	Information technology services
Che Hsing (Nominees) Limited	Hong Kong 23 April 1980	HK\$10,000	100.00%	Nominee services
Po Sang Financial Investment Services Company Limited	Hong Kong 23 September 1980	HK\$335,000,000	100.00%	Gold trading and investment holding
Po Sang Securities and Futures Limited	Hong Kong 19 October 1993	HK\$335,000,000	100.00%	Securities and futures brokerage
Sin Chiao Enterprises Corporation, Limited	Hong Kong 13 September 1961	HK\$3,000,000	100.00%	Property holding and investment
Sin Hua Trustee Limited	Hong Kong 27 October 1978	HK\$3,000,000	100.00%	Trustee services

Subsidiaries of the Company (continued)

Name	Place and date of incorporation/operation	Issued share capital	Interest held	Principal activities
Billion Express Development Inc.	British Virgin Islands 7 February 2014	US\$1	100.00%	Investment holding
Billion Orient Holdings Ltd.	British Virgin Islands 3 February 2014	US\$1	100.00%	Investment holding
Elite Bond Investments Ltd.	British Virgin Islands 7 February 2014	US\$1	100.00%	Investment holding
Express Capital Enterprise Inc.	British Virgin Islands 3 February 2014	US\$1	100.00%	Investment holding
Express Charm Holdings Corp.	British Virgin Islands 7 February 2014	US\$1	100.00%	Investment holding
Express Shine Assets Holdings Corp.	British Virgin Islands 3 January 2014	US\$1	100.00%	Investment holding
Express Talent Investment Ltd.	British Virgin Islands 13 February 2014	US\$1	100.00%	Investment holding
Gold Medal Capital Inc.	British Virgin Islands 3 January 2014	US\$1	100.00%	Investment holding
Gold Tap Enterprises Inc.	British Virgin Islands 13 February 2014	US\$1	100.00%	Investment holding
Maxi Success Holdings Ltd.	British Virgin Islands 7 February 2014	US\$1	100.00%	Investment holding
Smart Linkage Holdings Inc.	British Virgin Islands 13 February 2014	US\$1	100.00%	Investment holding
Smart Union Capital Investments Ltd.	British Virgin Islands 3 January 2014	US\$1	100.00%	Investment holding
Success Trend Development Ltd.	British Virgin Islands 18 February 2014	US\$1	100.00%	Investment holding
Wise Key Enterprises Corp.	British Virgin Islands 18 February 2014	US\$1	100.00%	Investment holding
BOCHK Asset Management Limited	Hong Kong 28 October 2010	HK\$272,500,000	100.00%	Asset management

* BOCI-Prudential Trustee Limited is a subsidiary of a non-wholly-owned subsidiary of the Company and, accordingly, is accounted for as a subsidiary by virtue of the Company's control over it.

Definitions

In this Annual Report, unless the context otherwise requires, the following terms shall have the meanings set out below:

Terms	Meanings
"ADR"	American Depositary Receipt
"ADS(s)"	American Depositary Share(s)
"ALCO"	the Asset and Liability Management Committee
"AT1"	Additional Tier 1
"ATM"	Automated Teller Machine
"Associates"	has the meaning ascribed to "associates" in the Listing Rules
"BOC"	Bank of China Limited, a joint stock commercial bank with limited liability established under the laws of the PRC, the H shares and A shares of which are listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange respectively
"BOC (BVI)"	BOC Hong Kong (BVI) Limited, a company incorporated under the laws of the British Virgin Islands and a wholly-owned subsidiary of BOCHK
"BOCCC"	BOC Credit Card (International) Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of BOCHK
"BOCG Insurance"	Bank of China Group Insurance Company Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of BOC
"BOCHK"	BOC Hong Kong (Group) Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of BOC
"BOCHK" or "the Bank"	Bank of China (Hong Kong) Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of the Company
"BOCI"	BOC International Holdings Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of BOC
"BOCI-Prudential Manager"	BOCI-Prudential Asset Management Limited, a company incorporated under the laws of Hong Kong, in which BOCI Asset Management Limited, a wholly-owned subsidiary of BOC International Holdings Limited, and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively
"BOCI-Prudential Trustee"	BOCI-Prudential Trustee Limited, a company incorporated under the laws of Hong Kong, in which BOC Group Trustee Company Limited and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively
"BOC Life"	BOC Group Life Assurance Company Limited, a company incorporated under the laws of Hong Kong, in which the Group and BOCG Insurance hold equity interests of 51% and 49% respectively
"BOC Malaysia"	Bank of China (Malaysia) Berhad, a wholly-owned subsidiary of BOCHK
"BOC Thailand"	Bank of China (Thai) Public Company Limited, a wholly-owned subsidiary of BOCHK
"Board" or "Board of Directors"	the Board of Directors of the Company
"CAS"	Chinese Accounting Standard for Business Enterprises
"CE"	Chief Executive
"CET1"	Common Equity Tier 1
"CFO"	Chief Financial Officer
"CIC"	China Investment Corporation
"CRO"	Chief Risk Officer
"CVA"	Credit Valuation Adjustment
"Central Huijin"	Central Huijin Investment Ltd.

Terms	Meanings
"Chiyu"	Chiyu Banking Corporation Limited, a company incorporated under the laws of Hong Kong
"DCE"	Deputy Chief Executive
"DVA"	Debit Valuation Adjustment
"ECL"	Expected Credit Loss
"EV"	Economic Value Sensitivity Ratio
"FCC"	the Financial Crime Compliance Department
"FIRB"	Foundation Internal Ratings-based
"Fitch"	Fitch Ratings
"FVOCI"	Fair value through other comprehensive income
"FVPL"	Fair value through profit or loss
"GDP"	Gross Domestic Product
"HIBOR"	Hong Kong Interbank Offered Rate
"HKAS"	Hong Kong Accounting Standard
"HKFRS"	Hong Kong Financial Reporting Standard
"HKICPA"	Hong Kong Institute of Certified Public Accountants
"HKMA"	Hong Kong Monetary Authority
"Hong Kong" or "Hong Kong SAR" or "HKSAR"	Hong Kong Special Administrative Region of the PRC
"ICAAP"	Internal Capital Adequacy Assessment Process
"IFRS"	International Financial Reporting Standard
"IMM"	Internal Models
"IT"	Information Technology
"LCO"	the Legal & Compliance and Operational Risk Management Department
"LCR"	Liquidity Coverage Ratio
"LIBOR"	London Interbank Offered Rate
"Listing Rules"	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
"MC"	the Management Committee
"MPF"	Mandatory Provident Fund
"MPF Schemes Ordinance"	the Mandatory Provident Fund Schemes Ordinance, Chapter 485 of the Laws of Hong Kong, as amended
"mainland" or "Mainland of China"	the mainland of the PRC
"Moody's"	Moody's Investors Service
"N/A"	Not applicable
"NII"	Net Interest Income Sensitivity Ratio
"NSFR"	Net Stable Funding Ratio
"ORSO schemes"	the Occupational Retirement Schemes under Occupational Retirement Schemes Ordinance, Chapter 426 of the Laws of Hong Kong
"OTC"	Over-the-counter
"PD"	Probability of Default
"PRC"	the People's Republic of China

Definitions

Terms	Meanings
"PVBP"	Price Value of a Basis Point
"QDII"	Qualified Domestic Institutional Investors
"RMB" or "Renminbi"	Renminbi, the lawful currency of the PRC
"RMC"	the Risk Committee
"RMD"	the Risk Management Department
"RWA"	Risk-weighted Assets
"SFO"	the Securities and Futures Ordinance, Chapter 571 of the Laws of Hong Kong
"SME"	Small and Medium-sized Enterprise
"STC"	Standardised (Credit Risk)
"STM"	Standardised (Market Risk)
"STO"	Standardised (Operational Risk)
"Standard & Poor's"	Standard & Poor's Ratings Services
"Stock Exchange" or "Hong Kong Stock Exchange" or "Stock Exchange of Hong Kong"	The Stock Exchange of Hong Kong Limited
"the Company"	BOC Hong Kong (Holdings) Limited, a company incorporated under the laws of Hong Kong
"the Group"	the Company and its subsidiaries collectively referred as the Group
"US"	the United States of America
"VAR"	Value at Risk

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